Corporate Services Scrutiny Panel Report

Review of the Zero/Ten Design Proposal

States of Jersey

Presented to the States on 28th September 2006

S.R.4/2006

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1. Executive Summary

The Panel:

Overall

accepts the general principle of the move to a zero/ten corporate taxation structure, and believes that this is necessary in order for the Island to remain competitive as an international finance centre and so to maintain employment and the Island's services and infrastructures, while still collecting a substantial tax contribution from the finance industry; **(Section 3.1)**

Financial Information

is alarmed, and has been hampered, by the total lack of data available from the Treasury and Resources Department with regard to the expected tax losses and yields from the zero/ten proposals; **(Section 5.2)**

RUDL

was persuaded that the concerns of Jersey-owned Jersey-trading businesses, that zero/ten would leave them at an unfair disadvantage against foreign-owned competitors, were well-founded.

However, the Panel cannot support the proposed Regulation of undertakings & development ('RUDL') charge and recommends the proposal should be abandoned as it would be excessively complex, administratively expensive for both businesses and government, discourage new investment into the Island, and increase prices for consumers **(Section 5.5)**. The Panel also cannot support the requirement for locally owned non-finance companies to have to convert to an LTP to offset the RUDL charge **(Section 5.9)**.

The Panel therefore calls upon the Treasury to urgently examine alternatives to RUDL, such as the two proposed by the Panel; **(Section 5.5.3)**

Deemed distribution

accepts that after the introduction of a general zero rate of corporate tax it will be essential to tax Jersey resident individual shareholders. However, the Panel found the proposed deemed distribution system unnecessarily complex and potentially damaging to minority shareholders **(Section 5.7)**.

The Panel notes that there are problems with each of the potential alternatives; however, it feels that subject to data from the Treasury and Resources Department, one of the following options may be preferable:

- a ‘minimum distribution exemption’, where a company would be exempt from the deemed distribution rules provided it paid a guaranteed percentage of its profits to its shareholders as a dividend (this is the basis of the Isle of Man proposals which are currently subject to EU Code of Conduct approval); or

- an ‘actual only’ basis (as Guernsey are proposing), where company profits are only taxed when paid out to shareholders (subject to introducing shareholder benefit in kind provisions);

The Panel felt unable to make a firm recommendation on this point as yet, due to the lack of Treasury data, and therefore calls for the Treasury to produce detailed calculations on the effectiveness of these options.

Deferred distribution

sees the proposed deferred distribution charge as an unnecessary and complex burden for what appears (allowing for the lack of Treasury data) to be of little benefit, and calls for it to be abandoned even if the deemed distribution system is maintained; **(Section 5.8)**

Administration

is not convinced by the Comptroller of Income Tax’s assertion that the proposals would not affect staffing levels, and remains concerned that, with the proposed new tax structure and enhanced opportunities for avoidance, the current staffing levels may prove to be insufficient; **(Section 5.10)**

is concerned that the proposals for increased powers and information requirements for the Comptroller would damage relations between taxpayers and the tax office. **(Section 5.10)**

1.2 Key Principles

The Panel agreed that the Treasury needed to ensure the proposals adhered to the following key principles in order for them to be a suitable working alternative to the Island's existing corporate taxation structure:

1. International competitiveness:

Remaining competitive with other similar jurisdictions is vital to the future prosperity of the Island's finance industry, and therefore the whole economy.

2. Simplicity:

Until recently, one of the main advantages of the Island's tax structure has been its relative simplicity. To prevent avoidance, reduce costs, and preserve equity between taxpayers, and in order for the Island to remain attractive to inward investors, it is vital to keep the tax system as simple as possible. The current proposals increase complexity and uncertainty, which may discourage investment in the Island and could allow some taxpayers to exploit loopholes.

3. Equity:

It is imperative that the tax system is equitable both for businesses and individuals. As a result of the EU Code of Conduct it is also important that this equity extends to both locally and non-locally owned companies. The Panel is also keen to ensure that the proposed system would not have an unfair impact on minority shareholders.

4. Yield:

It is of utmost importance that the proposed tax system is able to raise the necessary yield to address part of the deficit created by the move to a zero/ten corporate taxation structure. The other proposals to recoup the tax loss from moving to zero/ten were approved in the Fiscal Strategy[1] and include; growing the economy; the Public Sector Change Programme; ITIS; GST; and 20 means 20. The finance industry is reliant upon the Island's fiscal stability. Without raising the needed funds through taxes, Jersey would be forced to make severe cuts in public expenditure.[2]

2. Panel Membership

The Corporate Services Scrutiny Panel is constituted as follows –

Deputy P. J. D. Ryan, Chairman
Senator J. L. Perchard, Vice Chairman
Connétable J. Le Sueur Gallichan
Connétable D. J. Murphy
Deputy J. Gallichan

Officer support: Mr M. Haden and Miss S. Power

For the purposes of this review the Panel formed a Sub Panel, which was constituted as follows –

Senator J. L. Perchard, Sub Panel Chairman
Senator B. Shenton
Deputy P. J. D. Ryan
Deputy G. Southern

2.1 *Independent Expert Advice*

The Panel engaged the following advisers to assist it with the review –

> Mr. Brian Curtis, FCIB, MSI (dip.), PFS, FInstD, has worked in Jersey's Finance Industry for some 35 years and is currently involved with a number of activities within the industry and the voluntary sector.
>
> Mr. Richard Teather, BA, ICAEW, a senior lecturer in Tax Law at Bournemouth University; a Freelance Tax Consultant and a writer on Tax Law and Policy.

2.2 Terms of Reference

The Panel agreed the following terms of reference for its review -

To review the draft "Zero/Ten Design Proposal" consultation document and subsequent draft legislation, and to assess its suitability as a replacement for Jersey's current tax system, with a particular focus on the following issues –

1. Compliance with the EU Code of Conduct on business taxation; OECD's Harmful Tax Competition initiative; and the European Convention on Human Rights.

2. The effect on Jersey's tax revenues and the resource implications of the legislation.

3. The effect on the Financial Services Industry and the wider effect on Jersey's economy.

4. The distributional effects and the equity of the proposed Zero/Ten Design Proposal and the potential for avoidance.

To include a review of –

Look through arrangements
Regulation of Undertakings and Development ('RUDL') charge
Other measures for maintaining the tax base
Effectiveness; fairness and efficiency of anti-avoidance measures

3. Introduction

3.1 The Zero/Ten Design Proposal

Finance is Jersey's dominant industry and is therefore of fundamental importance to the Island's economy. It provides 60% of the Island's Gross Domestic Product, and 60% of the Island's Tax Income. Even after the reforms, the industry will continue to provide a major part of the Island's tax revenues. The comment in Attac's submission that *"to date the finance industry has paid to be in Jersey. Now the people of Jersey are to pay for finance to be in the island."* is simply unfounded.

Jersey's appeal as a major finance centre is based around its stable political and fiscal infrastructure, which is key to encouraging investment in the Island. The Island is therefore an appealing base for banks, fund management companies and other financial professionals. The industry has an exceptionally high profitability per worker, averaging £90,000 per worker per year, compared to a much lower £5,000 a year for the rest of the economy. Employment in the financial services industry also accounts for 25% of the Islands workforce.[3]

The zero/ten proposal is designed to protect the finance industry, and the jobs that it brings to the Island, in the light of international clamp-downs on 'offshore' finance by the European Union (EU) and the Organisation for Economic Cooperation and Development (OECD).

The current corporate taxation structure, with its highly competitive income tax rates available for non locally owned companies, is very attractive to inward investors to the Island. The entities currently available include:

Standard companies taxable at 20%;
International Business Companies (IBCs) who pay between ½ - 2% income tax; and
Exempt companies who do not pay income tax on overseas income.

In contrast to this, any local companies are required to pay 20% income tax on worldwide income,[4] yet under the EU and the OECD's concerns over 'harmful tax competition' the Island has had to agree to end the distinction between locally owned and non locally owned or operating companies. As it would be exceptionally difficult to remain competitive with other jurisdictions without a corporate entity such as that of the exempt company, in order to safeguard the Island's financial services industry, and in turn the Island's economy, the States agreed[5] that by June 2008[6] the general tax rate for companies would be reduced to 0%.

The exceptions to this will be financial services management (which will have a corporate tax rate of 10%), and public utilities and all Jersey property income (which will retain the current 20% tax rate).

As a result of the potential impact this proposal could have on the Island's economy, and therefore future prosperity, the Corporate Services Scrutiny Panel agreed to review this topic as a matter of urgency. A Sub Panel was therefore formed to conduct the review, under the chairmanship of Senator Perchard (the Vice Chairman of the full Corporate Services Panel). The Panel began its review based on the Zero/Ten Design Proposal document released for consultation by the Treasury and Resources Department on the 5th May 2006.

Given the length of the Zero/Ten Design Proposal, it would have proven impossible for the Panel to review every section. This was also unnecessary, as the Panel was in agreement with many of the proposals put forward by the Minister, Treasury and Resources. The Panel therefore based its review on the areas which were raised by witnesses as causing the most concern.

3.2 Summary of the proposals

1. The main proposals:

a. Companies

There will be a general tax rate for companies of 0%.

There will be specific tax rates for companies with the following types of income:
Financial services management (as defined) – 10%
Income from Jersey land & buildings – 20%

b. Individuals

Individual taxpayers will still be taxed at 20%, as at present.

2. Consequential proposals to maintain the tax base:

The current tax system relies on companies being taxed at the same rate as individuals. There is therefore no need to tax individuals on dividends or other profits received from a Jersey company, because those profits have already been taxed at the company level.

Under zero/ten this is no longer the case, so a method will be needed to tax Jersey-resident individuals on the profits they receive from companies. They could be taxed simply when those profits are received, in the form of dividends or in any other way, but the Treasury felt that this would seriously delay, and in some cases reduce, tax revenues, so alternative proposals have been put forward.

a. Look-through (investment companies only)

Shareholders in investment companies will be taxed on a 'look-through' basis, that is the income of the company will be treated as apportioned between the shareholders in proportion to their shareholding, and any Jersey-resident individuals will be taxed on their share of the company's income (whether or not they have received an actual dividend).

b. Deemed distribution charge (Trading companies only)

Jersey-resident individual shareholders in a trading company will be taxed on the dividends they receive from that company. However if a company does not pay its profits out as a dividend within 3 years then it will be deemed to have done so,

and the shareholders will be taxed on the dividends that they could have received.

This charge would not apply to small shareholdings in a stock-market quoted company, because of the difficulty of obtaining the necessary information.

c. Deferred distribution charge

The deferred distribution effectively means that tax payments on a company's profits can be deferred by up to 3 years. To maintain the value of the Treasury's revenues, these delayed payments will be subject to a deferred distribution surcharge of 20% of the shareholders income tax liability on the distribution (equivalent to an interest charge of 4%).

d. Benefits in kind

To prevent avoidance by shareholders taking profits out of a company by ways other than dividends, the current benefits in kind rules for employees would be extended to shareholders. This would therefore mean that any attempts to take value out of a company (e.g. by way of non-commercial loans or non-cash benefits) would be taxed at that point.

3. Additional proposals:

a. Regulation of undertakings & development ('RUDL') charge

The RUDL charge is a further refinement to the proposed tax system designed to deal with the problems caused by the general 0% tax rate for companies. For companies not in the Finance sector, the profits of Jersey-owned companies will be taxed when they are paid up (or deemed to be paid up) as dividends to the shareholders. In contrast the profits of non-Jersey owned companies will not pay any Jersey tax (although they may be taxed in the parent company's home country). This potentially puts Jersey-owned businesses at a competitive disadvantage to their foreign competitors.

The proposal is that a RUDL charge will be levied, at a fixed fee for each RUDL-licensed employee (the actual fee would vary from industry to industry, based on the average earnings of the sector concerned). This will be recoverable against Jersey tax (if any) payable by the employer on their profits.

b. 'Limited trading partnership' ('LTP'):

Companies would not be able to recover the RUDL charge, as they would not have any tax liability against which to set it (because of the 0% rate). Nor would the shareholders be able to set the RUDL charge off against their tax on dividends, because it was paid not by them but by the company. This would make the RUDL charge an additional cost for Jersey businesses.

To mitigate this problem, the LTP will be introduced as an alternative vehicle for conducting trading activities in the Island, into which companies could be converted. The LTP would be a tax transparent trading vehicle, meaning that shareholders would automatically be taxed on their share of the profits, which would mean that:

- LTPs would not be subject to proposals such as deemed and deferred distribution (because they would effectively have full look-through); and
- the RUDL charge would be creditable against income tax for any LTPs, because the members / shareholders would be treated as having paid their share of the tax personally.

3.3 Jersey's Commitments to:

a. The European Union's (EU) Tax Package

On the 3rd June 2003 EU finance ministers reached agreement on the terms of the EU Tax Package which was launched by the European Commission in 1997.

This is a package consisting of three measures designed to remove harmful tax competition:

1. A European Savings Tax Directive to ensure effective taxation of interest income from cross-border investment of savings that is paid to individuals within the EU;

2. A Code of Conduct for business taxation and;

3. A Council Directive to eliminate withholding taxes on payments of interest and royalties made between associated companies of different Member States.[7]

This tax package affects EU member states in addition to many non-EU finance centres, which have negotiated agreements with member states to introduce measures which are compliant with those in the package. In terms of Jersey's commitments to the Tax Package, the Island has agreed to cooperate with the EU in relation to the two measures applicable to the Island; the Code of Conduct on Business Taxation and the Directive on the Tax Treatment of Savings Income.

i. The Code of Conduct on Business Taxation[8]

The Code of Conduct includes two commitments:

a. To not introduce new tax measures that are 'harmful' (a 'standstill' commitment)
b. To remove existing 'harmful' tax measures (a 'rollback' commitment)

The Code of Conduct is not an EU directive, but an agreement between all EU member states. However, all member states are still expected to work within its guidelines. The Code of Conduct group identified the following taxation measures in Jersey which were classified as 'harmful':

tax-exempt companies,
International Business Companies (IBCs),
captive insurance companies and treasury operations.

In agreement with the UK government, Jersey has agreed to phase out its 'harmful' practices, which will include the introduction of a general zero rate of tax for all Jersey companies to replace the current practices for exempt companies.

ii. Directive on the Tax Treatment of Savings Income[9]

This measure focuses on cross-border savings income with regard to interest paid by an institution in one member state to individuals resident in another member state. The basis of the Directive is to enable member states to have the information required to apply the level of taxation on savings income that they believe is appropriate to their residents. On the 10th June 2002 it was announced that Jersey would be introducing withholding-tax arrangements for EU residents receiving interest income. As an alternative, the recipients of this income could choose to have information on their income given to the tax authorities in their country of residence rather than the withholding tax.

b. The Organisation for Economic Co-operation and Development (OECD)

The OECD develops measures to counter the distorting effects of taxation on investment and financing decisions and the consequences for national tax bases. As an extension to this it began to look at tax competition, and in 1998 the OECD published a report titled "Harmful Tax Competition: An Emerging Global Issue",[10] defining "harmful" tax competition and seeking to restrict and eradicate it.

Following this, in June 2000 Jersey was among 35 other jurisdictions identified by the OECD as meeting its technical criteria for being a tax haven. As a result of this, on the 22nd February 2002 Senator Horsfall, then President, Policy and Resources Committee, wrote to the OECD [11] and stated that, in consideration of there being a level playing field, Jersey was prepared to reflect the OECD's principles of effective exchange of information and transparency both in a general political commitment and in tax information exchange agreements to be negotiated with individual jurisdictions. Jersey agreed to ensure these commitments were in place by 31st December 2005, and as a result of these commitments Jersey was not listed as an un-cooperative tax haven.

c. The European Convention on Human Rights (ECHR)

The European Convention on Human Rights was signed for the United Kingdom and Northern Ireland on 4th November 1950, and ratified by His Majesty's Government on 22nd February 1951.

In a Home Office letter, dated 21st May 1951, the Secretary of State asked to be informed whether the Insular Authorities wished the Convention to be extended to Jersey[12].

The Island's affirmative response was confirmed in an Act of the States of Jersey dated the 30th October 1951 which detailed the States wishes for the Bailiff to inform the relevant UK Secretary of State that it was the desire of the Assembly that the European Convention of Human Rights should be extended to Jersey.

As a consequence of this ratification of the Convention on behalf of the Island, a person aggrieved by an alleged interference of a Convention right is entitled to bring proceedings before the European Court of Human Rights (ECtHR). The Respondent in such a case would however be the United Kingdom, not Jersey, as it is the United Kingdom which is the State party.

3.4 Comparison between other jurisdictions

As a result of the OECD's and the EU's crackdown on harmful tax practices, Jersey was not the only jurisdiction that had to reform its corporate taxation structure. To aid its review, the Panel therefore researched the situation in other jurisdictions. This research was confined to the Isle of Man and Guernsey, as given the proximity of these jurisdictions they are amongst the Island's main competitors.

Guernsey's corporate taxation structure –

In June 2006 the States of Guernsey approved a set of economic and taxation changes that included a zero rate of income tax on corporate profits, except for a 10% rate for specific banking activities. A 20% rate still applies to Guernsey resident individuals on assessable income. Unlike Jersey's deemed distribution proposals Guernsey will implement a distribution only system, where Guernsey resident shareholders will only pay tax on distributed company profits, except for investment companies, which will be taxed on a look-through basis. The zero/ten rates of corporate taxation will be introduced from 1st January 2008. The approved tax reforms will mean the Island will face an anticipated deficit of £50 million which will temporarily be financed by the Island's Stabilisation Fund. Guernsey will also be increasing employers national insurance contributions by 1% and introducing a personal income tax cap of £250,000.

The Isle of Man's corporate taxation structure –

On the 6th April 2006 the Isle of Man reformed its corporate taxation structure and adopted a 0% standard rate of corporate income tax. Licensed banks (those regulated by the Financial Supervision Commission) and companies with income from land and property in the Isle of Man have a 10% income tax rate. In the Isle of Man income tax is levied at a rate of 10% on the first £10,300 of taxable income and 18% on the rest. The Isle of Man has introduced a look-through system for investment companies and trading companies, which only requires 55% distribution for trading companies. If this level of distribution is reached the company is fully exempt from the Distributable Profits Charge. Unlike Jersey's proposals where the tax is collected from the shareholders, the Isle of Man's system involves the company paying tax on behalf of the shareholders. In terms of the proposed timescale for the distribution of profits, Jersey has proposed a limit of 3 years, whereas the Isle of Man has only provided 1 year for a company to distribute its profits. The tax base for profits in the Isle of Man is the taxable profits of the company. The national insurance contributions remained the same when the tax structure was reformed. For employees the average rate is 10% of a person's income. The Isle of Man has introduced a maximum personal tax cap of £100,000 on all income.

4. Method

a. Call for evidence

The Panel began its initial investigations by placing a ‘Call for evidence’ advert in the Jersey Evening Post, and in the States Bookshop, Morier House. The advert stated the Panel’s terms of reference, and requested for any submissions to be forwarded to the Scrutiny Office by the 30th June 2006. Following the extension of the Treasury and Resources Department’s consultation period, the Scrutiny Department accepted any submissions up until the 31st July 2006.

b. Written Submissions

The Panel considered the following written submissions when compiling its report (to view the submissions in full please refer to the Scrutiny website www.statesassembly.gov.je):

Mr R Barnes, Barnes Daniels and Partners

Mrs E Breen, Mourant du Feu & Jeune

Mr P Ellison, Jersey Group of the Royal Institution of Chartered Surveyors

Mr P Hobbs

Mr J P Frith, Fellow of the Chartered Institute of Taxation, Member of the Society of Trust and Estate Practitioners

Institute of Directors, Jersey Branch

Jersey Chamber of Commerce and Industry Incorporated (original and supplementary submissions)

Jersey Finance, Fiscal Strategy Group (FSG)

Jersey Hospitality Association

Jurat P G Blampied, OBE (original and supplementary submissions)

KPMG

Ms P Lucas (Attac and Tax Justice Network)

Mr D Pearce

PricewaterhouseCoopers

Le Rossignol, Scott Warren and Company

Mr J Russell, Fox International Property Holdings Limited

Mr R Stadden, Jersey Gas Company Limited

Mr P St John Turner

c. Public Hearings

The following witnesses attended public hearings with the Sub Panel -

Mr J Shenton, Tax Director, Ernst & Young Jersey.

Mr J Riva, Head of Tax, KPMG Channel Islands Limited.

Senator F H Walker, Chief Minister, accompanied by Mr J Harris, Director, International Finance, Chief Minister's Department.

Senator T A Le Sueur, Treasury and Resources Minister, accompanied by Deputy J A N Le Fondre, Assistant Treasury Minister; Mr M Campbell, Comptroller of Income Tax; Mr J Harris, Director, International Finance, Chief Minister's Department and Mr D Peedle, Economic Adviser.

Jersey Finance Fiscal Strategy Group (FSG) Representatives; Ms W Dorman; Mr G Grime; Advocate A Ohlsson; Ms J Stubbs; Mr D Wild.

Mr D Stuart, Le Rossignol, Scott Warren & Company, Chartered Accountants.

Mr J P Frith, Fellow of the Chartered Institute of Taxation, Member of the Society of Trust and Estate Practitioners.

Mr C Spears, The Jersey Chamber of Commerce and Industry Incorporated.

Jurat P G Blampied, OBE.

Institute of Directors, Jersey Branch representatives; Mr S Radford (Chairman); Mr D Drinkwater; Mr J Laity.

Full verbatim transcripts of the public hearings are available on the Scrutiny website.

5. Evidence:

5.1 Are the proposals compliant with the EU Code of Conduct?[13]

Given that the reform of the Island's taxation system was initiated in order to comply with the EU Code of Conduct, this issue is arguably the most important factor associated with the tax reforms.

Unfortunately, because of the nature of the Code (which is a political process rather than just a legal document), and Jersey's indirect relationship with the Code group (Jersey cannot attend meetings of the Code group, and is merely represented by the UK); it is also the hardest to judge.

During the States sitting on the 16th May 2006, Deputy Southern asked written questions of the Chief Minister regarding the reaction of the EU Code of Conduct Group and ECOFIN to the Island's proposals to eliminate non-compliant business taxation by the replacement of such taxes with the zero/ten mechanism.[14] From the Chief Minister's responses to these questions it appeared that the general approach of zero/ten had been accepted by Rt Hon Dawn Primarolo MP, (who as well as being the UK's Paymaster General is also Chair of the EU Code of Conduct Group), but that the more detailed provisions had not been discussed in any detail.

During a Public Hearing the Chief Minister elaborated upon this response and stated:

> *"…the zero/ten proposals have been, in outline, approved by ECOFIN… What we have got then are a number of issues of detail, which are subject to negotiation.*
>
> *I think the important point to make here is that we are not looking at a black and white legal position in terms of our compliance with the code of conduct; we are looking at a political position, and our political positions are subject to discussions, negotiation and agreement or not, as the case may be.*
>
> *There are a number of detailed issues under zero/ten, which are still the subject of discussion and, if you like, negotiation with the UK Government and we anticipate that will remain the case for quite some time yet. But at the same time it has to be said, and I think you know this too, that the UK have supported our overall proposals to ECOFIN, indeed they presented them to ECOFIN on our behalf in the first place."*

During the course of the Public Hearing the Chief Minister was asked whether the proposed RUDL charge would appear to the EU Code of Conduct as a tax, given it would only apply to non-locally owned companies (if local companies convert to an LTP). The Chief Minister responded:

> *"There are remaining issues to be discussed on those… It is still the subject of political, as I say, discussion and negotiation."*

The Chief Minister then went on to say;

> *"I think the first hurdle we have got to overcome with RUDL is get the UK Government to understand what we are doing and why exactly, what the nature of it is, and we will have to take some decisions no doubt later in the day depending on how successful or not we are--*
>
> *I think we have got strong grounds for continuing with it and pushing it through, but I could not tell you today that the RUDL charge is something that has got universal general acceptance, because it has not."*

In considering compliance with the Code, the Jersey Finance FSG's submission to the Panel stated;

> *"… We did not identify any areas of obvious non-compliance [with the Code] during the course of our work, nor did we conclude that any of the specific proposals would create potential difficulty in terms of potential non-compliance."*

However, this statement was qualified by stating that it was not within the scope of the FSG to establish whether the proposals would satisfy Jersey's political commitment to comply with the requirements of the Code, and that this would be a matter for the States of Jersey.

The Panel was advised by Mr Teather that the general approach of the Zero/Ten Design Proposal appeared to be compliant with the Code of Conduct, as although there is discrimination *against* some companies (with regard to the Financial Services Industry) there is none specifically in *favour* of 'offshore' companies. However he warned that some aspects were on the borderline, and that adding any additional tax rates to tax particular companies (such as different rates for retail businesses, as initially proposed by the Isle of Man) could jeopardise the whole proposal with the EU, because as more exceptions to the 0% rate are introduced it becomes more difficult to maintain that the standard tax rate in the Island is 0%.

However it is impossible at this stage to give a firm answer. The process of judging reforms against the Code has only just begun, but more importantly there remains a serious problem in terms of lack of information about the way that the Code will be interpreted and applied, largely because Jersey does not have a

place in Code discussions but has to operate through the UK. As one witness said:

> ***Mr. J. Shenton:***
> *"Whether it is a moving feast I do not know, I have not spoken to the Code of Conduct Committee. I do not know who has. I do not know what their agenda is. Nobody has told us what their agenda is."*

5.2 Data on the size of the Black Hole

The Zero/Ten Design Proposal makes no mention of the tax loss involved through the move to a zero/ten corporate taxation structure. The Fiscal Strategy stated;

> *"The States has agreed that in 2008 it will introduce a 0% rate of tax on the profits of most companies, but a 10% rate of tax on the profits of companies in areas such as the financial services sector. These measures safeguard our economy but, as a result, Jersey's tax take is expected to fall by up to £80-£100 million a year by 2010."*[15]

As one of the Panel's terms of reference was to review the effect of the proposals on Jersey's tax revenues, the Panel was keen to see the figures involved with the proposed taxation structure. Despite continuous requests to the Treasury and Resources Department, the date for the publication of figures was regularly pushed back. During a Public Hearing on the 4th August 2006 the Minister for Treasury and Resources stated:

> ***Senator T.A. Le Sueur:***
> *"The latest update, I expect you will see the detail in a couple of weeks… At the moment, all I can say is the indications are that we are still talking in the same ballpark figures relating to £100 million, and so as far as the fiscal strategy is concerned, there is no significant variation from that point of view."*

At that point the Minister made the following statement, which suggested that the work involved in producing the updated figures was well advanced:

> *"Malcolm [Campbell, the Comptroller] has done some figures for me updating it. They have been validated"*

Despite these assurances, the Panel had still not received any updated figures at the time of going to press (some seven weeks after the Minister's comments).

This issue was raised during a Public Hearing with Mr Shenton, referring to the information that had been made available to the initial consultation team;

> ***Mr. J. Shenton:***
> *"I would have liked a lot more background, I would have liked more information concerning where they get the numbers from. I would like to have seen the projections."*

Further on in the hearing he went on to say;

> *"Yes, we asked, there are numbers thrown around in the document about how much they are going to get from this and how much they are going to get from that. I have not seen any underlying numbers whatsoever in order to substantiate that.*

… We are technical people and I am not sure whether the zero-ten as discussed here is going to raise tuppence or £200 million. I cannot tell you.

Before I give the thumbs up I would like to see a breakdown of how the numbers are going to be made up. How much money we are going to get and where we are going to get it from, because the whole idea behind zero-ten was not meant to be a revenue raising exercise. It was meant to, as far as I was concerned, put us on a sound footing internationally."

Similar questions were asked of members of the Jersey Finance FSG group who were involved in the original consultation process with the Treasury;

Senator B.E. Shenton:
"You were part of the consultation process so I assume you saw more detail than we have certainly seen?

Advocate A. Ohlsson:
No. The Comptroller of Income Tax's figures are subject to confidentiality obligations and none of us swore to any oaths of confidentiality so have not seen any of the numbers or any of the underlying data."

5.3 Avoidance – 0% and 10% companies

Panel's research

Given that part of the Panel's scope for this review was to identify the potential for avoidance with the proposed system, the Panel asked Mr Teather to investigate the scope for companies in the finance sector to try to avoid the 10% rate. The Panel was subsequently advised that the extent of this problem would be dependent upon two factors:

1. The relationship between Jersey and the banks (the more attractive Jersey is as a venue, the more the banks will feel a need to keep on the right side of the authorities); and

2. Whether the bank can recover any Jersey tax charges against its home country tax.

Recovery of Jersey tax

A UK-based parent company can generally recover non-UK income tax paid by its subsidiaries, because it can be set against the UK tax payable when the parent receives a dividend (this relief is given automatically, whether or not there is a tax treaty). In that case the Jersey 10% tax would not represent a real cost, as there would be a corresponding reduction in UK tax liability.

However, several factors could prevent this, including:

- The parent company may have sufficient losses so that it would not pay tax on its Jersey dividends even without the double tax relief; or

- Profits may be retained in Jersey (double tax relief generally only applies when a dividend is paid up to the parent company); or

- If the parent company is not based in the UK it may face different rules, which may not grant such generous double tax relief; or

- The parent company may pay a lower rate of tax than the Jersey rate.

Avoiding Jersey tax

Assuming that for at least part of the financial services sector the 10% Jersey tax will represent a real cost of doing business in the Island, some of the main methods of avoiding the 10% tax are likely to be:

Activity manipulation

Since the proposed 10% rate only applies to a limited range of activities, under zero/ten it could become possible for some financial services companies to change their business slightly to fall outside the charge and benefit from the general 0% rate.

Mixing

The proposed system is based on classifying the whole company as 0% or 10%.[16] It might therefore be possible under zero/ten to shelter some 10% activity within a generally 0% company.

To avoid this, the Design Proposal would need to be amended so that the 10% rate operates on an 'income stream' basis (as proposed by the Isle of Man) rather than a 'whole company' basis.

Splitting

In the opposite direction to 'mixing', activities that are currently combined in a single company could be split, taking some activities out of the 10% company into a 0% company.

For example, the Zero/Ten Design Proposal says that although fund managers would be exempt, most fund management operations would be taxed "since typically these are [outsourced by the fund manager and] carried out by specified financial services companies"[17] which would be taxable at 10%.

If under the proposals there is no regulatory need for those activities to be carried out by a regulated company, then it would be likely that that activity would be transferred to an unregulated 0% company.

Jersey outsourcing

Under the Zero/Ten Design Proposals it is likely that many 'back-office' functions could be carried out by an associated 0% company within the group structure.

The outsource company would charge the bank for these services, which would be a deductible expense, and as the outsource company would charge enough to make a profit it would effectively transfer some of the bank's profit to a non-regulated, and hence 0% company.

Under the current 20% tax system, this could only be done by moving the back-office operation out of Jersey to a tax-free jurisdiction. However 0%

companies will be available in Jersey under zero/ten, allowing this type of avoidance to be carried out on-Island at minimal cost and disruption.

Non-Jersey outsourcing

More worryingly, some of the bank's activities could be outsourced to a non-Jersey affiliate; this could allow even core banking operations to be taken outside the Jersey tax net, leaving the Jersey bank with little more than a shell operation making a minimal profit. If this were to occur this would mean that Jersey would lose the employment; the income tax on employees' salaries; and the 10% income tax on profits.

This could be done under the current 20% system, and there is nothing about Jersey's introduction of zero/ten that increases the opportunities (indeed the motive will be reduced, as tax would only be saved at 10% rather than 20%). However, if there are differences in the scope of the 10% charge between Jersey and Guernsey or the Isle of Man then there may be scope to shift operations there (presumably at a lower cost than finding a 0% jurisdiction currently).

Inter-group charges

Similar techniques to the ones described above can be used without having to move any actual operations; a group company in another low-tax jurisdiction could charge fees to the Jersey company, for example for use of the name, or use of group computer systems.

As legitimate business expenses (provided the fees are kept to a reasonable level) these charges would reduce the profits of the Jersey operation and hence reduce its tax bill.

This method of avoidance is equally possible under the current 20% system, and there is nothing about zero/ten that is likely to increase its prevalence.

Agency

At the most extreme, the Jersey company could become a mere local agent, with the group's actual banking activities being based elsewhere. The Jersey bank would manage customer relations with UK and other European customers, but an agency operation would have low staff levels and low profits.

Again, planning of this type would be equally possible under the current 20% system. However, there is a risk that other moves (such as the Savings Tax Directive or the UK crackdowns on tax avoidance) could encourage some banking operations to move out of Jersey for other tax reasons.

Evidence received

The evidence overwhelmingly supported the theory that avoidance of the 10% rate by the financial services industry would be possible, but would not be likely in practice, partly due to the internationally competitive position of the 10% rate but more because of the tax systems of the banks' home countries.

The Jersey Finance FSG were questioned on their views concerning the potential avoidance of the 10% rate:

Advocate A. Ohlsson:
"For many of these 10 per cent payers the 10 per cent is not a real cost; if they do not pay it in Jersey, they will be paying it somewhere else. So the extent to which

they wish to wriggle will be limited by the fact that if they wriggle here they will simply be paying the same amount or more somewhere else."

During a Public Hearing Mr Shenton was asked how easy he thought it would be for the finance sector to avoid paying the 10 per cent charge, to which he responded:

"To be honest I do not think it is actually going to happen I think that you have -- because of the international structures of all these companies, because of Plc rules, because of the relatively minor profits which are held in Jersey by some of the big corporates - it will not happen… The ones where it could happen would be your small, locally owned company but there is no point them avoiding the 10 per cent charge because effectively it is going to get picked up through their shareholding. So, I do not think there will be, I may be wrong, but in my personal opinion I do not think there will be any abuse of the 10 per cent charge."

The Minister for Treasury and Resources was questioned on the potential for avoidance with the proposed system, and stated:

Senator T.A Le Sueur:
"As far as the people on the fringe between zero and ten, we are talking about financial institutions here with a mix of activities. I think, yes, they will obviously try to structure their affairs in the most effective way.

Mr. J. Harris:
There is a specific proposal in the document to try and treat them as a specified financial services group, so they might get away from the idea that they can effectively download some activities into non-regulated activities and therefore avoid the 10 per cent, but nevertheless, these are multi-national organisations and I go back to

the point just made, that they have a lot of tax planning capability, and that is a risk that you are going to be exposed to, to some extent. The

bet that is basically being placed here is that the 10 per cent rate of taxation for the financial services group is competitive and that there is therefore no great incentive for them to do that, because that is a rate that is comparable to similar rates that they can enjoy in other jurisdictions. We know who they are: the Isle of Man, Singapore and so on. So, you are trying to pitch the rate of tax at one which effectively does not provide a great incentive for people to try and organise their way out of it, because it is not worth the cost and the complexity of doing it and ultimately, whether you pitch it at 10 per cent or 7 per cent or 12 per cent or whatever… you are going to have a risk that you have to accept, I think, in the long run."

This issue was also raised with Mr Riva during a Public Hearing:

Deputy G.P. Southern:
"To what extent do you see all of those businesses that are supposed to be paying 10 per cent rebalancing, splitting, using transfer pricing, forming subsidiaries so that they minimise their turnover?

Mr. J. Riva:
If they were to operate a subsidiary and drop down the profits into that subsidiary, then that subsidiary would, I would expect, be subject to the CFC provisions and the profits would be imputed up to their parent and taxed at 30 per cent. So, yes, they would lose their Jersey tax bill but they suddenly have a larger amount of UK tax."

Defining the 10% rate

Section 11.2.6 of the Zero/Ten Design Proposal states;

> *"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')."*

The Panel was keen to review the definition that would be used for a 10% company, and the mechanisms that would be used to enforce this definition. Uncertainty in this area could lead to increased avoidance or unfairly categorising a company in terms of being taxed at the 10% rate.

In their submission, the Institute of Directors noted that neither the FS(J)L or the BB(J)L were written with the intention of deciding the taxation treatment of the entity concerned and that this would further add to the complexity of new businesses establishing in the Island who may be at the "edges".

The Jersey Finance FSG's submission also made reference to this issue:

> *"Whilst we agree in principle with this broad approach to determining a company's corporate tax structure, we would notice that in practice there are likely to be many 'grey areas' and potential complexities if the test is solely a 'regulatory' one. This is because, particularly in the context of exemptions from FS(J)L, there is currently a great deal of complexity in relation to whether or not certain types of structure fall to be regulated."*

The submission went on to state;

> *"We therefore believe, in broad terms, that the test for identifying 10% companies will need to be a dual one, i.e.:*
>
> - *is the company carrying on a prescribed regulated financial business that, all other things being equal, would bring it within the scope of the 10% regime; and*
>
> - *if so, does that company trade through an "established place of business" in the Island?"*

This issue was also raised with the Jersey Finance FSG during a Public Hearing, when they were asked whether there was a danger of partial tax avoidance by 10% companies if there wasn't clarity with regard to how these companies would be defined. The following response was received:

Mr. G. Grime:
"I think our concern was rather the other way round, and this was a point made to us by the Law Society, that because of the lack of clarity in the definitions at the moment, that some vehicles might find themselves liable to 10 per cent."

Mr Frith and Mr Stuart were asked whether they were satisfied that the 10 per cent companies were clearly defined in the Zero/Ten Design Proposal, to which Mr Frith responded:

Mr. J.P. Frith:
"I cannot quote verbatim the definition in the design proposal, but the definition that I read seemed to me to be an acceptable definition. I think of it in terms of a business that is registered or licensed by the Jersey Financial Services Commission."

Banks' Tier 1 Capital Interest

Section 15.3 of the Zero/Ten Design Proposal:

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%.

Jersey's proposal to introduce Tier 1 capital income at 0% is in contrast to the Isle of Man's proposed rate of 10%.

This issue was addressed with Mr Shenton during a Public Hearing:

Deputy G.P. Southern:
"Can I take you on to the Tier 1 capital zero rating… I think the Isle of Man is looking at 10 per cent on Tier 1[18] *are we being over generous?*

Mr. J. Shenton:
I think we are probably being a little over generous."

The Panel subsequently compared the Isle of Man's latest published proposals with Jersey's Design Proposal, and found the following apparent difference:

Jersey Design Proposal:
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%.***

Isle of Man (Practice Note PN124/06):
One of the Financial Supervision Commission's regulatory conditions attached to the holding of a banking licence is for a minimum amount of capital to be held. As this minimum regulatory capital is related to banking business, ***income arising from it will be taxed at the 10% rate****.*

(Emphasis added)

5.4 Avoidance – 0% for companies, 20% for individuals

The current Jersey tax system is strong, because companies and individuals are taxed at the same 20% rate. However under zero/ten non-finance companies will enjoy 0% tax, while individuals will still be taxed at 20%. This will open up new avenues for avoidance, by transferring businesses or investments into tax-free companies. Shareholders will still be taxed when they take dividends out of the company, but there is a risk that this can be postponed or avoided, or that the share ownership could be disguised to prevent the tax office finding out about the dividend.

The issue of tax avoidance or evasion[19] by Jersey residents was raised with the Minister for Treasury and Resources at a Public Hearing, and he agreed that there would be a risk of tax losses through avoidance:

> ***Senator T.A. Le Sueur:***
> *"Yes, I think these zero/ten proposals will increase the possibility of Jersey resident shareholders trying to find ways of avoiding having the tax element transferred to their personal shareholders as an individual, and part of the zero/ten proposals involve looking at strengthening the anti-avoidance procedures in order to ensure that that does not occur. I think it is a risk."*

The general view from most witnesses was that tax avoidance or evasion would be possible under zero/ten, and that the gap between 0% for companies and 20% for individuals would give a motive, but that the actual losses could be mitigated by the traditionally good relationship between the taxpayer and the tax department.

> ***Mr. D. Stuart:***
> *"Because the Jersey owners of those companies will still be paying 20 per cent tax on their share of the profits from those companies, so Jersey is still getting a 20 per cent share of the profits made by those companies; it is just getting one tranche from the company[20] and one tranche from the shareholder."*

Mr Frith was asked whether he thought it would be likely for Jersey shareholders to superimpose non-Jersey structures between themselves and their companies, in order to avoid the 20% rate of shareholder taxation under the proposed system:

> ***Mr. J.P. Frith:***
> *"No. At present with a tax rate of 20 per cent one does not see that happening, so there is no reason to suppose that if the rate was reduced -- which it will not be, in effect, for Jersey residents; they will still pay 20 per cent. I cannot see that there is any great incentive for them to want to do that. In my experience, the desire on the part of local residents to avoid tax is pretty limited, certainly in relation to trading profits, business profits. Where the problems arise with local residents is on investment income. That is where the issues arise typically under the anti-*

avoidance legislation, et cetera.

…Local residents, if they control the company, are going to be taxed at 20 per cent anyway. Interposing foreign structures in order to pay no tax at all -- well, there may be some that are tempted to do it but even under the existing anti-avoidance legislation – I know that amendments are proposed – that probably would not stand up to attack by the comptroller."

There was a further issue of illegal evasion; even if shareholders could be subject to tax on a look-through basis, it could be possible for Jersey-resident individuals to own a Jersey-based company through a non-transparent offshore structure to make it difficult for the Comptroller to know that the company was Jersey-owned and therefore impossible for him to levy any tax. Currently the company itself would be taxed at 20%, but under zero/ten the only possibility of collecting tax will be at the shareholder level. When asked whether he had sufficient information to prevent tax evasion by Jersey-resident shareholders, the Comptroller of Income Tax, Mr Campbell, was positive:

Deputy G.P. Southern:
"What we are talking about, that thing, one of the ways to avoid tax, is it not likely that Jersey shareholders will superimpose non-Jersey structures between themselves and their companies, especially for new businesses and investments? Jersey Finance themselves, in their report, in their comments, have pointed this out, you know, a trust mechanism or whatever which avoids tax paying. Is that a possibility? Is that something you have considered?

Senator T.A. Le Sueur:
It is a possibility, and something that we will need to make sure that the compliance and the anti-avoidance procedures are adequate to cope with it.

Deputy G.P. Southern:
Now, that comes down to this next question. Does the Comptroller have access to the necessary information to determine who are the real ultimate shareholders of a Jersey company, if the shareholders are held, say, by a Guernsey company or a Cayman trust? Can we get to that or, again, will that be a loss?

Mr. M. Campbell (Comptroller of Income Tax):
The draft law which is currently with Her Majesty's Attorney General for Human Rights Issues does contain a provision which will allow me to find out who the ultimate beneficial owner is of a particular company. Even if they superimpose a structure on top of it, the law will allow me to go behind that veil, and the taxpayer himself, the Jersey resident, must declare his beneficial ownership in the company to me.

Deputy G.P. Southern:
Even if that is a trust?

Mr. M. Campbell:
Yes."

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

Zero/Ten Design Proposal:

5.1.1 It is therefore proposed to levy a 'RUDL charge' annually in January each year on all businesses which are registered under the RUDL [Regulation of Undertakings and Development (Jersey) Law, 1973, as amended] 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.

5.5.1 The issues behind RUDL

There is significant concern that the 0% rate will give an unfair competitive advantage to businesses owned by non-residents, particularly retailing and tourism. Retail companies will not be taxed on their trading profits, but the retained profits of companies that are Island owned will be taxed when deemed to be distributed to the shareholders. In contrast profits of non-Island owned companies' will not be taxed in Jersey, and are unlikely to be taxed elsewhere until they are actually distributed (and may not be even then, depending on the circumstances of the shareholders).

Whether this is an actual problem (other than the loss of tax revenues for Jersey) depends on whether these companies will be paying full tax in their parent's home country (primarily the UK). There was some disagreement about this point amongst witnesses, with some claiming that it was only a theoretical, not a practical, issue.

Jersey Finance tended to minimise the practical risk, but admitted that there was an issue and that overall zero/ten would increase the appetite and scope for avoidance:

> ***Senator J.L. Perchard:***
> *"It is claimed by some that Jersey owned businesses would not be disadvantaged. That assumes that the profits of UK businesses will be taxed in the UK, so some people claim there is no need for a charge. But I want to ask you a question; is it realistic to assume that UK groups trading on the Island will pay 30 per cent, a third of their profits to the UK Exchequer? Is that realistic? Are they really going to do that?*
>
> ***Ms. J. Stubbs:***
> *At some point they probably will. I think the first point to make is that most of those groups will be subject to UK transfer pricing and CFC*
>
> *rules, which I suspect means that the margin that they make in Jersey is relatively low because if you think about a simple importer of toiletries or shoes or something, they are not really adding much in terms of value to the end product over here. There is very little goodwill being built up in the business here. The brand is probably owned somewhere else, so I guess the starting point would be that the*

margin is probably lower than you might suspect in some of those businesses. If they were to start to roll up aggressively then they would start to get caught by UK CFC laws. They could start to indulge in some of the more sort of recherché CFC planning ideas that one regularly sees at the top end of the tax planning industry coming out of various places. I guess that is a possibility. I am not sure that rolling up in Jersey is necessarily high on the agenda of some of these retailers but perhaps it could become so.

…

Senator J.L. Perchard:
I think what you were quoted as saying is that it could be an increased appetite for tax planning.

Ms. J. Stubbs:
Well, that comment was really borne out of our experience in other jurisdictions, which is broadly that the more focused your anti-avoidance legislation becomes the greater the incentive for businesses and their advisers to try to find ways around those rules. … Absolutely. … I think that is just a fact of commercial life that if you introduce a rule people are suddenly inspired to think around it."

On the other hand, other witnesses thought that this view of corporate behaviour was "naïve". [21] When asked specifically to consider the issue, the Institute of Directors thought that the greater opportunities for tax planning under zero/ten would increase the appetite for it, and hence the likelihood of it taking place:

Deputy G.P. Southern:
"Yes, that is an issue and we are treating it rather lightly but it is an issue to be considered. As soon as you introduce a multiple rate of tax --

Mr. C. Spears:
I think you are absolutely right, Geoff, that the more complex you make a law the more the tax industry will work hard to create methods of mitigating that tax. I think experience shows, the more complex you

become, the more competitive that industry becomes. So, yes, it is inviting that risk, I would say."

Jurat Blampied supported this view, with the advantage of being retired and hence being able to give a disinterested view of the tax planning industry:

Deputy P.J.D. Ryan:
"You think in your view a professional advisor or an accountant of those companies would be advising that course of action, would you?

Jurat P. Blampied:
Oh, yes, I am sure. I mean, it is not evasion, it is avoidance, is it not? … They would

be in an advantageous position compared to [a Jersey-owned company, whose shareholders] would pay 20 per cent on their profit, but [a non-Jersey owned company] could pay nothing. So, they have got more money to retain and plough back into the business."

The Panel concluded that this risk of unfair treatment was too high to be ignored, and that it was important to try to resolve it (although bearing in mind the danger highlighted by the Institute of Directors that with an over-complex scheme "the medicine does not warrant the illness").

5.5.2 Problems with the RUDL charge

The RUDL charge is one attempt to deal with this unfair advantage (whether actual or merely perceived) for non-Island owned businesses. By a charge on the RUDL headcount, with different rates for different business sectors based on profitability, all businesses operating in the Island will pay tax.

To prevent double tax for Island-owned businesses, the RUDL charge will be offset against income tax on the business' profits. However it will NOT be set off against the tax payable by shareholders on dividends (actual or deemed) received from a company. For shareholders in Island-owned companies therefore the RUDL charge will be an additional layer of taxation. The intention is that such companies will be reformed as Limited Trading Partnerships, to avoid this double charge (partners in an LTP will be taxed directly on their share of its profits, so will be able to offset the RUDL charge).

The RUDL proposal was arguably the most contentious part of the Zero/Ten Design Proposal. The Panel received numerous submissions detailing lengthy concerns with the proposed charge. The majority of witnesses were in agreement with the concept of having some charge for foreign owned companies trading out of the Island, but were also in agreement that the RUDL levy was not an appropriate tool to achieve this.

The Panel's research has illustrated several potential consequences of introducing the proposed RUDL levy, which are described below:

Inflationary pressures

The RUDL levy would cause overall costs to increase for the following types of businesses:

- Jersey-owned companies (not all of which would be expected to convert into LTPs to avoid this problem)
- Foreign owned businesses that currently claim double tax relief to recover their Jersey income tax

This means that the introduction of the RUDL levy would only cause increased prices if the market in the Island is dominated by foreign-owned companies which can currently recover their Jersey income tax through double tax relief.

Figures from the Income Tax department show that there could be 152 or so non-finance non-

Jersey owned employers in the Island. This information came with a caveat, as beneficial ownership information is not supplied to the Comptroller of Income Tax, and it is also difficult to establish where ownership of some companies lies.[22]

The States Economic Adviser, Mr Peedle, produced a paper on the economic implications of the RUDL charge. The paper stated that the charge could lead to higher prices, and that if all the increase in costs is passed on to the customer it means that the total expected yield from the charge of £5-6m would be paid for by Islanders in one form or another.

Mr Shenton stated that:

> *"It has a very adverse knock-on effect to the local community. The cost to the local community will far outweigh the money which you get from the RUDL charge, plus it is another tax through the back door through administration."*

The representatives of the Jersey Finance FSG were in support of the principle of collecting tax from Jersey-operating companies, but they had some concerns about the potential effects:

> ***Advocate A. Ohlsson:***
> *"The problem with RUDL is it is a new charge; it is an entirely new cost of doing business in Jersey. It is not creditable[23]; it is not a tax, it is a charge. The idea, in order to effectively not to double tax Jersey taxpayers, if you like, is to make it creditable against 10 per cent taxpayers. On a zero per cent taxpayer it will not be creditable to the shareholder which is another idea behind conversion to an LTP."*

Reduced employment

For businesses based in Jersey, there would be an incentive to employ workers off-Island, including by outsourcing operations to non-Jersey group companies. This could reduce employment, and therefore lower income tax revenues. Through the proposals, it would theoretically be possible to set up a Guernsey-based subsidiary to run some of the company's operations while still keeping the 0% tax on the company's profits. Mr Peedle's paper reflected this by stating:

> *"The marginal impact of RUDL on prices and incentives for non-Jersey non-finance businesses to invest in Jersey could slightly undermine employment prospects in the Island."*

Economic impact

Encouraging competition is one of the seven key strands of the Economic Growth Plan (EGP) [24], and it is vital to the Island's future prosperity. The proposed RUDL charge is in conflict with this aim, as it is a potential disincentive to inward investment in the Island for companies where it would be an absolute cost of doing business in Jersey. This view was supported by the submission from the Institute of Directors, which stated:

> *"Given that the RUDL charge will almost certainly be non-creditable in the home*

jurisdiction of the business concerned, it will represent a cost of providing employment in the Island and must surely therefore act as a disincentive to inward investment…"

The potential negative economic consequences of the charge were highlighted by the Minister for Treasury and Resources, and his response indicated serious misgivings about the introduction of such a charge:

> ***Senator T.A. Le Sueur:***
> *"Certainly, when we look at the ways of trying to get money back from non-resident shareholders, the advice we got – and which I totally accept – was that whatever mechanism we introduce, it is bound to have a detrimental economic effect on those particular companies, and it is purely a trade-off between whether you want to have economic dis-benefits for the political benefits of maybe being able to score a point off those companies.*
>
> *My thinking, particularly reflected from the views that I have had through the consultation process, is that since part of the fiscal strategy is based on economic growth, it would seem perhaps perverse to introduce a RUDL charge in complexity in that area at the same time as economic growth."*

The proposal includes the introduction of a tax holiday period for foreign owned start ups to the Island to encourage inward investment; however this was highlighted as a potential problem by the Jersey Chamber of Commerce. Its submission stated that this would be unfair on local business to the extent that initial cost is avoided for a period for incoming businesses only, which would have an immediate advantage compared to local business.

The increased administrative impact the proposed RUDL charge would have on companies could also act as a disincentive for investing in the Island for both local and non-locally owned companies. The Jersey Finance FSG submission highlighted the fact that for locally-owned businesses the process of paying and reclaiming the annual charge could be administratively burdensome. This submission also stated that it would have a negative cash flow impact for many small businesses, and may adversely impact their working capital arrangements.

Link with zero/ten

Another factor to consider with the proposed RUDL charge is whether its proposal belonged in the zero/ten consultation document. During a public hearing, Mr Harris stated;

> *"We have talked to the UK about RUDL, and I have a great deal of sympathy for them because they do not understand it very easily, and I think that is true of a lot of people, and it is difficult to explain. They equally do not have a view as yet, but they are thinking about whether it could be characterised as a charge or a tax, so right there is still an open discussion to be had, and I think it is clear that they take the view that it is a matter that probably should not be in the presentation of the proposals to the code, which is concerned with other criteria, and that it probably belongs in some other place."*

5.5.3 Proposed alternatives to the RUDL charge

Throughout the course of the public hearings held for this review the Sub Panel heard numerous witnesses raise concerns over the proposed RUDL charge, and the related proposal to introduce 'Limited trading partnerships' as a trading entity. However, despite the concerns raised the majority of witnesses were in agreement with the reasons behind the RUDL proposal:

- The perceived unfairness that non-locally owned non-finance businesses would be operating in the Island without contributing to States revenues.

- The potential competitive advantage these companies would have over locally-owned businesses whose profits would be taxed (either directly or as a deemed distribution).

The Sub Panel was therefore pleased to hear two potential alternatives to RUDL during its public hearings, both of which could go some way to solve the above two issues. The two alternatives and the research the Panel has conducted into their viability are detailed below:

a) Goods and Services Tax (GST) Restriction:

This proposal was put to the Sub Panel during the course of a hearing with Mr Shenton, Tax Director, Ernst & Young Jersey. Under the proposed GST system non-finance businesses would charge GST on their sales, but would recover all of the GST paid on their expenses and purchases. Mr Shenton suggested that recovery of input GST could be restricted. As an example, Mr Teather, the Panel's adviser, calculated that in order to raise the £5 million proposed by RUDL, non-Island owned businesses might only be allowed to recover 65% of the GST they pay.[25]

This would be explicitly discriminatory; Jersey-based businesses would suffer the restriction unless they revealed Jersey-resident beneficial shareholders. Mixed ownership companies could suffer a proportionate restriction.

EU Code compliance

There is some uncertainty about this, as with all aspects of the detailed operation of the Code, but it appears that the Code is not currently being used to examine VAT-type taxes.

If GST restriction was regarded as a corporation tax substitute, then it would probably be treated as falling under the Code, but this seems unlikely because the tax base is very different.

Taxes off-Island owned businesses

Off-Island owned businesses would pay some tax. However this would not be a direct substitute for income tax, because the tax collected would be a percentage of GST-liable expenses (loosely non-staff costs).

Level playing field

Off-Island owned businesses would pay a percentage of GST-liable expenses (loosely non-staff costs), Island-owned businesses would bear income tax on their profits (mainly through actual or deemed distribution).

Depending on the relative expenses and profit margins, one system would be more beneficial than the other for different businesses, as shown below:

Example comparison of Income Tax and GST restriction

		Retail		Services
Turnover		100,000		100,000
Stock purchases		(60,000)		0
Staff costs		(20,000)		(80,000)
Other expenses		(16,000)		(16,000)
Profit		**4,000**		**4,000**
Income tax (20%)		**800**		**800**
GST restriction (35%)		**800**		**170**

As can be seen, the restriction on GST recovery would be far more significant for a retail business (with high levels of costs subject to GST) than for a service business (with a high proportion of staff costs, which are not subject to GST).

Inflationary

The GST would not be creditable against UK tax (although it would reduce profits liable to UK tax), so Jersey-based businesses which are currently getting a full credit in the UK for Jersey income tax would see their cost of doing business in the Island increase.

Exports jobs

Unlikely; if sales are being made in Jersey, then it would be difficult to avoid a GST restriction.

LTPs

The restriction would only apply to off-Island owned businesses (on the assumption that the Code allows discrimination in GST), so companies with Jersey-resident shareholders will not suffer the restriction. There would therefore be no need for LTPs to allow Jersey-resident shareholders to recover any additional tax.

Avoidance of deemed distributions

A GST restriction could reduce avoidance of look-through. Assuming that it is permitted under the Code to discriminate on GST, there could be an explicit requirement to disclose Jersey-resident beneficial owners in order to be exempted from the GST restriction. This data could then be used to tax shareholders on deemed distributions.

b) Taxing Deemed Rents:

This proposal was put to the Sub Panel by Jurat P G Blampied during a public hearing. Under this proposal, the rental value of all business premises would be taxed; landlords would pay tax on actual rents, and owner-occupying businesses would pay tax on a market-level deemed rent. To prevent avoidance, the tax exemptions for foreign pension funds would have to be removed (as proposed under the repeal of Article 115 in the Zero/Ten Design Proposal).

EU Code compliance

The EU accepts that Jersey land is a non-mobile tax base, and will not be distortionary. It therefore falls outside the Code of Conduct. It is already proposed to charge 20% on actual rents; this is merely an extension.

Taxes off-Island owned businesses

All companies would pay the tax, but as a corporate income tax Jersey-resident shareholders could credit it against their personal tax on dividends received (or deemed) from the company. Jersey-taxable businesses (finance & utilities companies, and Jersey-owned unincorporated businesses) would be able to treat the deemed rent as a business expense, reducing their taxable profits.

From Rates information provided to Scrutiny, a 20% tax on all non-domestic property would yield £38 million[26]. This would be reduced by the tax already received on actual rents, and the tax credited to Jersey-resident shareholders and Jersey-taxable companies, but it seems likely that the yield from off-Island owned businesses would be greater than the £5 million proposed for RUDL.

This yield assumes that no deductions are allowed against rental income (i.e. gross rental income is taxed, with no allowances for costs or interest). As a tax on a scarce resource that is theoretically a reasonable approach, although in practice the effect on property businesses could be substantial.

Level playing field

Off-Island owned businesses would be taxed on the value of their premises. Obviously this would be a different percentage of profits for different sectors, so could be higher or lower than the tax on profits for Jersey-owned business.

Inflationary

Assuming that it would be treated as an income tax it should be fully creditable against UK tax, just like current Jersey income tax, so the total amount of tax paid would not be more than at present.

Exports jobs

It would be possible to avoid the tax, but only by moving physical operations offshore (so reducing premises size). However, assuming that it would be treated as an income tax it should be fully creditable against UK tax, giving less motive for avoidance.

LTPs

As an income tax, Jersey-resident shareholders could credit it against their personal tax on dividends received from the company. LTPs would only be needed for loss-making businesses, which would still have to pay income tax on their deemed rents but would not have any dividends (deemed or actual) where the tax could be offset by the shareholders. As an LTP, the loss on the business could be offset against the deemed rental income.

Avoidance of deemed distributions

All businesses would pay this tax, so at least some tax will be collected from all companies. Credit will only be given against Jersey tax to declared Jersey-resident shareholders who are being taxed on actual or deemed dividends.

Effect on property market

This tax could make property ownership less desirable, so could put downward pressure on property values. Overall the view of the Panel was that this would not be undesirable, as high property prices are currently likely to be a disincentive to business expansion in the Island. In reality though the effect would be minimal, because the tax is designed to be fully creditable (against either Jersey or UK tax), so would not be an additional cost.

If commercial rents were to be taxed with no deduction for expenses or interest, then costs for those property developers and investors who are not currently paying significant amounts of Jersey or UK tax (e.g. pension funds) would increase. These could seek to increase rents, but the view of the Panel was that the market would probably not bear increased rents at present, so the result would be a one-off reduction in property values to reflect the reduced after-tax yield. The extent of this reduction would depend on the dominance of such investors in the Jersey property market. This could cause a reduction in investment into construction of Jersey property, but again the Panel's view was that this would only be a short-term problem; once property prices had stabilised at a lower level, then yields would return to their normal level and there would be no continuing barrier to investment.

5.6 Management fees and group relief

Management fees:

Zero/Ten Design Proposal:

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.

A side effect of look-though for investment companies is that individual Jersey-resident shareholders will be taxed on the company's income, rather than the company. Currently Jersey-resident investment companies are able to deduct management fees (including investment management charges), and are only taxed on their net profits. In contrast under zero/ten the shareholders will be taxed on their share of the company's gross income, with no deduction for the management fees.

This proposal has caused concern for several individuals. Mr Frith's submission stated that the termination of this relief is a political issue which should be decided by the States. The submission also raised concerns with regard to the effect this proposal would have on attracting high value residents to the Island.

Mr Frith extended this statement during a Public Hearing:

> *"I question whether a paper such as this is the correct place to be putting forward a radical – in Jersey terms it is radical, believe me – because there are lots of private people in Jersey with their own investment companies. One might say: "Well, they can afford to pay." Well, maybe they can but hitherto they have been used to having their companies managed for them. The management expenses have been allowed and somehow it has got into this paper that that relief should be terminated. I do not understand why it has not come from a political decision rather than to be in this paper.*
>
> *…What I would say though is that the law which has existed for decades has provided relief for management expenses and it is one of the attractions, if you like. I deal with quite a number of wealthy people and I deal with quite a number of 1(1) K's, which we have not touched on at all in our discussions so far. But it is a very important part of our economy and as we go forward the wealthy people in the Island are going to become increasingly more important, in my view, if you go to zero tax and everything else. So, what we want to do, as a business community, if you like, is to preserve our tax base as far as possible and if possible, increase it. By removing what, in the great scheme of*
>
> *things, must be a pretty minor allowance, to me does not strike the right notes. It sends the wrong message to wealthy people."*

Similar concerns were raised by the submission from Le Rossignol, Scott Warren & Company, which stated that the proposal would be seen as a tax on "middle Jersey" and penny pinching. The submission went on to state:

> *"Many such investment companies are managed by third-party Jersey based administrators. The management fees and directors fees charged for these services form part of the taxable income of the provider and will therefore continue to bear tax under the zero/ten proposal. Consequently, by denying relief to the investment company for its expenses of management double taxation will result so that for each Pound of investment income received paid out in expenses the overall tax rate will be a maximum of 40%. This does not sit well in an Island that is attempting, as part of its economic growth strategy, to attract high value residents."*

Group relief:

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

This proposal is a result of the fact that under the zero/ten system different companies in the same group may be subject to 0% and 10% tax rates. This would therefore mean that taxable income could be transferred from the 10% tax regime to the 0% tax regime by using Concession 23, which allows for group relief.

The Jersey Hospitality Association made the following statement with regard to the proposed introduction of statutory group relief:

> *"In general we welcome the introduction of statutory group relief, which may be relevant to some of our larger members. However, there will be some instances where the payment of a management fee is still the preferred option and we would request that this form of relief be continued in parallel with the proposed statutory relief."*

5.7 Deemed distribution charge

Zero/Ten Design Proposal:

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.

The proposed deemed distribution charge was another contentious area within the Zero/Ten Design Proposal. Jersey's proposals are unique; Guernsey has agreed a distribution only process, and the Isle of Man has agreed to a Distributable Profits charge on a company unless it distributes a certain amount of its profits (55% for a trading company and 100% for an investment company).

The main criticism the Panel heard with regard to the deemed distribution charge was the assertion that the *"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." (Section 24.3.1)*

This statement was met with disapproval by a number of witnesses. The submission from Le Rossignol, Scott Warren & Company stated:

> *"Some of the profits may be paid as dividend but the balance remaining is invariably invested or applied for business purposes. The idea that profits are retained with a view to tax free extraction will be an affront to most business people.*
>
> *The assumption in this paragraph is that the regular payment of dividends is part of the normal economic cycle of a trading company. While this may be so in regard to some established profitable businesses it will not be the case in all businesses. Nor will it be so in the case of businesses that are in their start up phase or businesses encountering difficult trading conditions, either actual or prospective. In any event the proposed deemed distribution relates to 100% of the profits whereas those companies that do pay dividends may pay only a fraction of their reported profits."*

Jurat's Blampied submission stated:

> *"Most companies retain profits to finance capital expenditure to repay borrowed money and to finance additional working capital which is required because of inflation. These retained profits are not actually distributed. It is not correct to say that "the 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".*

The Jersey Finance FSG submission went a step further in terms of the problems this charge would cause:

> *"Specifically, a majority of the FSG members expressed concern that the introduction of a deemed distribution charge for Jersey-resident shareholders (but not for non-resident shareholders) would fundamentally conflict with established company law principles which provide for parity of treatment between ordinary equity shareholders in a company."*

The proposed two tier system (one for investment companies and another for trading companies) also caused some concern. Le Rossignol, Scott Warren and Company felt that this matter would be further complicated if a company was conducting both types of activity, and would therefore require special rules to determine on which side of the line the company would fall. Mr Frith's submission mirrored this view by stating:

> *"The proposal for deemed distributions is unwieldy and administratively complex. It will simply add further to the compliance costs of business in Jersey. It is not clear why different systems should apply to investment companies and trading companies. The shareholders in a group holding company with the two types of company will find themselves in an intolerable position."*

Minority Shareholders

The impact the proposed deemed distribution charge would have on minority shareholders was of great concern to many witnesses, and was mentioned in almost every submission sent to the Panel. The submission from the Jersey Finance FSG believed that it would be inequitable for a minority shareholder in a company to suffer the tax burden arising under a deemed distribution when they may not be in a position to receive any dividend, due to their lack of control or significant influence over the company's distribution policy.

Mr Frith made the following statement concerning minority shareholders during a public hearing:

> *"I think one has to express some surprise that the position of minority shareholders has not been covered in any great detail in the document except insofar as there is a deferred distribution. In other words, it is giving the shareholder some time to collect his funds together in order to pay the tax. But, in essence, that deferral will only apply for the first 3 or 4 years. Thereafter, a minority shareholder will have to find the tax each and every year on something which he may never receive. That to my mind cannot be right."*

Jurat Blampied mirrored this view in his submission to the Panel:

> *"What lacks social justice and promotes inequity is that there are a large number of individuals who have a modest number of shares in trading companies or who hold more than 1% of the shares in a public company."*

Mr Frith felt that the fact that the deemed distribution charge would have such a negative impact on minority shareholders could be a strong enough argument to introduce a system similar to that of the Isle of Man, where it is proposed that the company will pay tax on behalf of the shareholder:

> *"My understanding of the situation is that there are concerns (and I know that the word "agent" is referred to in the paper itself) that we might be in breach of the code if the company is seen to be an agent. However, I have not seen anything in writing to this effect… But I think that because of the minority shareholder situation, if we are going to ride roughshod over the minority shareholders, well, fine. Whether that passes human rights tests, et cetera, is another matter. It seems to me that it is a very powerful argument for being able to say that the shareholders' liability ought to be funded in some way or other by the company because otherwise the minority shareholder is at a financial loss."*

On the other hand, the Institute of Directors thought that this issue had been given too much prominence and that its likely impact would be small:

> ***Mr. S. Radford:***
> *"from my experience as an audit partner for many years, minority interests in trading companies; non-public ones are actually quite rare. I do not know whether again this is an example of us just overcomplicating the thing and getting tied up with something that is not that prevalent."*

However they did not dispute that the impact on those who were minority shareholders would be personally significant.

Generally Accepted Accounting Principles (GAAP)

As it is proposed to tax the shareholders of trading companies on deemed dividends, this means that the tax will be based on the company's Accounting Profits (which govern the amount of dividend that could be paid out) rather than the taxable profits of the company. This caused concern for several people, with Mr Shenton making the following statement when he appeared before the Panel:

> ***Mr. J. Shenton:***
> *"…they are talking about picking these distributable profits up under accounting profits as computed under GAAP or IFRS or whatever accounting treatment we use. For small companies there is no requirement in Jersey for a company to be audited. The majority of these companies are probably not compliant with GAAP, IFRS or even some of the probably standard accounting practices. In order for you to have a distribution on GAAP or whatever system you use I think is fundamentally wrong. I think that if you are going to do a distribution policy then you have to compute the distributable profits in accordance with standard tax principles as you would tax a sole trader."*

The Jersey Finance FSG raised this issue in their submission:

> *"The calculation of the deemed distribution appears to rely on GAAP profits as*

opposed to taxable profits which potentially could result in taxable profits being greater than the profits that are actually able to be distributed under GAAP/company law. This could lead to the unacceptable situation of a company never being able to fulfil the 100% distribution effectively required under the proposals. This, together with the ability of Jersey companies to choose their relevant recognised GAAP, is likely to serve only to further complicate this situation."

However the Comptroller saw the move away from a special calculation of taxable profits to general accounting profits, as reducing administrative costs:

Senator B.E. Shenton:
"Can I just ask what are the manpower implications for your department? What are the costs of bringing any staff on for compliance, for processes?

Mr. M. Campbell:

What I intend to do is to shift some current resources from the accounts inspection role which they currently do, because if the proposals go through as they stand, there will not be a need for account inspection any more and add-backs under the tax law. So, those resources which I currently have will be shifted into compliance and investigations. So, there will be no additional manpower resources."

Proposed LIFO (last in, first out) basis

One area where all witnesses were in agreement was that the deemed distribution charge should not allocate dividends on a LIFO basis, and that if the charge were necessary a FIFO (first in, first out) basis of assessment would be more appropriate. The difference can be illustrated:

Table - effect of LIFO & FIFO methods on deemed distributions

Year	Actual profits	Actual dividends	Undistributed profits FIFO	Undistributed profits LIFO
1	100		0	100
2	110		0	110
3	120	100	0	20
4	130	110	0	20
5	140	120	0	20

The company in this example pays out all its profits with a three year delay. Under a FIFO scheme there are no deemed dividends, because each year's profit is paid out within the 3-year time limit. However under a LIFO scheme the dividend paid out in year 3 would be assumed to be year 3's profits rather than year 1's, so year 1's profits are treated as undistributed and subject to deemed distribution.

The submission from the Institute of Directors expressed concern over the proposal to tax on a LIFO basis and stated that they could not understand the logic of the proposal. They believed a FIFO basis would sit more comfortably with the logic of the deemed distribution scheme, given it is rare for a business to distribute all of its profits immediately, and for many it would be impossible.

Mr Shenton also had strong views on this issue:

> *"At the moment the deemed distribution charge when you refer it back to the distributions made over the previous years, they are saying it is on a LIFO basis so therefore every three years you have to distribute everything in order to get back to where you started. Otherwise you end up with a deemed distribution charge in relation to the first year of trading. So, effectively every three years you end up having to start again, which is completely bizarre.*
>
> *They might as well have a complete look-through and do it on a year-by-year basis as they're proposing to do with investment companies. If you did it on a FIFO basis then at least it allows the company to maintain its distributable reserves to reinvest for a rolling three-year period, which I think from a commercial prospective is probably right, in*

order that it gives some flexibility to reinvestment for the company and gives them enough opportunity through adverse trading conditions or where they're looking for expansion or merger in order to keep their balance sheet relatively strong going forward."

The following exchange took place with the Minister for Treasury and Resources when he was asked why he had opted for the LIFO proposal:

Deputy P.J.D. Ryan:
"Why did you go for last in, first out?

Senator T.A. Le Sueur:
I think because we had to make our mind up one way or the other, and that was the proposal. I am happy to look at the arguments for and against either.

…it would be the basic principle, whether FIFO (First in, first out) or LIFO (Last in, first out) was easier from an administration point of view, and what the effect would be on the yield.

…certainly from the submissions I have seen to date, first in, first out appears to be the preferred solution, if we are going to go down that route, and I do not think I am going to lose too much sleep over that one, unless there was some significant argument why LIFO is better."

Alternatives

Although there was widespread agreement that deemed distribution was flawed, there was less agreement as to what should replace it. Three main alternatives emerged:

- Actual distribution only (no tax on the shareholder until a dividend is paid), as proposed in Guernsey.

- The company acting as agent, paying tax on behalf of the shareholder (therefore avoiding problems of minority shareholders), similar to the Isle of Man proposal;

- Full look-through for trading companies (with Jersey-resident shareholders taxed on their share of the profits), just as for investment companies or LTPs);

Actual distribution only

The Jersey Finance FSG submission supported 'actual distribution', stating:

"It is therefore the current view of the majority of FSG members that a simple

approach to taxing shareholders of trading companies on a straight forward distribution basis would be preferable, and those members remain to be convinced that such an approach would in practice have a significant adverse impact on the overall tax yield (other than perhaps an initial cash flow impact)? We would welcome the publication of further detailed economic analysis by Treasury and Resources in this regard."

The submission went on to state that subject to the satisfactory outcome of the discussions concerning the Isle of Man's proposal for the company to act as 'agent' for its shareholders, this would be the preferred position of the group for the way forward for Jersey (assuming that the straight forward taxation of distributed profits approach is not economically viable and/or politically acceptable.

The following statement was made during the Jersey Finance FSG public hearing:

Mr. G. Grime:
"Generally speaking, the view of the group is it should be kept simple, and that goes back to this whole question of avoidance, because the more complex it becomes I guess the easier it is to start avoiding. I think the general view is that a deferred distribution and a deemed distribution is something that is not a good thing, and that we should just rely on normal distribution with anti-avoidance provisions in there, for example, directors taking loans and that sort of thing."

However there is a clear risk of reduced revenues from a 'distribution only' system, as no tax will be collected until profits are paid out to the shareholders.

This was acknowledged by the Chamber of Commerce, which broadly supported an 'actual distributions only' policy but were concerned about potential revenue loops and felt that the policy may have to be reviewed within a few years:

Mr. C. Spears:
"I like the Guernsey route as an interim measure because it will prove to us whether we need the deemed distribution rate or not. But I do accept there is a need to budget properly and if we find we do need to do that then we do."

Guernsey's adoption of 'distribution only' is based on such a policy boosting investment and therefore creating economic growth. There was cautious support for this, although it was felt that Guernsey was relying too heavily on it. The

following exchange took place during the Public Hearing with the Chamber of Commerce:

Deputy P.J.D. Ryan:
"It could be beneficial?

Mr. C. Spears:
It is a very difficult number. I suppose you can say that if you are looking at small business end and that is where inherent growth comes from … I would think in the world of retail this could be healthy."

The Minister for Treasury and Resources was asked for his opinion concerning the Guernsey option of actual distribution during a public hearing:

> ***Senator T.A. Le Sueur:***
> *"I think the difficulty with pure actual distribution, it is again a question of simplicity versus yield. If you go for actual distribution, am I going to get my required yield, and I suspect that the answer is maybe yes, maybe no, but it could appear uncertain. I think there would be a tendency to distribute as little as possible. I think what you might need to do is sort of have a "suck it and see" system, that you might need to have something on the statute book to say: "Well, we need to have a deemed distribution legislation available in case actual did not yield the sort of levels we needed."*

Company pays tax

In contrast to Jersey's proposals to directly tax the shareholders, under the Isle of Man system the company would pay the tax by acting as agent for the Jersey-based shareholders.[27] However this means that there is very little practical difference between look-through and a corporate tax on locally-owned companies, which has raised concerns that it would be unlikely to comply with the Code of Conduct. This caused major concern in PricewaterhouseCoopers (PwC) report to Guernsey,[28] but the Isle of Man proposals received Royal Assent on the 11th July 2006.[29]

The acceptability of the Isle of Man proposals was raised at the hearing with the Minister for Treasury and Resources:

> ***Senator T.A. Le Sueur:***
> *"The Isle of Man version is simpler. It may well be more palatable from a commercial point of view. It does, from my point of view, again reduce my potential yield, because we could be talking about 55 per cent ongoing, rather than if you are catching up to 100 per cent, but it is only for those companies in the non-finance, non-investment holdings sector.*
>
> *So again, we are talking about maybe a relatively small proportion of the whole overall yield. It will, nevertheless, have an effect on yield. It is a balance which I have to strike between simplicity, which I like; yield, which I need; being code compliant, which goes without saying, effectively. All this needs to be put into the balance, but certainly I would be attracted to the situation."*

The potentially contentious issue of the company acting as agent for the shareholder was also raised at the hearing:

> ***Mr. M. Campbell:***
> *"I have looked at what the Isle of Man have legislated for, and it seems to me,*

looking at it, that there may well be a chance of it not being Code compliant, because they are still assessing the company on the company profits. There is another issue which the Isle of Man also legislated for: they can allow the company to elect to pay a 10 per cent tax rate rather than have the distributable profits charge. Again, it seems to me that that may very well not be Code compliant either, if they are allowed to elect to pay tax for their profits at 10 per cent rather than pay this charge. We will just have to wait and see what the view is in ECOFIN."

The PricewaterhouseCoopers submission echoed these concerns:

"In our view, calculating a tax on company profits and requiring the company to pay it is effectively corporation tax. The tax could not be collected from companies with non-resident owners (because it would still be a tax on shareholders in law) and we would therefore be concerned that the requirements of the Code of Conduct Working Group would not be met. There would also be the same difficulties over how to calculate the tax (accounting profits versus taxable profits). Tax paid by the company would be a distribution, requiring additional distributions to be made to other shareholders with no tax liability."

Their submission also outlined the effects of limiting the proportion of a company's profits which are subject to the charge:

"This is the preferred approach in the Isle of Man, where the "forced" distribution rules will apply to only 55% of profits. We think this approach mitigates the problems to a large extent, but does not deal with the fundamental issue of protecting the company as a person

legally separate from its shareholders. Administrative complexity would continue to be a problem."

The submission finally outlined PwC's preferred option, for an actual distribution basis. PwC believed that this option would have numerous advantages, such as providing an incentive to invest in the business community; encouraging new entrepreneurs to the Island; and removing a significant administrative burden from the Tax Office. However, the submission also highlighted that if this basis was adopted there would be possible cash flow implications, and it would call for a review into the policing of the Island's general anti-avoidance rules.

One refinement was suggested by Mr Riva during a public hearing:

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

Mr. J. Riva:
I agree and that is where I think there are only 2 possibilities, and this is the company acting as agent, which has code issues but maybe the Isle of Man may resolve them for us, or alternatively the statutory right of reimbursement, which is not the same as compelling a company to make a dividend."

The Institute of Directors made a similar point in their evidence:

> ***Mr. J. Laity:***
> *"All that happens is the shareholder pays the tax, gets a certificate saying how much tax he has paid and then goes back to the company as a statutory right of reimbursement, so that is neither a distribution then again taxable on the shareholder or any other way."*

Full look-through

Full look-through was supported by the Institute of Directors, on the grounds that it was simpler than the proposed deemed distribution system and more likely to be acceptable to the Treasury than the alternatives. They stated:

> ***Mr. J. Laity:***
> *"There are only 3 ways to deal with them* [the local profits and the local trading companies]*, as I said, which is we tax on a distribution policy, so essentially go the route of Guernsey, and the Minister appears unhappy with that on the basis he cannot budget for his receipts. We look for a middle ground, or we go into some form of full attribution.*
>
> *Now, essentially, what we have in the proposal is full attribution, but with a number of bells and whistles. Principally, there is a 3-year deferral and our point is, is it really worth it to achieve that 3-year deferral to go through all the hoops which you could need to jump through to make that deemed distribution system work? Could we not just have a straightforward look through on trading profits?"*

Similarly, the submission from KPMG supported the extension of the 'look through provisions' as applicable to investment companies to trading companies, and stated:

> *"However, we would wish to explore the possibility of extending these to both Jersey and non Jersey resident companies but limiting the application of the provisions to trading profits arising through an established place of business in Jersey. This proposal would discourage resident individuals establishing (say) Guernsey resident companies that trade in Jersey, and encourage international expansion of Jersey enterprises."*

However the submission also notes that one of the major problems with 'look through provisions' is that a person is subject to tax on profits they have not received.

The Jersey Finance FSG submission did not support full look-through; however it did state it warranted further investigation:

> *"In our view look through does require further consideration, not least because of the fact that many of the suggested arguments against look through (paragraph 23.1.3) would apply equally to the deemed and deferred distribution charges."*

However look-through for trading companies was strongly opposed by other witnesses, who thought that it would damage businesses investment and hence growth. The Chamber of Commerce addressed this point specifically:

> ***Mr. C. Spears:***
> *"That ignores the need for looking at entrepreneurial growth and how you generate working capital -- because most small businessmen use their capital growth to grow, do they not? I think, yes, it is totally fair but it is somewhat negative ... I would think that is an anti-growth request, personally."*

5.8 Deferred distribution charge

Zero/Ten Design Proposal:

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 distributional 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.

This section of the zero/ten document proposes that when shareholders pay tax on their dividends (actual or deemed), they will pay an additional amount to reflect the fact that there has been a delay of up to 3 years since the company made the underlying profits. This proposal sits uncomfortably for some, as the fundamental principles of a genuine zero/ten system is that tax is NOT payable on the profits of non-FSI companies – tax is only payable by shareholders on the income they receive from the company.

The submission from Le Rossignol, Scott Warren and Company believed the proposed system of deferred and deemed distributions is complex and would result in additional compliance costs for taxpayers and an increased work load for their professional advisers.

There was also an interaction with the LIFO basis for deemed distributions (see above). The Jersey Finance FSG submission stated:

> *"We recommend that, as an absolute minimum, basis for the charges should be changed from a LIFO to a "First in First out" ("FIFO") basis, as the LIFO basis could result in a company being deemed not to have made a distribution of profits for a particular year (and therefore subject to an 'interest charge' on such profits), when all such profits have in fact been previously distributed."*

5.9 'Limited trading partnership' ('LTP')

Zero/Ten Design Proposal:

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

The proposal to introduce LTPs as an alternative trading vehicle was met with mixed responses in submissions to the Panel. Although it was felt that it could be a useful entity that some businesses may use on a voluntary basis, the proposal is that it would be the only way for Jersey-owned companies to avoid some of the problems of zero/ten:

- Profits would be attributed to the 'shareholders', so there would be no need to calculate deemed or deferred distribution charges;

- The profits would be taxed directly in the hands of the owners, so the RUDL charge could be set off against the tax (unlike for a Jersey-owned company, which has 0% tax and so cannot offset its RUDL charge).

One of the main problems with this proposal was the potential costs involved for a company to convert to an LTP. Jurat Blampied's submission highlighted the fact that there are a large number of small companies trading in the Island, who would be met with substantial costs if they converted to a limited trading partnership.

The Jersey Chamber of Commerce made the following statement in their submission:

> *"In order for local companies to be able to recoup the RUDL charge as intended, there is a necessity to reform as an LTP in all cases. This will be costly in terms of professional advice and continuity of existing contracts. As this will apply to all businesses this will of course include SMEs, which will have even greater difficulty in finding the money, resource and time to reform. We believe that the cost and complexity of the exercise is excessive for what will be a relatively small return to accommodate a principle, laudable as it is. In other words this seems a case of the cure killing the patient on this occasion.*
>
> *In consequence of complexity, it is fairly certain a number of incorporated entities will not convert through cost, complexity, fear of change or an apathetic approach to yet further administration. The unintended consequence will be that some local companies will end up*
>
> *paying RUDL themselves, which will rather defeat the principle of fairness the approach is trying to achieve."*

The second issue which seemed to concern witnesses appearing before the Panel was whether LTPs would have continuity of contract (i.e. would the LTP inherit the company's contracts, or would they have to be negotiated anew? This was particularly problematic for foreign contracts, where any specific Jersey law on LTPs might not be recognised). This point was made by Mr Frith:

"There are other issues that have to be borne in mind if one wishes to convert from a company to an LTP. Is there going to be continuity of contract? For example, if the company has borrowed money on mortgage to finance its development or to extend its premises, et cetera."

This concern was mirrored by the Le Rossignol, Scott Warren and Company submission which stated:

"Continuity of contract is essential but legal costs in achieving this will in most cases be inevitable. Any assistance the States can give to business to smooth the transition will be welcomed. A standard form document approved by the Law Society at the expense of the States would be a good start. Legislation for the limited liability partnership is already on the statute book and we question is this could be adapted to cover the LTP."

A further query with the proposal was whether the LTP would be recognised as a legitimate trading vehicle by other jurisdictions. The Jersey Chamber of Commerce voiced this concern in their submission:

"We also are informed there is a school of thought in the legal world that the standalone integrity of an LTP internationally remains untested which would expose business stakeholders to great uncertainty where they might be operating outside of this jurisdiction."

The Jersey Hospitality Association stated that there could be legitimate commercial reasons why a business does not opt for the LTP, particularly in the early years of existence until the legal and business sectors becomes comfortable with it as an acceptable legal concept.

The submission from the Jersey Finance FSG believed that the proposal to introduce the LTP to avoid the deemed and deferred distribution charge simply served to recognise the complexity of the proposals.

Despite the concerns that were raised several witnesses also believed that the introduction of the LTP, or a similar vehicle, would be a bonus to the Island's corporate identity. The following exchange took place during the public hearing with the representatives from the Jersey Finance FSG:

Advocate A. Ohlsson:
"The LLP (Limited Liability Partnership) in the UK has been widely used as not just an entity through which accountancy firms can incorporate, which was the original concept, but it is now the preferred model through which hedge fund managers, and private equity managers establish themselves and it is unfortunate that we do not have that available in Jersey where that is the nature of business that we are seeking to attract at the moment and we are frequently requested whether we can

establish Jersey based LLPs.

Senator J.L. Perchard:
Why are they attractive to those types of relatively new businesses?

Advocate A. Ohlsson:
Because they are bodies corporate and therefore they limit the liability exposure to the members of the body or the shareholders but equally they are taxed on a transparent basis so that members are taxed on the profits that the partnership makes."

It therefore seems that if this proposal was to be introduced there are several issues that would need to be addressed to provide companies with the confidence needed to use the LTP as a trading entity. It seems that it certainly cannot be regarded as a solution to the problems of RUDL or deemed distribution, because of a lack of suitability for many Jersey companies.

5.10 Information powers and anti-avoidance

30.2 ***This section of the Design Proposal details the proposals for Enhanced disclosure –***

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'.***

The proposal to extend information powers caused concern for several witnesses. A submission from Mr St John Turner to the Panel expressed extreme concerns over the proposals, believing them to be unduly onerous for both the taxpayer and the Comptroller, and effectively amounting to fishing (because the taxpayer would have to disclose assets that may not be generating taxable income).

Mr St John Turner believed the proposals would breach a taxpayer's entitlement to privacy in respect of his affairs, possibly to an extent breaching Human Rights. The submission went on to state that there should not be enhanced disclosure requirements relating to the general asset position of an individual, and any additional requirements should be limited to holdings in companies and other assets of which income or gains tax liability is affected by the zero/ten changes.

As a result of these concerns, the Panel researched the position with regard to Human Rights legislation. The Convention right in question for these proposals would be Article 8:

Article 8 – Right to respect for private and family life

1. Everyone has the right to respect for his private and family life, his home and his correspondence.
2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of rights and freedoms of others.

The Panel's understanding of the human rights compatibility of the proposals to enable the Comptroller to have access to details about the general assets of taxpayers is that the appropriateness of the introduction of such powers would be dependent upon the meaning of the wording in section 30 of the Zero/Ten Design

Proposal. The section in question is ambiguous in terms of whether enhanced disclosure provisions would form part of Article 134A, or whether they would be standalone provisions which would apply routinely to taxpayers submitting a tax return.

It is the Panel's understanding that if the disclosure provisions were to form a subset of Article 134A, there would be little problem in terms of a breach of a person's human rights. However, it seems that should the intention be to introduce standalone provisions different considerations may well apply. The question then would be whether the language adopted in the legislation revealed a regime which was proportionate in a democratic society to achieve the goals which needed to be achieved. There is of course a wide margin of appreciation allowed to Convention states where taxation matters are concerned.

The submission from Mr St John Turner also believed that these proposals could have detrimental effects on the 'relationship' between the taxpayer and the Comptroller of Income Tax:

> *"It is a fundamental principle of confidence between the tax collecting authorities and the taxpayer that the latter is required to declare fully and honestly his income and other gains subject to tax. Demanding information beyond what is directly relevant to this is likely to risk undermining that confidence."*

Le Rossingol, Scott Warren & Company made the following statement concerning the new anti-avoidance measures in their submission to the Panel:

> *"It is noted that new anti-avoidance measures are to be introduced. Until recently one of the main advantages of the Jersey tax code has been its relative simplicity. Latterly it has become rather more complex and the matters covered in the Paper will only add to this. The simplicity of the Jersey tax system has undoubtedly been instrumental in attracting to the Island high value residents. It is part of the Islands economic strategy to continue attracting such residents. We therefore urge that any new anti-avoidance legislation should focus on the bigger picture and not do anything to upset the delicate balance that has hitherto prevailed."*

Their submission expressed equal concern with regard to the enhanced disclosure proposals, stating that although the authors of the Paper may find it remarkable that individuals do not file a balance sheet, this is a state of affairs prevailing in many jurisdictions with more sophisticated tax systems than Jersey's. The submission explained that whether the provision of the additional information set out in the proposal's was onerous or intrusive was a matter of opinion, and that conversations the authors of the submission had had to date found that the proposals were disproportionate to the perceived abuse, whatever that might be.

A submission from Mr Frith extended these concerns by explaining that until now Jersey had been recognised internationally for its low tax rate and absence of capital taxation either during lifetime or on death. The proposal that taxpayers should disclose their capital transactions was believed to indicate a move towards the taxation of capital, which would act as a disincentive for wealthy individuals considering moving to the Island for tax purposes.

This issue was also raised with Jurat Blampied, where a different opinion from that of the other witnesses was expressed:

> ***Jurat P.G. Blampied:***
> *"There is a requirement in anti-avoidance for more disclosure and I think that is right. People who put their money in a Cayman Islands company and accumulate*

the income there, that should be disclosed and taxed."

The issue of enhanced disclosure proposals and increased anti-avoidance measures was raised during the Public Hearing with the Minister for Treasury and Resources. The following statements were made:

Mr. M. Campbell:
"We have to ensure that we tackle tax evasion and tax avoidance. We tackle tax evasion and tax avoidance now. With zero/ten, we have to have provisions to ensure that Jersey resident individuals do not have a zero rate Guernsey company which I do not know about, and that is why the tick the box regime and the suggestion for the capital contributions to be declared with the tax returns.

There is a proposal that if a shareholder takes out a loan that be taxed as a benefit in kind at 20 per cent, so you can no longer extract the zero rate tax-free profits for a loan that will be taxed.

Senator T.A. Le Sueur:
It is inevitable that the anti-avoidance law has to be strengthened, and that is a fairly obvious sort of strengthening which you would so as a natural consequence of having a zero rate tax."

Manpower implications

Part of the Panel's remit for this review was to investigate the potential resource implications of the legislation. The manpower implications for the Income Tax Department with regard to the enhanced disclosure provisions were therefore raised at the hearing with the Treasury and Resources Minister. The Comptroller stated:

Mr. M. Campbell:
"What I intend to do is to shift some current resources from the accounts inspection role which they currently do, because if the

proposals go through as they stand, there will not be a need for account inspection any more and add-backs under the tax law. So, those resources which I currently have will be shifted into compliance and investigations. So, there will be no additional manpower resources."

5.11 Foreign Charities and Superannuation Funds

Zero/Ten Design Proposal:

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.

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

The Panel received a copy of a submission sent to the Treasury and Resources Department from Mourant du Feu & Jeune expressing grave concerns over the proposed repeal of this article. The submission explained how the proposals had already begun to have a negative impact on the market. The submission stated that if the article was repealed it would have a prejudicial and detrimental effect upon the property investment market in Jersey, consequently adversely affecting the Island's economy.

The Panel received a second submission from the Treasury on this issue from Mr Russell on behalf of Fox International Property Holdings Ltd. This submission similarly voiced concerns over the proposal to repeal this article. The submission explained that the UK market has operated very effectively with gross funds and tax-paying entities alongside each other since time immemorial, and argued that the gross funds provide the ultimate liquidity that enables the developer/traders to provide product for the funds in the form of completed and let schemes that are producing income. The banks can then provide the interim finance that is generally short to medium term. The submission claimed that repeal would also cause reductions in capital values, including States owned property, which would have a consequent material effect on the residual site values of new developments. The submission also explained that retrospective repeal may have serious consequences for properties in the Island already funded through gross funds. However it is the potential reduction in liquidity in an already illiquid market and its effect on inward investment that is the greatest concern of the property professionals.

Mr Barnes, Director of Barnes Daniels and Partners wrote to the Panel expressing his concern with the proposal, on behalf of his firm's clients. The submission explained that pension funds operate in the UK as gross funds, and it was therefore believed that such funds would not consider Jersey for future investment if they were to be taxed. It was stated that those currently invested in the Island would be likely to sell their assets. Pension funds have significant shortfalls to make up following the stock market crash and will be seeking maximum return. The author believed that the proposal would have the following effect on Jersey:

A number of landmark retail and office investments could be sold in the near future.

There could be a lack of potential purchasers for these investments due to concerns over what effect this may have on the pricing of the market.

The demand for Jersey investments will be greatly reduced and there will have to be a downward price correction.

> Any correction in price will be manifested in valuations of existing investments as well as in actual sale values and will therefore affect many local owner occupiers' and investors' balance sheets.
>
> It will have a detrimental value on the Waterfront site values as the land values being paid by developers are based on the end investment value.
>
> The States property portfolio's value would suffer the same fate.

Similar concerns were expressed in a submission sent to the Panel by Mr Ellison, on behalf of the Jersey Group of the Royal Institution of Chartered Surveyors. The submission stated that the impact of the new tax locally would be a decline in demand from institutional investors in landmark retail/office property investment interests in Jersey. It was believed that investors would withdraw from the market, subsequently depressing demand. Price is determined by supply and demand. The tax is also likely to impact negatively on the valuation of Jersey commercial property interests. It was stated that the tax could also have an adverse impact on the balance sheets of local owners and investors. The submission concluded with the following statement:

> *"Any uncertainty in the market is a major disincentive to inward property investment. At a time when the States are considering a major capital asset disposable programme, seeking inward investment and trying to maximise the value of its Waterfront land it is the considered view of members that the tax would be akin to the 'States shooting themselves in the foot'.*

One witness saw this as an essential step to level the playing field:

> ***Mr. J. Shenton:***
> *"If you own a property in the UK (…inaudible) you pay tax on the rental income on that property whether you live in Jersey or you live in Mongolia, it makes no difference. For Jersey to follow suit I think it is right, I think they are using Jersey resources. … I completely agree and I think it is a good move, as I think the change to superannuation funds in relation to rental income is also a good move."*

However some witnesses shared Fox International's concern about the impact of the change on the property market:

> ***Ms. J. Stubbs:***
> *"I know that there is a strong feeling in some quarters that it would be equitable for these schemes to be taxed in Jersey. Perhaps it is a bit like the man who went to Kings Cross Station and asked how to catch a train to Brighton. The only answer is I would not start from here. We would not if we were perhaps designing a tax system with a blank sheet of paper introduce that relief, but the difficulty is that we have it and it has created a sort of market equilibrium which you then tilt when you start to*

play around with it and I think, without being property consultants or economists, it is quite hard for us to go any further than that. But we did see grandfathering as one potential compromise."

Mr. G. Drinkwater:
"I think there are a few property transactions that have been held off, one of the companies inwardly investing in Jersey, particularly down in the waterfront, buying big premises. Whether that is an argument, I do not know. You might say: "Well, they are just whingeing because they are not getting as big a return on their investment as they would have done." The problem is it is the uncertainty and Jersey does benefit by inward investment and do we need it? Yes, I think we do."

5.12 Exempt company fees

6.4 Foreign incorporated investment companies ('FIIC')

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.

Currently exempt companies that are incorporated in Jersey pay an annual fee of £600; exempt companies that are incorporated outside Jersey[30] pay nothing.[31]

No register is kept of foreign-incorporated exempt companies, so it is uncertain how many are resident in Jersey. Estimates have been given of 5 or 6 foreign-incorporated companies to each 1 Jersey-incorporated exempt company.[32] On this basis, a fee of £150 from all Jersey-resident companies will bring in up to 50% more than a fee of £600 from only Jersey-incorporated companies.

In addition, the GST review has highlighted a £50 annual fee for all "International Service Status" companies; this appears likely to cover a similar range of companies to the FIIC fee.

The Panel has heard comments that these fees would damage the finance industry by driving new business away. The total proposed fees of £200 can be compared with annual legal fees for corporate management of £1,200 plus directors' fees.[33]

6. Conclusions

General (Section 3.1)

The Panel accepts the move to a zero/ten corporate taxation structure, and believes that this is necessary in order for the Island to remain competitive as an international finance centre and so to maintain employment and the Island's services and infrastructure. Whilst we disagree with some of the detail, zero/ten achieves this while still collecting a substantial tax contribution from the finance industry.

Compliance with the EU Code of Conduct (5.1)

The full detail of the proposal has not yet been put to the Code group, although we are told that the broad outline is acceptable.

The Panel recognises that Code compliance is a difficult question, and that the nature of the Code and Jersey's lack of direct involvement (negotiations are carried out through the UK) make it difficult to be certain precisely where the boundaries lie. However the Panel did not identify any particular problems with Code compliance and believed that the Treasury was taking a cautious approach.

Data on the size of the Black Hole (5.2)

The Panel was disappointed in the lack of data from the Treasury, as were many witnesses. The Panel felt that its investigations were thereby hampered in terms both of scrutinising the proposal itself and of investigating alternatives. The Panel needs to see Treasury estimates of the revenue losses and gains from the different aspects of the proposal and be told the basis for these estimates.

Despite frequent requests and claims that this data would be made available, it had not yet been produced at the time of going to press. It is not certain whether the figures are not yet released because of difficulties in calculating them, or because the Treasury is trying to plug a "black hole" which is larger than the £80-100 million initially estimated.

Avoidance – 0% and 10% companies (5.3)

The Panel's initial research highlighted a number of ways in which financial services companies would be able, legitimately, to avoid the 10% rate. Some of

these methods could be followed under the current 20% system but some would be new opportunities created by the co-existence of 0% and 10% companies under zero/ten.

The evidence from the Panel's witnesses was that whilst such avoidance by 10% companies would be possible, it would be unlikely in practice due to the competitive position of the 10%

rate and the fact that it would generally be creditable against the parent company's home tax liability.

The Panel remained sceptical about whether this would apply in all cases, particularly to non-UK banking groups (whose desire to reduce Jersey taxation is evidenced by the number that operate as IBCs), but on the whole was satisfied that the reduction in the banks' Jersey tax rate from 20% to 10% would mean that tax avoidance was unlikely to increase significantly as a result of Jersey's adoption of zero/ten.

Issues were raised by some witnesses about the danger that some currently exempt activity could be charged at 10% under the proposals, and several witnesses felt that it was wrong for the tax classification to depend on the Jersey Financial Services Commission's definition of a regulated entity.

Avoidance – 0% for companies, 20% for individuals (5.4)

One of the reasons that the current Jersey tax system is strong is because companies and individuals are both taxed at the same 20% rate. However, under zero/ten it will be possible for individuals to transfer businesses or investments into tax-free companies so that these profits can only be taxed in the hands of the shareholders. This relies on the tax office knowing who the ultimate owners of Jersey companies are – ownership that can be disguised through trusts or offshore structures.

Effectively zero/ten blows a large hole in Jersey's income tax system, and many of the attendant proposals are designed to try to patch up that hole.

Shareholders will still be taxed on dividends (including deemed dividends), but there is a risk that this could be postponed or avoided or that the share ownership could be disguised to prevent the Comptroller of Income Tax becoming aware of the dividend payment.

All witnesses agreed that zero/ten would increase the opportunities for avoidance; the question was the extent to which those opportunities would be taken, and the ability of the tax office to deal with them in practice.

There remains a strong risk that the tax yield from zero/ten will be compromised by avoidance or evasion. However this is an inevitable consequence of trying to maintain an income tax for individuals in parallel with a 0% rate for companies.

At the minimum, strong shareholder benefit in kind rules will be needed in order to prevent shareholders from extracting value from a company in a tax-free form.

Regulation of undertakings & development ('RUDL') charge (5.5)

The 0% rate could give an unfair competitive advantage to businesses owned by non-residents (who will not pay Jersey tax on their profits) compared to Jersey-owned businesses (whose profits would be taxed at 20%), particularly for retailing and tourism.

If the non-resident owners are paying tax on their Jersey profits in their home country then this competition issue will not arise. Evidence from witnesses was divided on this point but overall the Panel was convinced that there was a real risk that some off-Island owned companies would avoid tax on all, or at least a proportion, of their profits.

The RUDL charge was the Treasury's proposed solution to this issue. All non-finance businesses would pay a flat rate (depending on sector) for each potential employee, but mechanisms would be put in place to allow Island-owned businesses to recover the charge.

The Panel heard overwhelming evidence that, in the words of the Institute of Directors, "the illness does not justify this medicine". The RUDL charge would increase the cost of doing business on the Island, would be a tax on jobs, and would stifle economic growth. It would run directly against the policy of encouraging business expansion to reduce the Island's dependence on financial services. It would not even solve the problem it was introduced to prevent, because the mechanism for allowing Island-owned businesses to recover the charge is too flawed.

The Panel recommends that the RUDL charge be abandoned. However it believes that the problem the RUDL charge was meant to eliminate is real, and that alternatives should be urgently explored.

Proposed alternatives to the RUDL charge (5.5.3)

The Panel believes that the competitive disadvantage of Jersey-owned businesses under zero/ten (see 5.5 above) is real, even though the proposed solution (the RUDL charge) is too flawed to be acceptable.

We were therefore pleased that witnesses suggested 2 alternatives:

- GST restriction, under which off-Island owned businesses and companies would only be allowed to reclaim part, rather than all, of the GST on their costs.

- Taxing deemed rents, under which all business property would be taxed at 20%; either the actual rent paid or, for business owner-occupiers, a deemed market-level rent. Jersey-owned businesses would be able to recover this tax, in a much more efficient way than the RUDL charge.

From the Panel's initial investigation, the second proposal (taxing deemed rents) seems more suitable for Jersey, because it may be possible to structure the tax so that the UK will regard it as an in income tax, so that UK-owned businesses should be able to recover it against their UK tax (as they can currently with Jersey income tax); it would therefore not increase the cost of doing business on Jersey. However these are complex areas, so the Panel calls on the Treasury to investigate both options thoroughly and publish its findings.

Deemed distribution charge (5.7)

There are 3 main options for taxing shareholders on the company's profits:

- Full attribution (look-through), under which the income or taxable profits of the company are divided between the shareholders and each is taxed on his share – regardless of whether a dividend is ever paid;

- Deemed distribution, where the shareholders are taxed on the dividend they could have received had the company paid out its entire accounting profits; this can be subject to various modifications, such as:

    - A time delay, so that shareholders are only taxed on a deemed distribution if an actual dividend is not paid within the time limit;

    - Partial deemed distribution, where only a percentage of the company's profits are assumed to be paid up in dividends;

    - An acceptable distribution exemption, where full deemed distribution is applied unless the company actually distributes a minimum percentage of its profits

- Actual ('distribution only'), under which no tax is charged until a dividend is paid to a Jersey-resident shareholder.

Jersey's proposals are for:

- Full attribution for investment companies; and
- Deemed distribution for trading companies, modified by a 3-year time delay

There is a secondary issue as to who pays the tax. Under Jersey's proposals the tax will be paid by the shareholder, creating potential problems for minority shareholders (who will be taxed on dividends that they may never receive).

Instead the Isle of Man proposes to collect the tax from the company, which would act as an agent for the shareholder. However there is a danger that this would be seen as too similar to a corporation tax, and so would fall foul of the EU Code of Conduct. An alternative suggested was a statutory right of reimbursement, under which the shareholder would pay the tax but would be allowed to claim it back from the company.

The evidence clearly suggests that the proposed system would be extremely complex, and the Panel's preference is for it to be abandoned in favour of one of the other alternatives; either an initial 'actual' basis (as Guernsey are proposing, with the option of taxing deemed distributions in the future if the loss of tax is too high), or on a percentage basis (like the Isle of Man proposal). However the lack of data from the Treasury on the predicted yield of deemed distribution made it impossible for the Panel to assess the risks of the proposals.

The evidence presented to the Panel unanimously agreed that the deemed distribution charge should not allocate dividends on a LIFO basis, and that if the charge were necessary a FIFO (first in, first out) basis of assessment would be more appropriate.

Deferred distribution charge (5.8)

This is effectively an interest charge; because there is a time delay for deemed distribution, it could be three years between the company making profits and a taxable event (actual or deemed distribution) for the shareholder. The deferred distribution charge attempts to compensate the Treasury for this delay.

The evidence presented to the Panel was that this charge would be unnecessarily complex. It also went against the spirit of zero/ten, which is that shareholders are taxed on their dividends but company profits are untaxed.

Unfortunately the lack of data from the Treasury on the expected yield from this charge left the Panel unable to assess the loss from dropping it from the proposals.

'Limited trading partnership' ('LTP') (5.9)

The LTP was primarily proposed as an adjunct to the RUDL charge, to allow Jersey-resident shareholders to set the company's RUDL charge off against their tax on its profits.

As a tax-transparent entity the LTP would also reduce the complexity of deemed distribution – but at the cost of effectively opting for full attribution (see 'deemed distribution', above).

Various concerns about the LTP were expressed by witnesses, primarily:

- The costs of conversion;

- Continuity of contract (would the LTP inherit the predecessor company's contractual rights, or would they have to be negotiated anew; this was particularly a concern for businesses with business connections outside Jersey, where the courts might not follow Jersey law);

- Limited liability (again, particularly a concern for businesses with business connections outside Jersey, where the courts might not follow Jersey law).

The Panel felt that the LTP was an unnecessary complication to the proposal, and that the implications of a company's conversion to a LTP had not been explored sufficiently to make it effectively compulsory for many Jersey-owned businesses. It should therefore be dropped along with the RUDL charge.

Some witnesses felt that the LTP could be a useful vehicle, provided its adoption was fully voluntary. However the place for this is in a business reform package, not the tax system.

Information powers and anti-avoidance (5.10)

To counter the risk of increased tax avoidance and evasion under zero/ten (see 5.4 above), the Comptroller is to be given greater powers to collect information from taxpayers.

Although witnesses understood the need for this, there were serious concerns that the proposals went much too far (possibly to the extent of breaching Human Rights law, although it was difficult to reach a conclusion on this matter[34]). This could damage the relationship between taxpayers and the tax office.

There was also a concern from some professionals that the information requirements would be a serious disincentive to potential k-category residents, and so could damage Jersey's future tax revenues.

This concern is reinforced by recent moves under which Jersey would provide information to overseas tax authorities (under the OECD initiative), which it was felt could damage Jersey's reputation as a low-complexity jurisdiction and hence damage the offshore finance industry.

Foreign Charities and Superannuation Funds (5.11)

Although a minor part of the Design Proposal, the Panel received evidence that this was an important issue.

Under zero/ten non-finance companies will only be taxed on Jersey rents, and so an exemption for foreign superannuation funds and charities would be significant, both in terms of loss of revenue and market distortions.

However, the property industry was concerned about reduced investment in Jersey property leading to a reduction in prices, and possibly a loss of liquidity and investment that could reduce future development prospects.

7. Recommendations

The Panel recommends that:

The proposed RUDL levy be abandoned (Section 5.5)

The Treasury and Resources Minister investigates the viability of the proposed alternatives to the RUDL charge as a matter of urgency, as they could contribute to the overall tax take and overcome the problems of inequity between locally owned and non-locally owned businesses. (Section 5.5.3)

The deferred distribution policy be abandoned, and the Treasury investigates the advantages and risks of either actual distribution or a minimum distribution exemption. (Section 5.7)

Strengthened and proportionate anti-avoidance legislation (including shareholder benefits in kind) will be necessary to counter the increased risk of avoidance and evasion under the proposed system. (Sections 5.3 & 5.4)

The Treasury and Resources Minister calculates and publishes the expected losses and yields from the individual aspects of the zero/ten proposals, including the financial implications of the alternative proposals discussed in this report. (Section 5.2)

The Treasury and Resources Minister thoroughly investigates the additional manpower implications involved with the zero/ten proposals. (Sections 5.4 & 5.10)

Before the final proposals are debated by the States, the definition of companies subject to the 10% rate should be carefully reviewed, ideally with a stand-alone definition rather than relying on the Jersey Financial Services Commission's definition of a regulated entity. (Section 5.3)

8. Glossary of terms:

a. Benefits in kind

Non-cash benefits (including loans and loaned assets) received from a company. If employees or shareholders are only taxed on the cash they receive from a company, then it would be possible to avoid that tax by taking benefits from the company in a non-cash form. This could include a company car, non-business meals paid for by the company, a low-interest loan, or even having the company pay household bills. Taxing benefits in kind prevents this avoidance

b. FIFO (First in, first out)

This would be a method used to allocate profits under the deemed (and by implication deferred) distribution charge. Under FIFO, a company's dividends are assumed to have been paid out of the *earliest* available profits. In contrast to the LIFO method of allocation (see below for definition) it would mean a company could maintain its distributable reserves to reinvest for a rolling three-year period.

See LIFO for further information

c. EU (European Union)

Has 2 current initiatives relevant to Jersey's tax position:

- The Code of Conduct on business tax, under which discrimination in favour of the 'offshore' industry is outlawed (see Appendix); and
- The 'Savings Tax Directive', under which interest payable to individuals in the EU has to suffer a withholding tax or be reported to the recipient's tax authority.

Although not a member of the EU, and not formally subject to the EU in tax matters, Jersey was under pressure to comply with these initiatives, and has agreed to do so. It is the Code of Conduct that is responsible for the current tax reform process.

d. Generally Accepted Accounting Principles (GAAP):

GAAP is the standard framework of guidelines for financial accounting. It includes the standards, conventions and rules accountants follow in recording and summarising transactions, and in the preparation of financial statements. Under the Zero/Ten Design Proposal, deemed distributions would be based on GAAP (i.e. the proper accounting profit of the company, which *could* legally be paid out as a dividend), and the distribution vouchers of companies would use

GAAP and the year(s) in which the income arose to distinguish between the revenue and the capital profits included in the distribution.

e. JFSC

Jersey Financial Services Commission, the regulatory body for the financial services industry

f. LIFO (Last in, first out)

Under LIFO, a company's dividends are assumed to have been paid out of the *most recent* available profits. If used for the deemed distribution charge, LIFO would mean that every three years a company would need to distribute all of its profits, otherwise undistributed profits in relation to the first year of trading would be subject to the deferred distribution charge. This would mean that old profits would often be treated as remaining permanently undistributed, unless the company paid out all of its accumulated profits in one year.

To illustrate the difference, see the following example:

Year	Actual profits	Actual dividends	Undistributed profits FIFO	Undistributed profits LIFO
1	100		0	100
2	110		0	110
3	120	100	0	20
4	130	110	0	20
5	140	120	0	20

The company in this example pays out all its profits with a three year delay. Under a FIFO scheme there are no deemed dividends, because all profits are paid out within the 3-year time limit (the dividend paid in Year 3 is Year 1's profits, etc.). However under a LIFO scheme the dividend paid out in year 3 would be assumed to be year 3's profits rather than year 1's, so year 1's profits are treated as undistributed and subject to deemed and deferred distribution charges.

g. 'Limited trading partnership' ('LTP'):

This is a new form of corporate vehicle to Jersey, although one that is popular elsewhere. The proposal is that for general legal purposes the LTP will be treated like a company, that is it is a separate legal entity and outsiders can generally only sue the company, not the shareholders, for losses caused by the company's business. However for tax purposes it will be treated as a partnership, so the income and profits of the company will be divided between

the shareholders; a 30% shareholder will be taxed as if he had personally received 30% of the profits of the business (effectively look-through).

h. Look through

Where look-through is applied, a company will be treated like a partnership for tax purposes, so the income and profits of the company will be divided between the shareholders; a 30% shareholder will be taxed as if he had personally received 30% of the profits of the business. Look-through is sometimes referred to as "full apportionment".

i. OECD

The Organisation for Economic Co-operation and Development, an umbrella body of major developed countries (the UK is a member, but Jersey is not). From being largely a technical organisation concerned with removing barriers to international business, it became one of the leading groups attacking 'tax competition'. Under its "Harmful Tax Practices" initiative most offshore centres (including Jersey but excluding OECD members such as Switzerland) were pressured into agreeing to remove various aspects of their tax systems and provide information about banking clients to overseas tax authorities. The initiative has slowed in recent years, mainly due to the offshore centres' insistence on a 'level playing field' under which small countries would not be pressured to comply with the initiative until OECD members did so also.

j. Regulation of undertakings & development ('RUDL') charge

A fixed fee (this would be dependent upon the industry, as differential rates would be charged based on the average earnings of the sector concerned) for each RUDL-licensed employee. This will be recoverable against Jersey tax (if any) payable on the profits of the business.

k. Tier 1 Capital Interest

This is the minimum level of reliable capital assets that a bank must have in order to be approved by the JFSC to carry on financial business. The principle is designed to minimise the risk of banks failing, and so the assets representing Tier One capital must be held in relatively liquid and secure form, typically government bonds.

9. Appendix

1. The EU Code of Conduct

> ***"the Code was specifically designed to detect only such measures which unduly affect the location of business activity in the Community by being targeted merely at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the … State concerned"***

EU Commission website

A. Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community.

Business activity in this respect also includes all activities carried out within a group of companies.

The tax measures covered by the code include both laws or regulations and administrative practices.

B. Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code.

Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.

When assessing whether such measures are harmful, account should be taken of, inter alia:

1. whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or

2. whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or

3. whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or

4. 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, or

5. whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.

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[1] States of Jersey Fiscal Strategy P.44/2005 (p.5)

[2] Finance and Economic Committee Report. (2004). Facing up to the future: reforming public spending and taxation to sustain a prosperous and competitive economy, 5.

[3] Oxera Report. (2003). Jersey without the Financial Services Industry.

[4] Law and Tax News. Retrieved September 25, 2006, from http://www.lawandtax-news.com/html/jersey/jjelatoltr.html

[5] on the 13th May 2005

[6] It is hoped that the actual starting date for existing companies will be 1st January 2009.

[7] Taxation: Commission welcomes adoption of package to curb harmful tax competition. (2003). Retrieved June 3, 2006, from http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/03/787&format=HT

[8] The EU's Tax Package – A Conclusion. (2003). Retrieved August 8, 2006, from http://www.volaw.com/pg481.htm

[9] op. cit., The EU's Tax Package

[10] OECD Report. (1998). Harmful Tax Competition: An Emerging Global Issue. http://www.oecd.org/dataoecd/33/1/1904184.pdf

[11] www.oecd.org/dataoecd/61/12/2067924.pdf

[12] Act of the States of Jersey, 30/10/51.

[13] For a detailed description of the EU Code of Conduct please see Appendix 1.

[14] Written Questions to the Chief Minister, answers tabled on 16th May 2006 (1240/5(2862))

[15] States of Jersey Fiscal Strategy P.44/2005 (p.5)

[16] See Zero/Ten Design Proposal, section 11.2.4

[17] See Zero/Ten Design Proposal, section 12.1.5

[18] See Isle of Man Treasury Practice Note PN 124/06 21st February 2006

[19] Avoidance is legally ensuring that there is no tax liability; evasion is illegal (for example by disguising ownership of a company so that the tax office cannot attribute a legal tax liability to the shareholder).

[20] In the case of a 10% company

[21] Jurat Blampied, "I saw an earlier report on the Zero/Ten strategy document that the States produced saying that they would be taxed in their place of residence but that is naïve. [These companies] would avoid tax"

[22] Economic Implications of the Regulation of Undertakings & Development (RUDL) Charge, 21st July 2006. Written by Mr Peedle, Economic Adviser.

[23] i.e. UK-owned businesses cannot recover the RUDL charge by setting it off against their UK tax – which they

can do with the current Jersey corporate income tax.

[24] Growing Jersey's Economy: An Economic Growth Plan, 1st March 2005. The Economic Development Committee.

[25] Assuming:

GST is to raise £45 million, of which £10 million comes from the finance industry; the GST restriction needs to raise the same £5 million as RUDL; and non-finance companies are split 50:50 between off- and on-Island ownership; the restriction would have to be equivalent to 28% of output GST. Assuming 20% gross margins, that would equate to 35% of input GST.

[26] Half of the Quarterage figure, as we are told that this includes both the occupier's and foncier's quarters. In discussions with Jersey's Rates assessor Edward Trevor we were told that this would be a rough approximation to rental values in 2003.

[27] Although instead of a 3-year deferral period, there would instead be an immediate charge on the assumption that 55% of the profits were distributed

[28] PricewaterhouseCoopers: Analysis of the Responses to the Second Consultation Document on the States of Guernsey Future Economic and Taxation Strategy. 31st January 2006.

[29] Isle of Man News: New Income Tax Legislation. Retrieved September 14, 2006, from www.iomguide.com/news/general-news.php?story=101048

[30] This would only apply to companies that are resident in Jersey because they are 'managed & controlled' here; loosely those with Jersey-based directors.

[31] Income Tax Office, "Guide to the Exempt Company"

[32] Jersey shareholders' registers are publicly available; in some jurisdictions, such as the British Virgin Islands, they are not.

[33] Jersey Trust Company fee schedule, accessed 19th September 2006, www.jerseytrustco.com/terms_of_business/company_fee_schedule.asp

[34] The question would be whether the powers were proportionate in a democratic society to achieve the goals which needed to be achieved; this is a difficult balance to assess.