States of Jersey

A FEASIBILITY REPORT INTO THE INTRODUCTION OF INDEPENDENT TAXATION IN JERSEY

October 2013

TREASURY & RESOURCES

Foreword – Minister for Treasury and Resources

As part of the tax system modernisation programme, the Tax Policy Unit was asked to review how Independent Taxation could be introduced into the Jersey system. This report identifies the anomalies of the current regime and ways in which these could be addressed in moving to Independent Taxation. It is clear from this research that while it is possible, it is complicated and will need time to implement properly.

The term 'Independent Taxation' refers to the policy of taxing individuals as individuals, regardless of their marital status. In Jersey there is currently a 'default' for married couples to be taxed jointly. There are also certain allowances that apply to married couples, which do not apply elsewhere within the tax regime, such as the Wife's Earned Income Allowance.

While married people have been able to opt for separate assessment, rather than joint, since 2003, there is a now a clear need for the tax regime to adapt and evolve so that in the eyes of the State each individual is treated equally for tax purposes.

It is a widely accepted principle that our tax system should be both efficient and equitable, and that tax policy should not be used to encourage or discourage lifestyle choices; individuals or couples, whether married or cohabiting, should be treated equally. Independent taxation is therefore an important aspect of tax modernisation and provision for the needs of today's families.

The United Kingdom (UK) has had a system of personal taxation in place that treats married women as completely separate and independent taxpayers, for both income tax and capital gains tax since April 1990.

This principle of a moving to Independent Taxation makes sense in a modern society. However, it is vital that the logistical, administrative and financial impact of this change is managed correctly and makes the tax system simpler.

While the report that follows has gone some way to providing us with a clear understanding of the potential impact of change, a wider review of the personal tax regime will be required to facilitate the introduction of independent taxation. It cannot be achieved, equitably, overnight. It needs a phased approach.

A first important step towards Independent Taxation will be made in this year's Budget, namely decreasing the marginal rate band by 1%. This will have the effect of bringing the Marginal Tax Rate and '20 means 20' into closer alignment so that we can consider bringing in further simplification in future.

There is a commitment to introduce Independent Taxation in Jersey. Over the next two years work will continue on introducing Independent Taxation to the following timetable:

- Review completed and recommendations included in the 2016 Budget at the end of 2015.
- Commencement of implementation in 2016.
- Implementation fully completed by 2020.

This timetable is based on the assumption that the cost (there is an inevitable cost to either the States or to taxpayers) of introducing Independent Taxation will be acceptable to the States.

In addition, a long-term tax programme will be published in 2014 alongside the 2015 Budget which will include the Independent Taxation review as well as matters such as self-assessment and current year basis. Consideration will be given to including further changes in the 2015 Budget.

Senator Philip Ozouf
Minister for Treasury and Resources
8th October 2013

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TAX POLICY UNIT REPORT

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[*NOTE: FOR REFERENCE TO 'MARRIED COUPLES' PLEASE ALSO READ 'CIVIL PARTNERS'; AND FOR REFERENCES TO 'HUSBAND' AND 'WIFE' PLEASE READ 'PARTNER A' AND PARTNER 'B' RESPECTIVELY.]*

1. EXECUTIVE SUMMARY

1.1. Background to the report

The publication of this report is in response to the commitment made by the Minister for Treasury and Resources in December 2012.

There have been a number of calls for the States of Jersey to consider independent taxation over the past few years.

The aim of this report is to identify whether it is possible to move from the existing joint assessment regime to independent tax and if so, what are the implications.

1.2. Issues considered in the review

The review considered the following aspects:

- anomalies and unintended consequences of the current regime;
- broad options for moving towards independent taxation;
- the financial implications, where possible, of moving to independent taxation; and
- the practical and operational issues of independent taxation.

It was not possible within the timeframe or given the difficulties in mining current data, to undertake a full financial impact analysis or a detailed review of each possible solution. It was clear early in the review that this is highly complex with many interacting elements which need to be considered more fully and over a longer period of time.

1.3. Key findings and recommendations

Independent taxation should be an integral part of Jersey's long term tax policy programme. There is a desire for the States of Jersey to consider introducing independent taxation and it is an important step in modernising the Jersey tax system.

It is possible to make this fundamental change to the tax system but it should not be done in the short term, as the financial implications could be substantial due to the complexity of the current regime and the anomalies it created. In addition it is not possible to identify all of the unintended consequences of each potential solution.

Taking steps to simplify the current tax regime in the near term would help facilitate the move toward independent taxation by spreading or alleviating the financial implications and minimising the risk of unintended consequences.

Jersey currently has a two tier tax system which adds to the complexity and creates the anomalies found in the system. These are the marginal tax rate and '20-means-20'. One method of simplification would be to remove the marginal tax band – i.e. the 27% tax rate and just have one regime. However removing the 27% rate in one step with no other changes would cost the States about £70m. This is not a feasible alternative but it may be possible to move towards a single rate over time and with compensating changes to, for example, exemptions and reliefs.

Another approach would be to replace the married tax treatment with the single person's treatment while maintaining the two tier system. However, simply moving a married couple to single person's treatment without considering the allocation of allowances and reliefs would cost taxpayers around £8m. These two extreme examples illustrate that this is not a simple measure that can be introduced in one step. A structured, stepped approach is needed to minimise the financial impact.

In summary the introduction of independent taxation should be pursued but as part of a wider modernisation programme, and in line with the development of the long term tax policy programme.

The recommended next steps are as follows:

- Given the interaction of independent taxation with other aspects of the tax regime that require modernisation or simplification, a first step should be to establish a detailed long term tax programme for the personal tax regime[1]. This should identify all aspects of modernisation/simplification with an indicative timetable and should cover the next 5 to 10 years.

- Take a step in the 2014 Budget toward simplification by reducing the marginal rate by 1% and consider further reductions in future Budgets

- Continue reviewing the exemption thresholds and allowances and determine how these can be changed in the short term to deal with the anomalies and help move towards independent taxation.

- Start to reduce the increases in exemption thresholds and allowances to reduce the growing discrepancies between married and cohabiting couples.

- Work will continue on designing a detailed step plan to introduce independent taxation to the following timetable:

    - Review completed and recommendations included in the 2016 Budget at the end of 2015.
    - Commence of implementation in 2016.
    - Implementation completed by 2020.

[1] This will also include a programme for other aspects of the regime such as property tax, stamp duty and GST.

This timetable is based on the assumption that the cost (there is an inevitable cost to either the States or to taxpayers) of introducing independent taxation will be acceptable to the States.

In addition, a long-term tax programme will be published in 2014 alongside the 2015 Budget which will include the independent taxation review as well as matters such as self-assessment and current year basis. Consideration will be given to including further changes in the 2015 Budget.

2. SCOPE OF REPORT

This report sets out the background to the review and why this work is necessary.

The purpose of the review is to objectively and rationally assess the potential strengths and weaknesses of introducing independent taxation in Jersey weighing up the potential value to be obtained against the potential cost.

This report explains what 'independent taxation' means and the ways in which this could be achieved in Jersey.

It goes on to discuss the potential economic impact of introducing independent taxation including the impact on different categories of taxpayers, as well as the practical and operational implications.

From a Treasury perspective, ideally this should be a revenue neutral measure. It is also assumed that the tax system is not a mechanism to be used to encourage or discourage marriage and that couples, whether married or cohabiting, are treated equally. The review has been carried out with both of these points in mind.

The appendices provide details of the supporting research and information.

Finally, the report concludes with recommendations on the next steps for the Minister for Treasury & Resources to consider.

3. BACKGROUND

3.1. Why has this report been prepared?

On 12 December 2012, the Minister for Treasury & Resources made a commitment to States Members that he would produce a feasibility report on the subject of independent taxation by the end of September 2013.

This report is the product of that commitment.

The detail of the commitment made is as below.

"I am committed to produce a report by the end of September 2013 which addressees the implications of amending the Jersey tax regime to introduce independent taxation. This is part of our ongoing commitment to modernising Jersey's tax regime. Independent Taxation is an important if not fundamental element of that modernisation.

A great deal of work is going to be needed to determine how this might be achieved and identify all the intended and unintended consequences. There are likely to be significant financial and manpower implications and the States will need to be invited to decide how these are to be dealt with.

The scope of the report is in the process of being determined, it is likely to include:

- *The interaction with other key elements of the existing tax regime such as the marginal rate tax band and the prior year/current year basis of tax collection;*
- *Investigating whether there is a neutral solution in terms of financial burden – due to the current nature of our regime there are likely to be winners and losers, be that taxpayers or the States revenues;*
- *Operational issues (Taxes Office resource, IT etc) in view of the other major changes to the personal tax system that are being implemented over the next few years;*

- *External economic advice on the wider impact of such a change;*
- *The impact on non tax matters such as pension entitlement or the Social Security Long Term Care charge;*

Following the completion of the report, which we will publish and present to members, there will need to be a period of time for consultation. It may be that there will need to be green and/or white papers consultations.

Whilst it is not possible to introduce changes in the 2014 Budget, I would hope to set out a firm timetable this time next year."

The detail within this report, and any subsequent recommendations that may result from the completion of its next steps, are underpinned by the taxation principles as outlined in the Strategic Plan (published in 2012). The long term tax policy principles as set out in the 2012 Medium Term Financial Plan are on included in Appendix 8.

3.2. What are the current rules?

Under the current rules, upon marriage a woman's income is deemed to be that of her husband. This income is recorded on a joint tax return form, which for most sources of income records the husband and wife's income separately. The resultant income tax liability is assessable on the husband.

The married couple is treated as one taxpayer. The 'Income Tax Registration Form' (Appendix 7 refers) which must be completed upon commencement of receipt of income, applies to a married couple as a taxpayer. Individual forms do not need to be completed.

There is no joint income tax liability; the liability lies with the husband.

In calculating whether that taxpayer is exempt from income tax, subject to tax at 27 % after deduction of an income tax threshold and other deductions, or subject to tax at the standard rate of 20%, a married couple rather than a single person's income tax exemption threshold is applied.

The 2013 income tax exemption thresholds are as follows:

	2013
Single Person	**£13,780**
Single Person (aged 63+)	**£15,370**
Married Couple	**£22,090**
Married Couple (aged 63+)	**£25,280**

There are also certain allowances which apply to a married couple that do not apply elsewhere within the tax regime, such as the Wife's Earned Income Allowance (currently £4,500).

Since 2011 the tax return has included a box on the married personal tax return enabling the husband within a married couple to allow the Taxes Office to correspond directly with his wife regarding their taxation affairs. Prior to this, the husband was required to submit a letter of authority in order to authorise communication.

The law was amended in 2003 to allow the parties within a married couple to apply to receive separate tax assessments. This means both the husband and wife would each complete their own annual tax return form declaring their own income, and subsequently would each receive their own income tax assessment. The effect of this election is that the wife's income is not deemed to be that of her husband and they are each separately assessed and charged to tax under the law.

However, the income tax assessment is identical to that which would be calculated had they not opted for separate assessments – i.e. from a tax perspective there is no advantage or disadvantage. The same exemptions and reliefs that would have applied on a joint assessment still apply. It also does not affect the ITIS rate that applies to both partners, which is based on the joint income.

From a taxpayer's perspective, this is primarily an administrative arrangement which allows a wife to deal with her own tax affairs but does result in the wife being personally liable for her tax liability.

3.3. Why are we reviewing this now?

The States recognises that aspects of Jersey's personal tax regime, including joint assessment, need modernisation. The establishment of a dedicated Tax Policy Unit provides the resource for Jersey to consider its long term tax programme and to specifically address this issue now.

4. WHY A REVIEW OF THE PERSONAL TAX SYSTEM IS NEEDED

In recent years there have been a number of requests for the States of Jersey to consider the introduction of independent taxation.

This is an extremely complex issue because of the way the personal tax system works. However, it is recognised that the current system needs to be modernised and results in some unintended consequences. This section highlights the challenges created by certain features of the current regime.

4.1 Tax bands

It is difficult to identify which tax payer bands are affected by changes to the tax system because of the way the ’20 means 20’ system interacts with the ‘marginal rate’. (Appendix 3 explains the operation of the marginal rate band.)

The marginal rate tax band is often associated with lower earners and ’20 means 20’ with higher earners. In reality, because of the way the allowances and reliefs are given within the tax system, this is not always the case. A summary prepared in June 2013 by the Taxes Office advised that a married couple household with income in excess of £150,000 could be a marginal rate taxpayer in certain circumstances, although in such a case paying an effective rate of almost 20%. The term marginal rate taxpayer clearly does not necessarily mean those on lower/medium income. Furthermore the effect of increasing exemption thresholds and the removal of allowances under ‘20 means 20’ means that approximately 84% of taxpayers are now paying tax at the marginal rate with an effective tax rate of less than 20%.

4.2 Allowances/reliefs

The tax system incorporates a number of allowances and reliefs, including some that are gender based.

The following[2] are available to all taxpayers regardless of their level of income:

- Child allowance
- Higher child allowance
- Additional personal allowance

The additional personal allowance was introduced to assist single parents but this additional allowance can also be claimed by cohabiting couples. This provides for different treatment between cohabiting and married couples and seems to be an unintended consequence of the current regime.

The following are available to marginal rate taxpayers:

- Wife's earned income allowance (gender based as not available to husbands)
- Childcare (and enhanced childcare) tax relief
- Mortgage interest relief

These allowances and reliefs are claimed via the tax return form and not specifically allocated against the husband's or wife's income.

Childcare tax relief can only be claimed by married couples if the wife earns income in excess of £4,500 and is set against their joint income; the male partner in a cohabiting household cannot claim this relief although the female can. It is therefore effectively a gender based allowance and again leads to different outcomes for cohabiting and married couples.

4.3 Cohabiting/married couples – inequalities

There are inequalities between the tax treatment of married couples and cohabiting couples in addition to those identified in 4.1 and 4.2. This is illustrated in Appendix 5. These examples use

[2] Other income tax reliefs are available to all taxpayers in respect of certain expenditure incurred

the basic scenario of income and allowances. They do not include claims for relief such as mortgage interest or child care tax relief which complicate matters further.

Whether a couple is financially better or worse off being married or cohabiting depends on the fact pattern of that particular household. Whereas in other cases, the position is more advantageous for the cohabiting couple because they may be able to maximise their allowances by, for example, using two single persons allowances which is greater than one married couple's allowance.

The point is that the ability to obtain a tax advantage or disadvantage as a result of being a married or cohabiting couple is dependent on that particular couple's circumstances.

For example, a working unmarried couple who both are within the marginal rate income tax band with one child may pay less income tax than a married couple with the same income. This is because of the differences in the single person and married income tax thresholds as illustrated below.

Table 4.3: Cohabitees:[3]

2 x single income tax thresholds (£13,780 each)	£27,560
1 x child allowance	£3,000
1 x additional persons allowance	£4,500
Total allowances	**£35,060**

Table 4.3a: Married couple:

1 x married couple income tax threshold	£22,090
1 x wife's earned income allowance	£4,500
1 x child allowance	£3,000
Total allowances	**£29,590**

[3] 2013 income tax exemption thresholds

The married couple would have a higher income tax liability than the cohabiting couple if the two couples have the same level of income.

Conversely there are situations whereby a married couple receives beneficial treatment compared to a cohabiting couple in similar circumstances. This is particularly acute where there is one spouse/partner who is not working.

Table 4.3b: Cohabitees:

1 x single income tax threshold	£13,780
1 x child allowance	£3,000
1 x additional persons allowance	£4,500
Total allowances	**£21,280**

Table 4.3c: Married couple:

1 x married couple income tax threshold	£22,090
1 x child allowance	£3,000
Total allowances	**£25,090**

In this scenario the cohabiting couple would have a higher income tax liability than the married couple if the two couples have the same level of income.

The above simple comparisons demonstrate the existing inequalities within the current tax regime.

The situation is complicated further when other income tax reliefs such as those shown in 4.1 and 4.2 are taken into account. The example below illustrates the position where the opportunity to claim childcare tax relief can be utilised to the advantage of a cohabiting couple, compared to a married couple. This is by one partner utilising sufficient allowances to bring their income below the income tax threshold so they fall outside of the tax net.

Table 4.3d: Cohabitees:

Man's income	£45,000
Less: Child allowance (split between partners)	£5,930
Additional persons allowance	£4,500
Income tax threshold	£13,780
Net taxable income	£20,790
Tax at 27% (marginal rate)	**£5,613**
Woman's income	£20,000
Less: Child care tax relief	£6,150
Child allowance (split between partners)	£70
Income tax threshold	£13,780
Net taxable income	NIL
Total tax liability	**£5,613**
Net income	**£59,387**

Table 4.3e: Married couple:

Husband income	£45,000
Wife income	£20,000
Total income	£65,000
Less: child allowance	£6,000
Child care tax relief	£6,150
Wife's earned income allowance	£4,500
Married income tax threshold	£22,090
Net taxable income	£26,260
Tax at 27% (marginal rate)	**£7,090**
Net income	**£57,910**

The cohabiting couple has a tax liability which is £1,477 lower than a married couple in this case.

The availability of other income tax reliefs, such as relief for mortgage interest paid can also affect the tax position in a similar way to the payment of Child Care Tax relief.

Continuing to annually increase income tax exemption thresholds exacerbates this problem. Consideration should be given to decreasing and, eventually, removing the 27% marginal tax rate and removing the two tier tax system.

There are other inequalities too. The Income Tax Law provides that in the event of an individual incurring a trading loss they may be able to offset against their taxable income for the year, thereby allowing a benefit where an unmarried couple would not be entitled.

Taxing individuals on an independent basis could help rectify this situation.

4.4 ITIS (Income Tax Instalment System)

A married couple's tax affairs are combined under one tax reference.

The Taxes Office issue a joint ITIS rate based on their estimated joint income. This can be problematic for taxpayers on marriage when one spouse's ITIS rate can be much significantly different than expected due to their spouse's level of income. However they may jointly elect for the rate applicable to the earnings of one of them to be increased and the rate applicable to the earnings of the other to be correspondingly reduced.

When ITIS was introduced in 2006, the 'current year' basis of tax collection was also introduced for new taxpayers. The extant 'prior year' basis of tax was retained and the two systems run concurrently. Individuals who were registered before 1 January 2006 have income tax deducted from their earnings on a prior year basis of collection. This means the tax deducted is offset against the tax liability for the prior year. Individuals who registered on or after 1 January 2006 have income tax deducted from their earnings that is matched against their current year tax liability. Whether an individual pays ITIS on a prior or current year basis has no impact on their overall tax liability, it just affects when the tax is paid.

The existence of these concurrent regimes may cause complexity in the event of marriage.[4] When an individual moves from being taxed as an individual to the married couples tax regime, the individuals involved may not be on the same ITIS basis. For example, a wife who pays ITIS on a current year basis may marry a husband who pays ITIS on a prior year basis. In this case the wife has the opportunity to benefit from the cash flow advantage of deferring the payment of her income tax liability for a year by moving from a current to prior year basis of ITIS collection.

The interaction of the prior year basis of tax collection with the taxation of married couples also presents further problems. Firstly, this is because those taxpayers are always a year behind in settling their tax affairs. Therefore there is always a latent liability. Further consideration would need to be given as to how to address this in the transitional period if independent taxation were introduced. Secondly, upon divorce this latent liability may also be an issue and specific provision is sometimes given to this in the divorce settlement. Moving to independent taxation could address these issues.

4.5 Year of marriage

In the year of marriage, a wife includes her own income on her own tax return up until the date of marriage. The husband then declares her income from date of marriage to the end of the tax year on his tax return form. A similar process is applied in the tax year of separation.

Consequently in a year of marriage or separation, the tax return process is more resource intensive for the Taxes Office to administer.

The income tax exemption thresholds available in the year of marriage are advantageous due to the change in status. The wife receives a full single person's income tax exemption. It is not time apportioned. The husband receives the full married couple's income tax exemption threshold and the full Wife's Earned Income Allowance. It is not time apportioned. The same thing happens in the tax year of separation**.**

[4] This is not the only issue caused by the prior year basis of tax. People who retire can have a substantial tax liability when their income decreases on retirement.

4.6 Spouses geographically separated

There is a provision in the Income Tax Law that applies to married couples where the spouses each have a different tax residence status. This enables them to be treated as if they had been separated, provided this does not result in a higher tax liability than if they were taxed as a married couple.

This illustrates another level of complexity arising from the current regime which would not exist if individuals were taxed independently, based on their own income and their own tax status.

4.7 Seasonal workers

In order to register with the Taxes Office, all individuals are required to complete an Income Tax Registration Form.

There is one form per married couple. In the case of seasonal workers, perhaps coming from overseas, it is possible that their spouses are not in Jersey and yet their details, including their estimated income, needs to be completed and submitted to the Taxes Office. There is a question over the accuracy and value of this information. It will also affect the taxpayer's ITIS rate even though the "absent" spouse's income is not subject to tax in Jersey.

4.8 Civil partners

Civil partners are required to notify the Taxes Office once their civil partnership has been registered in the same way that a married couple would do so upon marriage.

Civil partners are taxed in the same way as a married couple; they receive the same reliefs (married income tax exemption threshold, and earned income relief).

The income tax law treats civil partner 'A' (who is the older partner) the same as the husband in a married couple. Civil partner 'B' (the younger partner) is treated the same as the wife in a married couple. (It is possible for the older partner to irrecoverably elect to be 'B' and for the younger partner to be 'A').

There is a specific tax return for civil partnerships. It is identical to the complex tax return but refers to 'self' and 'partner' rather than 'self' and 'wife'.

There was some criticism levied at the time of the introduction of the Civil Partnership Law in Jersey that it provided a perfect opportunity to update and amend the income tax law which has been described by some as "archaic". Furthermore the ability to elect which is partner 'A' and which is partner 'B' may be seen as giving an unfair tax advantage over a married couple who cannot select who is treated as the 'husband' for tax purposes, by taking advantage of the wife's earned income allowance. This is one of the pitfalls of using gender based allowances in the tax regime.

4.9 Additional process for separate assessments

The Taxes Office administration of married couples who opt for separate assessment is cumbersome. Income tax allowances may be split between each spouse. If the taxpayers do not request this, the Taxes Office allocates them based on their income. The assessment is then generated in accordance with this. A further assessment is prepared treating the married couple as if they had not elected for separate assessments for comparison purposes. This is to ensure the individuals involved do not pay any more, or less, had they not made the election. It is a resource intensive process.

It is impossible to compare the cost of tax administration for married couples who opt for separate assessment with the potential cost of independent taxation. Currently the process for such couple is to treat them as the exception rather than then norm hence the level of manual involvement by assessment officers is disproportionately higher than for the joint assessment of a married couple. If the Taxes Office systems were set up to operate independent taxation this would not necessarily be the case, not least as under independent taxation the allowances and exemptions would likely be set by law which removes the need for manual involvement.

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4.10 Taxpayer reporting

Independent taxation would potentially allow more accurate reporting with one individual being treated as one taxpayer and their data being recorded separately from their spouses. It should allow easier data analysis which would better facilitate tax policy developments.

5. WHAT DOES 'INDEPENDENT TAXATION' MEAN?

The term 'independent taxation' can mean different things to different people and in terms of the Jersey tax system is open to interpretation. The OECD publish a glossary of tax definitions, and even this does not include the term 'independent taxation'.

This may result in taxpayers wanting independent taxation to be introduced but actually meaning something different.

5.1 Modernising the tax regime

In a Jersey Evening Post article dated 27 January 2012, a local family law expert referred to the law which automatically regards a married woman's income as belonging to her husband as 'ridiculous' and also that the law was 'archaic' and should be updated to reflect modern society.

This raises the question of whether there is a desire to modernise the tax system so that a wife's income does not belong to her husband but for the law to be amended to reflect a husband and wife as having joint income and consequently a joint and several income tax liability.

This would resolve the issue of the "dated" approach of a wife's income belonging to her husband without necessarily fundamentally changing the income tax system – i.e. there could still be joint taxation and the system could retain the current married income tax threshold rates/method of allowances/reliefs and the gender based allowances. However it would not address a number of the other issues of the current system identified in Part 4.

From a legislative perspective this would still require a fundamental amendment to the Income Tax Law and comprehensive Law Officers advice would need to be sought to ensure the creation of a liability which does not currently exist would not present any issues in respect of the European Convention on Human Rights.

5.2 Separate assessments

Some may view the existing option of separate assessments as a type of independent taxation. However, the way this operates does not equate to independent taxation.

Since 2003, the income tax law has included a provision to enable a married couple that is ordinarily required to complete a joint tax return, may elect for 'separate assessment'. The purpose of this is to allow spouses to have autonomy and privacy in conducting their tax affairs if they wish. (Appendix 2 refers.)

In terms of administration, the current approach is time consuming because it involves allocating the reliefs and allowances between the spouses in the most equitable and tax efficient manner. Such allocation is not determined by law.

There are currently about 400 married couples that claim the separate assessment, out of over 18,000 married couples. There is a perception that because the number of married couples opting for separate assessment is low, this could indicate a lack of demand for independent taxation. However the two systems are very different. Opting for separate assessments does provide some privacy for each spouse to deal with their taxation affairs. However the overall liability for the married couple is the same as if they were assessed jointly – therefore simply because people do not opt for additional paperwork in return for the same tax position does not necessarily mean they would not support the introduction of independent taxation.

5.3 Comparative jurisdictions

This is a very high level summary of the regimes that apply to married couples in other jurisdictions. It does not seek to identify the effect of the regime on married versus cohabiting couples. The differing treatment illustrates how independent taxation is not a straightforward issue.

Country	Tax regime
Ireland	There are three options available to married couples. These are: • Joint assessment (automatic) Tax credits and the standard rate tax band may be allocated between spouses to suit their circumstances. • Separate assessment (election required) The tax affairs are independent of each spouse and tax credits are divided equally between the spouses aside from those which relate to actual cost borne, which are given to the spouse who bore the costs. • Separate treatment (election required) Each spouse is treated as a single person for tax purposes.
Germany	Married individuals can opt to file a joint return, which can result in a reduced income tax liability. This is because the whole income is divided by two and then the income tax is calculated which may be at a lower rate. Therefore if one spouse has a higher level of income than the other spouse, it may be beneficial to file a joint tax return. The spouse with the higher income can take advantage of unutilised tax credits.
Portugal	Married individuals file a joint tax return unless one spouse is non-resident; in this case the resident spouse files a separate tax return.
Spain	Married couples may choose to file separately or jointly.
Isle of Man	In the year of marriage each individual is treated as single for tax purposes. They receive their own income tax assessment and are responsible for tax due. Married couples have the option to elect for joint taxation in the following tax year if they so wish. In the absence of an election the individuals will continue to be assessed individually. Joint taxation (which is optional) means that the husband and wife are jointly and severally liable for all of their joint tax affairs. The default position is independent taxation, for example, in the case of married couples moving to the island.
Guernsey	Separate tax returns are completed in the year of marriage and income tax

	assessments are issued individually to each spouse. For the following tax years, the husband files his tax return to include the income of both him and his wife. Consequently the income tax assessment is issued in the name of the husband only. Married couples can request separate assessment
Canada	There are no ‘family’ tax returns. Each member computes their own income tax liability.
New Zealand	Income is assessed individually, there is no joint assessment

5.4 Independent taxation

The definition of “independent” as defined by the Oxford English Dictionary is as follows:

“Capable of thinking or acting for oneself”

Applying such a definition to taxation, and hence introducing independent taxation would mean treating each individual as a taxpayer in their own right, subject to income tax based on their own income and their own entitlement to allowances. It is assumed, for the rest of this report that moving to ‘independent taxation’ means this.

6. HOW COULD INDEPENDENT TAXATION BE ACHIEVED?

The ultimate aim must be to have a tax system that taxes each individual based on their own income and circumstances without creating a financial disadvantage to taxpayers or the States.

This section examines four broad options that could achieve the aim of independent taxation, although none of them will be revenue neutral to both the taxpayer and the States.

This is not an exhaustive list and is only to illustrate the potential routes that could be considered and highlight the implications. Further work is required to determine which would be the most appropriate way forward. It could be a combination of one or more of these.

Part 4 of this report discussed why a review is needed and highlights some of the challenges created by the existing features of the current regime when considering independent taxation. Whilst considering the merit of each available option, an indication is also given to how they may be able to address these issues.

6.1 Option 1: "Split" the current regime.

One option may be to "split" the current regime but maintain the existing exemption thresholds and allowances and the marginal rate and '20 means 20' regimes.

Each married couple will be treated as an individual. The single person's income tax exemption threshold would apply to all taxpayers. However there are difficulties with the existing regime as most allowances and exemptions are only intended to be used once. Therefore it will be necessary to decide how such reliefs are to be allocated. There are a number of approaches to address this issue:

- Each married couple could choose which party is entitled to the income tax allowances via an irrevocable election. Forecasting the cost of this would be difficult because it would necessarily involve guessing which party would claim the allowances. Assumptions could be made from a tax perspective, for example the higher earner claims the allowances. However in reality some households may choose to allocate their allowances differently, perhaps in accordance with their allocation of household finances.

- Each married couple could claim their allowances annually via their personal tax return form based on their income. It would be difficult to forecast tax revenues on this basis, as a couple's financial situation could change year on year. This could create administrative difficulties for the Taxes Office.

- Allowances could be allocated against one spouse's income and any excess could be transferred to the other spouse for them to utilise. This could create administrative difficulties and it would be difficult to determine the financial implications.

- Each spouse could be entitled to 50% (or some other allocation) of the available allowances, regardless of their income level capacity to utilise them. This approach could be criticised as it could reduce the level of allowances currently claimed.

Other issues to consider are as follows:

- The Wife's Earned Income Allowances would need to be abolished or changed. Maintaining this would retain the inequality in treatment compared with cohabiting couples which may be able to claim the child allowance and the additional persons allowance for their child. To what extent the additional persons allowance is claimed by cohabiting couples compared to single parents for whom the rules were originally introduced to benefit, is unclear.

- Defining a cohabiting couple if extremely difficult as, evidenced by the recent UK changes. This could make it difficult to define the application of certain exemptions, for example.

A key advantage of maintaining the income tax thresholds is that this is a concept which was originally introduced, back in 1963, as a mechanism to alleviate the tax burden for low/ middle earners. To some extent this is still the case. However, this can still be addressed through a different mechanism, if necessary. Maintaining the core elements of the current regime will not be seen as a significant change and could be more accurately assessed, financially.

A key disadvantage is that this could have an unintended financial impact on certain households which may not be solved with introducing further complexity or discretion. As well as maintaining a two tier tax system, it could also be perceived as a 'sticking plaster' approach rather than pursuing the modernisation of the tax regime.

Furthermore, it may be that there is an elective approach to independent taxation, for example the default position is joint taxation and individuals elect for independent taxation, or vica versa. Either way this would have an impact on the costs of tax return administration and potentially a greater financial impact as couples would generally only elect if it was beneficial (i.e. if their tax liability would be reduced).

Comparison with how Option 1 may address the challenges raised in part 4.

Adopting this option would not impact on the issues around the tax payer bands as explained in 4.1. The impact on the income tax reliefs and allowances as explained in 4.2 would depend on the decisions made as listed above.

However this approach could potentially solve the anomalies detailed in sections 4.3 to 4.8. These being:

- the inequalities for married v cohabiting couples
- ITIS
- procedure in year of marriage (and separation)
- the treatment of spouses geographically separated, seasonal workers and civil partners

This is because each person would be treated individually for tax purposes, and so the discriminatory treatment removed.

The extent of the impact on process and taxpayer reporting as discussed in 4.9 and 4.10 would depend on the decisions taken regarding the income tax reliefs and allowances.

6.2 Option 2: Replacement of the income tax thresholds.

Another option is to remove the current two tier tax system by removing the marginal rate tax band, and replace it with a universal set of exemptions and allowances.

This could be done in stages, for example reducing the 27% in tranches of, say, 1%. The cost of reducing the marginal rate from 27% to 26% would be about £8million. This figure is made up of about £6.9million decrease in income tax from the marginal rate taxpayers. Additionally there would be a further 1,210 taxpayers who currently pay at 20% who would move back into the marginal band at an additional cost of £1.2 million.

A key advantage of this option is that it would provide opportunity to review some fundamental elements of Jersey's tax regime as part of the modernisation process.

This would, however, be extremely difficult to assess and those adversely affected may not be identified until after the event. As with Option 6.1, addressing those unintended consequences could be difficult.

<u>Comparison with how Option 2 may address the challenges raised in part 4.</u>

Adopting this option would potentially solve the anomalies and challenges within the existing tax system as identified in sections 4.1 to 4.10. These being:

- tax payer bands
- reliefs and allowances

- the inequalities for married v cohabiting couples
- ITIS
- procedure in year of marriage (and separation)
- the treatment of spouses geographically separated, seasonal workers and civil partners

This is because each person would be treated individually for tax purposes, and so the discriminatory treatment removed. It also moves towards one rate of tax.

The extent of the impact on process and taxpayer reporting as discussed in 4.9 and 4.10 would depend on the decisions taken regarding the income tax reliefs and allowances.

6.3 Option 3: Create a completely new personal tax regime

The third option is to create a completely new tax regime in order to facilitate the introduction of independent taxation.

The advantage of this approach is the opportunity to create a new regime with scope to target measures in order to protect those on lower incomes whilst ensuring equality amongst married/unmarried taxpayers.

The fundamental difficulty with this option is that it would be impossible to cost with any certainty. One of the main challenges when considering any change to a tax regime is the potential financial impact on taxpayers and to the Treasury. As the intention is not to introduce independent taxation as a tax revenue raising or reducing measure, estimating the financial implications is essential. Creating a completely new regime would be extremely difficult to model with any certainty based on the data currently available. Designing a tax regime from scratch is very resource intensive, but may be more effective in addressing the complexity and anomalies of the current regime.

The creation of a completely new tax system would obviously be designed with the clear intention of solving the issues raised in part 4.

6.4 Conclusion

The ultimate intention is for Jersey to have a simple tax system that delivers independent taxation with minimal financial impact on taxpayers or the States.

Due to the complexities of the current regime, which is highly dependent on individual and household circumstances, it is impossible to fully assess the financial impact on the States, or to identify each person who would benefit or lose out from any one of these changes. What this review demonstrates is that there is no easy solution.

Moving towards a 20% tax rate for all whilst providing specific, targeted, exemptions and allowances for certain taxpayers, depending on their level of income rather than their marital status, would be the recommended route if simplification is the key objective. This would involve reduction of the marginal rate and the eventual subsequent removal of the two tier system to be considered in line with independent taxation.

It is recommended that a fuller review of the tax regime be undertaken to identify areas that can be simplified first before taking the final step towards independent taxation.

7. FINANCIAL IMPLICATIONS

The purpose of this section is to highlight the financial impact on taxpayers and/or the States of Jersey Treasury of moving towards independent taxation.

The introduction of independent taxation is unlikely to be a tax neutral measure for individuals or for the States. This is because of the complexity of the current system, as illustrated in Part 4. It is probable that it would create financial 'winners and losers' within the taxpayer community.

For the purposes of this report the Taxes Office has provided some data, which can be used for illustrative purposes. It is not worthwhile using resources to model all of the possible options.

The Taxes Office data shows the financial implications of just one example. In essence this is an illustration of 'Option 1' as explained in Part 6 of this report, i.e. the Taxes Office data shows what the financial impact on taxpayers, and the State, of effectively 'splitting' the tax regime and applying the single person's income tax. The criteria for the data are as follows:

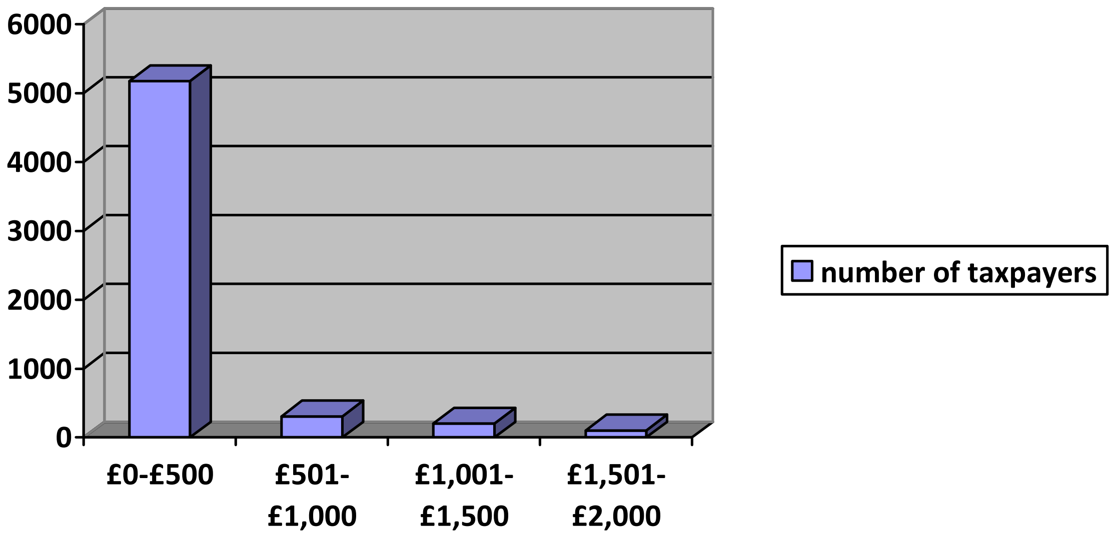
- The basic premise is that each individual in a married couple is treated as an individual;
- Each individual is entitled to a single persons income tax threshold;
- Those married couples that elect for separate assessments are not included (less than 200). Also there are number (about 1,400) of married couples that cannot be categorised because they do not compute as 'normal' assessments. These are also excluded from the sample;
- If a wife had no income, all allowances are allocated to the husband;
- If both husband and wife receive income the allowances are split equally between them – there is no opportunity to reallocate unutilised allowances;
- Any unutilised allowances and income tax thresholds are not transferred;
- The results show the impact for each married couple even though they would be taxed independently.

Below is a summary of the key results arising from this test. (Note: this summary ignores the cases where the measure would impact less than 100 married couples. Appendix 6 provides further information.):

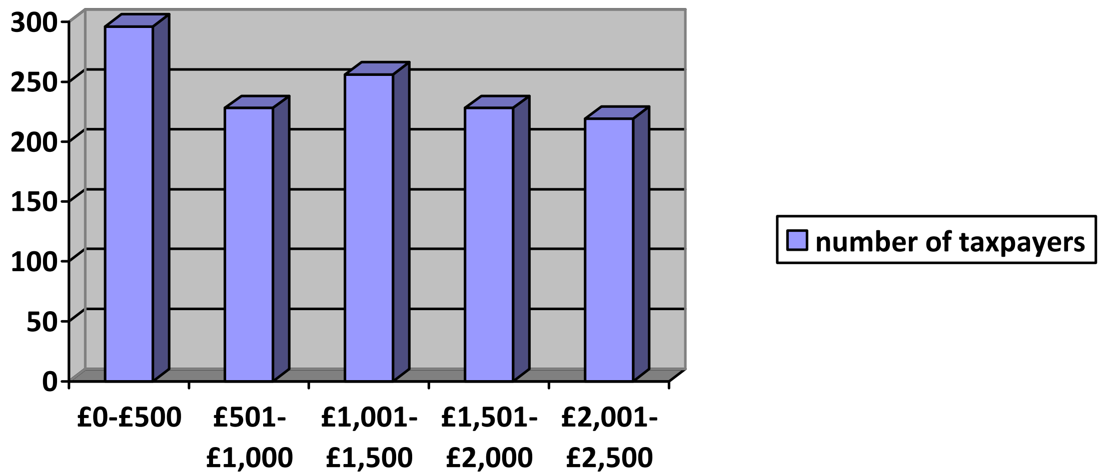
- The net position would be to increase income tax revenues by **£8.2million**, i.e. this would result in a **net cost to the taxpayer**.
- There is no conclusive answer as to which types of taxpayers will pay more income tax and which will pay less. There are winners and losers from various taxpaying groups.
- The results demonstrate that the impact depends on numerous factors – an inevitable conclusion when the tax regime includes so many allowances and applies them in tightly defined circumstances.
- The total number of taxpayers **paying less income tax** would be about **8,400 married couples.**
- The total number of taxpayers **paying more income tax** would be about **7,800 married couples.**
- The total number of taxpayers unaffected by this measure would be about 2,400 married couples.

Based on 2011 data, those taxpayers who would pay less income tax are shown in the illustrations below. Each graph refers to a specific taxpayer group and the shows the number of taxpayers within that band that will have a reduction in their income tax liability in multiples of £500.

Graph 7.1 Marginal rate taxpayers – reduction in tax liability

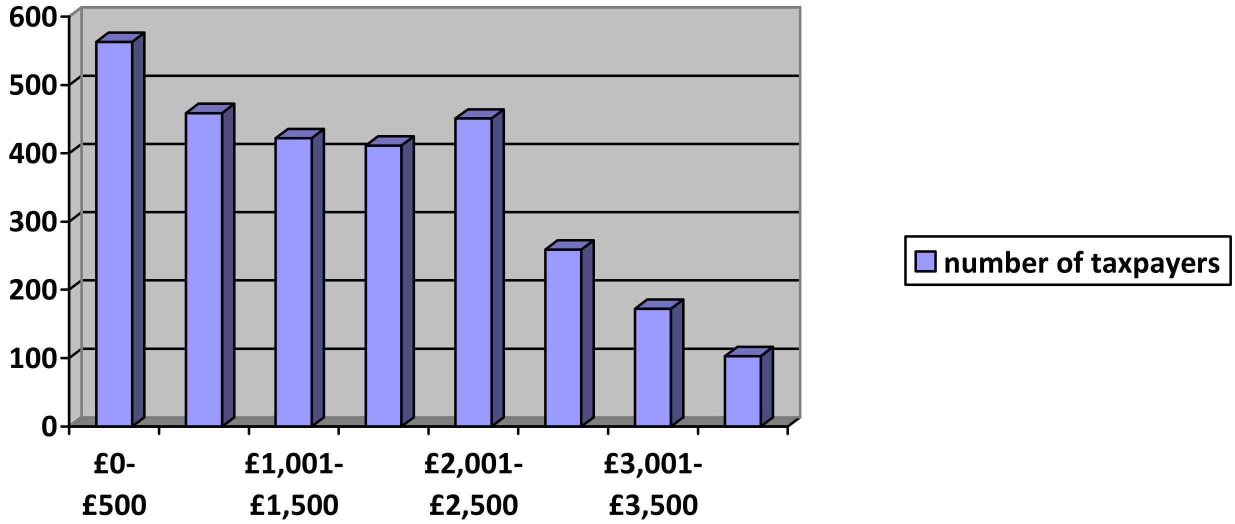


Graph 7.2 Standard rate taxpayers – reduction in tax liability

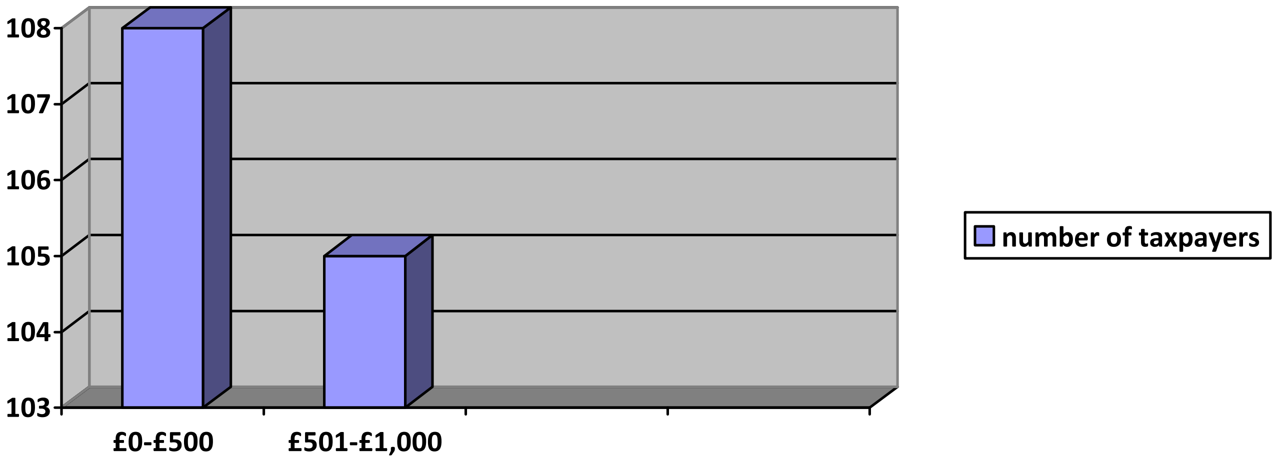


Those taxpayers who would pay more income tax are shown in the illustrations below. As with the illustrations above, each graph refers to a specific taxpayer group and the shows the number of taxpayers within that band that will have an increase in their income tax liability in multiples of £500.

Graph 7.3: Marginal rate taxpayers – increase in tax liability

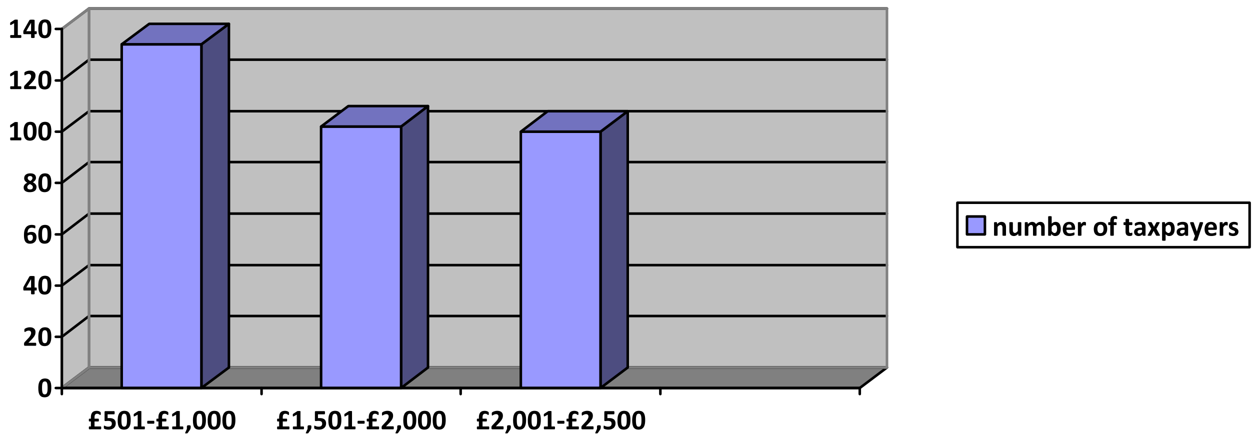


Graph 7.4: Standard rate taxpayers – increase in tax liability

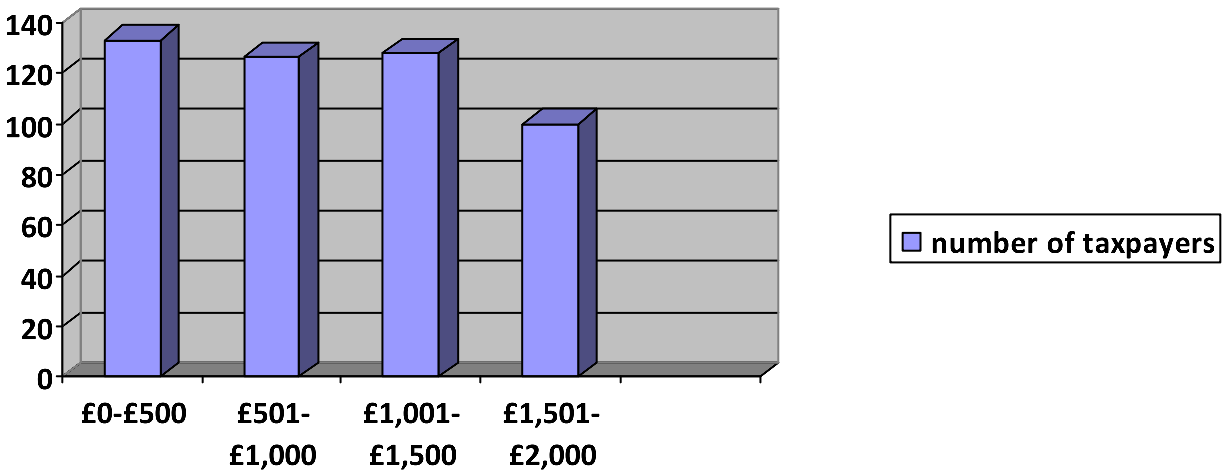


States of Jersey

Graph 7.5: Exempt taxpayers becoming subject to income tax



Graph 7.6: Exempt taxpayers, over 63 years of age, becoming subject to income tax



The following findings are not illustrated in the above graphs:

- 705 marginal rate taxpayers over 63 years of age would have a decrease in their tax liability of between £0 and £500.
- 1,479 marginal rate taxpayers over 63 years of age would have an increase in their tax liability of up to £3,000.
- Those marginal rate taxpayers where the wife has no income would see an increase in their tax liability of between £2,501 and £3,000. The number of taxpayers affected are as follows:
    - over 63 years of age – 479
    - under 63 years of age - 685

The conclusion of this data is that introducing independent taxation based on this type of model would be a cost to the taxpayer but not to the States. Within the various taxpayer bands it is difficult to generalise to who would be adversely affected and hence find a solution.

Inevitably a different route, such as removing the income tax thresholds and reducing the marginal rate from 27% to 20% would produce different outcomes, but as noted above it is extremely difficult to model the impact due to the complex nature of the regime.

It is recommended that further work be done to identify ways of simplifying the regime over time so that the financial impact can be minimised before a move to independent taxation is undertaken.

8. ECONOMIC IMPACT OF OPTIONS

The following comments have been provided by the Economics Unit in relation to the taxpayer modelling they have provided below.

In section 5.3, independent taxation has been described as treating each individual as a taxpayer in their own right and subject to income tax based on their own income and their own entitlement to allowances.

This analysis focuses on one way in which this could be done:

- the income of each spouse is taxed separately
- each spouse receives a single person threshold instead of jointly receiving a married couple threshold.
- the Wife's Earned Income Allowance is removed.
- where a married couple is entitled to further reliefs (because they have children or a mortgage for example) the higher income earner uses them.

In essence this modelling demonstrates the impact, from an economic perspective, of Option 1 as explained in Part 6 of this report, i.e. effectively splitting the tax system so as to allow each individual to claim the single person's income tax exemption threshold.

8.1 Impact on married taxpayers

The illustration below shows the impact of this change on married couple taxpayers.

These graphs are divided into three parts, and each part shows a different example of a married couple situation. The situations were chosen to show a range of consequences to taxpayers of moving to independent taxation. The consequences depend on the number of allowances and reliefs a married couple is entitled to, the size of household income and the split of how the income is earned between the married couple.

Each part shows the impact of a married couple having single income tax exemptions on:

1. The effective tax rate
2. The change in the effective tax rate
3. The change in disposable income

Within each part there are three household scenarios, which range from the case where one spouse earns 100% of the income to a household where their income is earned in equal shares.

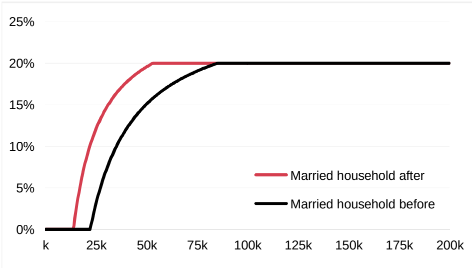
The results describe how much more/less disposable income (i.e. how much more/less income tax to pay) married couples in different situations would have by moving to independent taxation.

The first model refers to a married couple with no children and no entitlement to mortgage interest relief.

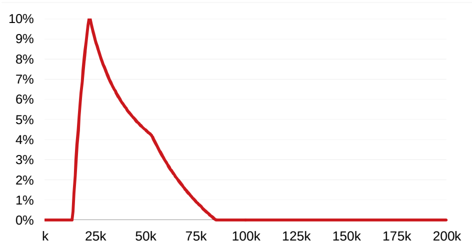
Married couple with no children and no mortgage

Household 1 100%/0%

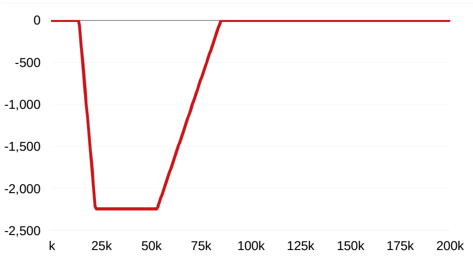
Effective tax rate with/without independent taxation



Change in effective tax rate

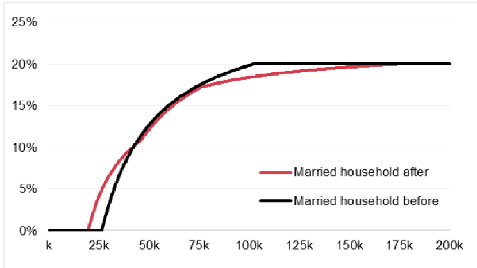


Change in disposable income

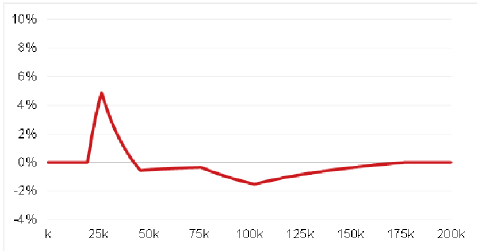


Household 2 70%/30%

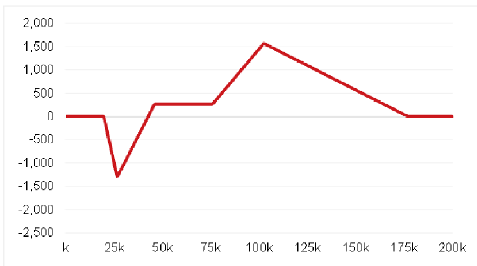
Effective tax rate with/without independent taxation



Change in effective tax rate

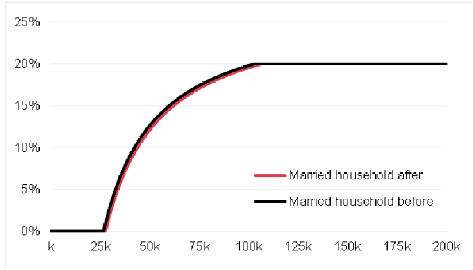


Change in disposable income

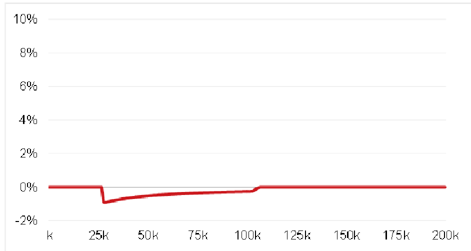


Household 3 50%/50%

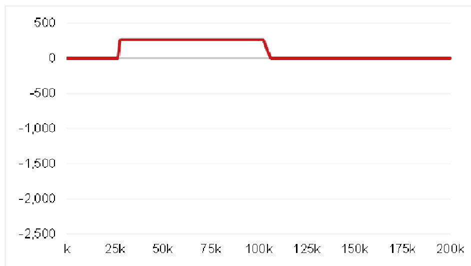
Effective tax rate with/without independent taxation



Change in effective tax rate



Change in disposable income



These graphs show the impact on married couples that have no children and no mortgage. There are no reliefs or allowances available to these taxpayers because they have no children and no mortgage (they either rent, or own property outright). The taxpayers are under 63 years of age and therefore not entitled to age related exemptions.

The main points are:

- Where there is a sole earner in this type of married couple:

    - households who earn income of between £12,000 and £80,000 would pay more tax. This is because the non-earner cannot use their personal allowance, whereas at the moment their married partner does.
    - the biggest losers would be the households who earn between £20,000 and £60,000 who would pay about £2,200 more in tax.
    - households who earn above £80,000 would not be affected by the change.

- Where there is a small earner in the married couple:

    - households where the lower earner earns less than their new personal allowance (£13,780) would pay more tax.
    - some high-income households (around £70,000 and above) would pay less tax because their partner's lower income would now benefit from their new personal allowance. The tax saving would be over £2,000 for households where the main earner earned £90,000 and above and the smaller earner earned around £15,000.

- Where each partner in the married couple earn similar amounts:

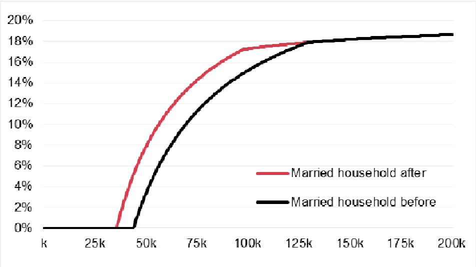
- households who jointly earn £28,000-£100,000 would pay around £260 more tax because the value of their new allowances would not be as high as the married couple allowance plus wife's earned income allowance.

The second model refers to a married couple with two children and a mortgage

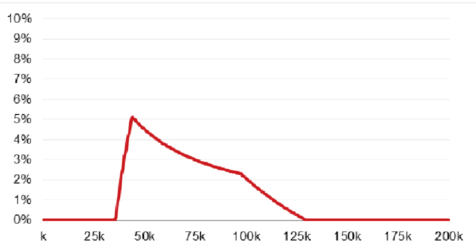
Married couple with two children paying mortgage interest of £7,500 and childcare cost £8,000

Household 1 100%/0%

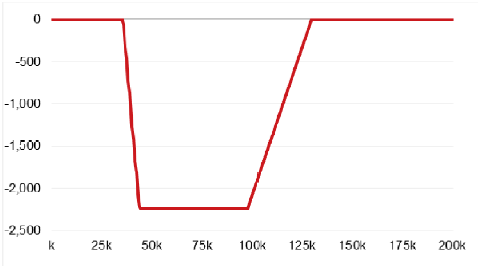
Effective tax rate with/without independent taxation



Change in effective tax rate

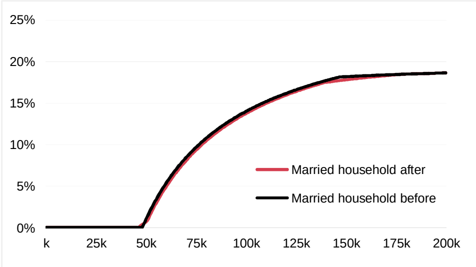


Change in disposable income

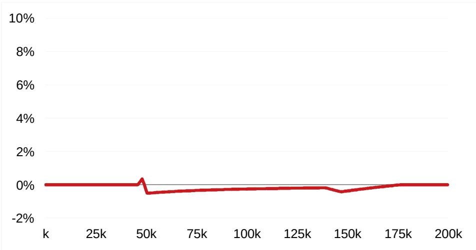


Household 2 70%/30%

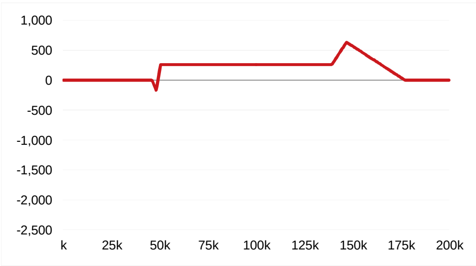
Effective tax rate with/without independent taxation



Change in effective tax rate

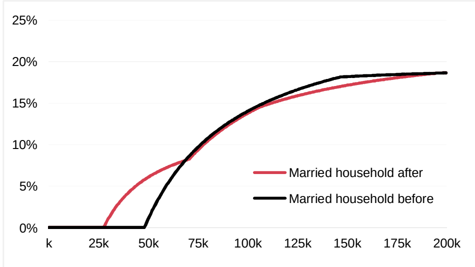


Change in disposable income

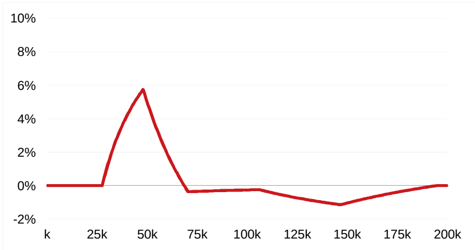


Household 3 50%/50%

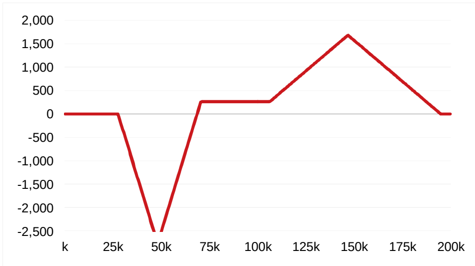
Effective tax rate with/without independent taxation



Change in effective tax rate



Change in disposable income



These graphs show the impact on married couples with two children, mortgage interest relief of £7,500 a year and childcare costs of £8,000. The higher earner claims all of these reliefs.

The main points are:

- Where there is a sole earner in the married couple:
  - households who earn income of between £33,000 and £125,000 pay more tax (up to £2,250).
  - the biggest losers are married couples with one earner earning between £45,000 and £100,000 who would pay about £2,250 more income tax.
  - households who earn income over £125,000 are unaffected

- Where there is a small earner in the married couple:
  - households who earn income of between £35,000 and £100,000 pay more tax (in the region of £1,000 more).
  - the biggest losers are married couples with one small earner who jointly earn between £40,000 and £60,000 who would pay up to £2,000 more income tax.
  - households who earn income over £100,000 pay up to £2,500 less tax. This is because the small earner now gets their own allowance, which is withdrawn (as the married couple exemption threshold) in the current system under 20 means 20.

- Where each partner in the married couple earn similar amounts:
  - households who jointly earn £35,000-£75,000 pay more tax (up to £2,500 more) because the main income earner cannot use all of their allowances. However, if

the allowances could be shared between them they would pay similar amounts of tax before and after the change.

- households who jointly earn over £75,000 would pay less tax.
- the biggest 'winners' would be those who earn between £120,000 and £160,000 jointly. They would pay £1,000 - £1,500 less income tax.

A third section of modelling was done based on a married couple over 63 years of age with no dependent children and no mortgage (i.e. the same fact pattern as for the first section but for an older married couple). There are no reliefs or allowances available to these taxpayers because they have no children and no mortgage (they either rent, or own property outright).

The outcomes are similar to those in the first section of modelling but at slightly higher income levels because taxpayers who are over 63 get slightly higher exemption thresholds than those who are under 63.

In conclusion, in the absence of compensating changes, a simple switch to independent taxation by splitting the current regime will adversely affect those at the lower to middle income bracket.

8.2 Comparison to unmarried couple taxpayers

The analysis shows the married couple 'winners and losers' that would result. However, it should be borne in mind that although many married couples will either win or lose, after the change they will be treated the same as unmarried couples bringing equity in treatment to the income tax system. (This is assuming there is equality across the available allowances).

Unmarried couples would not be affected by this model but could be affected by some of the others.

8.3 Effect on incentives to work

A person's decision to work and the amount they want work is affected by many different factors, including age, household situation and availability of work. The income tax rate they face on the next pound earned (the marginal rate of tax) is another consideration.

The exemption thresholds for taxpayers mean that up to that level of income, the marginal rate of tax is 0% and so the income tax system is not acting as a disincentive to start working.

Above the thresholds the marginal rate of tax becomes 27% of every extra pound earned, and at higher income levels the marginal rate of tax becomes 20% of every extra pound earned.

The earlier analysis showed that married couples with a sole income earner would lose out because they would not be able to use the exemption threshold of the spouse with no income. In this instance the incentive to decide to work has been improved because the spouse with no income does not have to pay any income tax on the first £13,760 of their earnings, whereas in the present system they would have to pay either 27% or 20% of this income depending on the other spouse's income level.

The earlier analysis also showed some married couples with a very high earning spouse and a low earning spouse could pay less tax because the low earning spouse would now have their own exemption threshold. However, the incentive to work extra hours has worsened slightly because they would have to pay 27% on any extra income earned compared to 20% at the moment.

Although the incentives to work may improve for some spouses, it should be borne in mind that some do not want to work (e.g. are retired) or are unable to work (e.g. unemployed or looking after a family). Naturally in most cases the overall household tax liability would contribute to the decision.

States of Jersey

Conclusion

Making these changes to the income tax system would generally affect more those married couples with one main earner and no second earner, and one main earner and a second earner earning less than around £15,000.

In these cases, married couples with lower incomes would pay more income tax (because they can no longer pool their income to benefit from all of their thresholds, allowances and reliefs) and married couples with higher incomes would pay less income tax (because the lower income earner now benefits from their own personal threshold which they would not have got as a couple as a standard rate tax payer).

Married couples that earn more equal amounts would not be affected at lower incomes, provided they can share the allowances and reliefs they may be entitled to. At higher incomes they would pay slightly less income tax, but this is because of the small difference between the married couple threshold and wife's earned income allowance vs. two single person thresholds.

Although some of these couples may be better or worse off than before, they would be treated the same as unmarried couples.

Purely from a tax perspective, the move to independent taxation may improve the incentive to work for spouses who do not work.

9. PRACTICAL/OPERATIONAL IMPLICATIONS

Changing the way that married couples are taxed would inevitably have a significant impact on the practical process of tax collection.

9.1 Interaction with other initiatives

The Taxes Office have committed to a number of other initiatives as part of the modernisation process that has already started to be implemented, such as online filing. This is part of the recommendation from the Taxes Transformation Programme which includes a number of modernisation measures for example, self-assessment.

In addition the Taxes Office will be collecting the Long Term Care charge which will be affected by a move to independent taxation.

As noted in section 4, there are a number of other issues such as prior year/current year basis, which need to be addressed and it could be beneficial to address these before moving to independent taxation.

All of the above will need to be taken into account when making major changes to the tax collection system.

The Tax Policy Unit is in the process of developing a long-term tax policy programme aligned with the existing tax strategy and the principles established last year in the Medium Term Financial Plan (see Appendix 8). This will include modernisation of the personal tax regime and a move toward independent taxation will form part of that. This strategy will be published in 2014 and will set out a timetable for the modernisation programme.

9.2 Taxes Office resource

From the perspective of the Taxes Office administering a system of independent taxation, there are a number of areas to consider:

Firstly, there is an obvious cost of administering and processing additional tax returns. The production of an additional 18,000 tax return forms to issue, receive, process and then to issue assessments and process tax payments would have an impact.

However there are a number of points that could mitigate this. Firstly the introduction of online filing could substantially reduce these costs. Secondly one option the Taxes Office is considering as part of the modernisation process is reducing the number of tax returns that are issued to some taxpayers and to potentially remove the tax return filing obligation from certain taxpayers. This could be because they pay all of their income tax via ITIS on their sole source of income. This work is ongoing and it is not possible at this stage to estimate how many taxpayers this will affect.

Secondly there is the additional burden on the ITIS tax collection, as additional ITIS rates will need to be issued.

In conclusion introducing independent taxation cannot be done in isolation, but steps can be taken to facilitate it and to introduce it in line with the long-term tax programme.

10. KEY FINDINGS AND RECOMMENDATIONS

There is a desire to modernise the tax regime, which would include the introduction of independent taxation.

There are a number of unintended consequences of the current regime that may be addressed by independent taxation and the system would benefit from simplification.

While it is possible to move to independent taxation, due to the complexity of the current regime, the financial implications are likely to be substantial either to the taxpayer (and hence the economy) or to the States revenues, neither of which is ideal during this economic climate.

More work is needed to identify ways of simplifying the regime and taking steps towards independent taxation to minimise the financial impact.

The findings of this review demonstrate that there is no quick and easy route. Simply replacing the married couples income tax exemption with two single persons allowances would create a significant net cost to taxpayers and could have a detrimental financial impact by removing over £8million from the economy.

The following next steps are recommended:

- Given the interaction of independent taxation with other aspects of the tax regime that require modernisation or simplification, a first step should be to establish a detailed long term tax programme for the personal tax regime. This should identify all aspects of modernisation/simplification with an indicative timetable and should cover the next 5 to 10 years.

- Take a step in the 2014 Budget toward simplification by reducing the marginal rate by 1% and consider further reductions in future Budgets

- Continue reviewing the exemption thresholds and allowances and determine how these can be changed in the short term to deal with the anomalies and help move towards independent taxation.

- Start to reduce the increases in exemption thresholds and allowances to reduce the growing discrepancies between married and cohabiting couples.

- Work will continue on designing a detailed step plan to introduce independent taxation to the following timetable:

    - Review completed and recommendations included in the 2016 Budget at the end of 2015.
    - Commence of implementation in 2016
    - Implementation completed by 2020

This timetable is based on the assumption that the cost (there is an inevitable cost to either the States or to taxpayers) of introducing independent taxation will be acceptable to the States.

In addition, a long-term tax programme will be published in 2014 alongside the 2015 Budget which will include the independent taxation review as well as matters such as self- assessment and current year basis. Consideration will be given to including further changes in the 2015 Budget.

APPENDICES - SUPPORTING RESEARCH

States of Jersey

Appendix 1: General principles and background behind the introduction of independent taxation in the UK

The 1988 Finance Act introduced the separate taxation of husbands and wives on their income and chargeable gains – known as independent taxation. This means the income and gains of each spouse within a married couple is entitled to their own personal allowance or annual exemption and is then taxed separately.

Under independent taxation, income generated from jointly owned assets is regarded as accruing equally to each spouse. If the property is held in anything other than equal shares, the husband and wife may make a joint application to effect that the income generated should be apportioned between them on the basis they hold the property. Special rules apply to joint bank accounts. This applied to tax years 1990-91 onwards.

Prior to that the UK operated an income tax system in which a husband was assessed on his and his wife's income jointly. From a capital gains tax perspective, the gains of each spouse were added together and also assessed on the husband.

There was a key campaign of women's movement in the UK in the late 1970s and early 1980s for 'legal and financial independence'. This included a specific demand for the independent treatment of women within the income tax system. Simultaneously a wider group of women were increasingly protesting about a situation in which their husbands received letters about their wives' tax affairs because at that time the husbands were legally responsible for the payment of tax on their wives' income as well as their own.

Wives could get a personal allowance if they were in employment – a 'wife's earned income allowance' – and most tax was deducted through PAYE (Pay As You Earn). If the wife's income exceeded her allowance she would pay tax at a rate determined by both her own and her husband's income i.e. this was a system based on the aggregation of couple's income. There was also a married couple's allowance, which was only payable to the husband.

The Conservative Government published a Green Paper in 1986 on the reform of personal taxation. This covered a wide range of issues but a key issue was the discussion of women in the income tax system.

One key issue identified was the balance between single earner and dual earner couples – i.e. they did not want to disadvantage a traditional single earner family on the assumption the non working spouse was doing valuable voluntary work.

One option considered at the time was the transferability of personal allowances between spouses – applying to couples both with and without children. There was a concern that joint taxation and transferable personal tax allowances have been shown to act as a disincentive to employment amongst the potential second earners in couples.

There was then an argument that it would be wrong to reward a husband just for being married with a married couples allowance when the money might be better spent on improving child benefit for example.

Independent taxation was subsequently introduced without the option for the transferability of personal allowance but the married mans allowance remained under the guise of the married couple's allowance.

Although under independent taxation each spouse in a marriage is treated as separate persons for income tax purposes, with their own personal allowances etc., under the tax credit system, in general, tax credits are given based on family income – be this married household/cohabitees or single parents. Married couples are required to make joint claims for tax credits and the claim is based on joint income. The new rules regarding the restriction on child benefit for higher income earners apply to cohabiting and married couples alike.

There is a concern in the UK that independent taxation is being compromised by the joint assessment of couple's income for tax credit purposes.

The operation of independent taxation does generate some tax planning opportunities for married couples that are not available to cohabiting couple (although a cohabiting couple could of course take advantage of these if they decided to marry). The majority of these opportunities are around utilising allowances or the basic rate tax band via the transfer of income generating or capital assets.

UK Prime Minister's recent announcement regarding tax breaks for married couples

In early July 2013, the UK Prime Minister David Cameron announced he would bring forward plans for tax breaks for married couples, by considering allowing non working spouses to transfer part of their tax free allowance to their partners.

It was suggested that £750 of the personal allowance, for income tax purposes, would be transferable between adults that are part of a married couple (provided the higher income spouse is not a higher rate taxpayer).

The potential measure has already received a significant amount of criticism from the media and other interested parties.

Firstly, only a minority of married couples would benefit. The type of couples who will not benefit would be couples where the lower income spouse was in receipt of income which utilises their personal allowance where they have to work for financial purposes, couples where the higher earner pays tax at the higher income tax rate, and low income households where both partners receive income less than the level of the personal allowance.

Secondly, there is a question of how effectively targeted this would be. One of the claims is that it will assist those lower/middle income families with children but in reality a significant percentage of the married couples that will be eligible will be pensioners and so unlikely to have dependent children.

Thirdly, from an administrative perspective this would be extremely complex for HMRC to administer. Furthermore it is not clear how this reallocation of part of the personal allowance would work in cases where the individuals involve do not file self-assessment tax returns.

On a more conceptual level this announcement has been met with a significant amount of criticism. The idea of a £150 tax saving (utilising £750 of excess personal allowance at an income tax rate of 20%) encouraging marriage has been questioned and also that marriage should be its own reward. There has also been criticism of the discriminatory social engineering nature of the measure. The Director of the 'Don't Judge My Family' campaign criticised the measure as being out of step with modern family and as promoting a "...fantasy 50s family, that's a married couple with a breadwinner and a homemaker. It's out of step with modern families who come in all shapes and sizes and discriminates against families with single parents, widows and widowers, couples who both work and couples who choose not to marry."

Finally, this announcement has resurrected the on going argument that recognising the value of marriage in society does not mean you have to give it preferential treatment i.e. just because don't give something an advantage over something else doesn't mean you don't support it. It just means being equitable.

Further details will be announced in the UK Autumn Statement, the date of which is to be advised.

Appendix 2: The current tax regime – joint taxation and separate assessments

Joint taxation

Income Tax (Jersey) Law 1961:

SPECIAL PROVISIONS AS TO MARRIED PERSONS

121 General rule as to income tax on husbands and wives

(1) Subject to Articles 121A and 121B, a woman's income chargeable to income tax shall, so far as it is income for a year of assessment or part of a year of assessment during which she is a married woman living with her husband, be deemed for the purposes of this Law to be his income and not to be her income:
Provided that the question whether there is any income of hers chargeable to income tax for any year of assessment, and, if so, what is to be taken to be the amount thereof for the purposes of this Law, shall not be affected by the provisions of this paragraph.430

(2) Subject to Articles 121A and 121B, any tax falling to be assessed in respect of any income which, under paragraph (1) of this Article, is to be deemed to be the income of a woman's husband shall, instead of being assessed on her, or on her trustee, guardian or curator, or on her heirs, executors or administrators, be assessable on him, or in the appropriate cases, on his trustee, guardian or curator, or on his heirs, executors or administrators:
Provided that nothing in this paragraph shall affect the operation of Article 74.

The Taxes Office published guidance
"Marriage or civil partnerships
If you are getting married or registering your civil partnership then your tax affairs will be combined under one reference number.
Tax information for civil partners
However, you can choose to have separate tax returns and bills if you require privacy or autonomy in conducting your own finances. This is called 'separate assessments'. There is no

cash advantage or disadvantage to this - the total of the two bills added together will be the same as the joint bill you would have received."

<u>Separate assessments</u>

<u>Income Tax (Jersey) Law 1961:</u>

121A Election by husband or wife for separate assessment432
(1) A married woman living with her husband, or her husband, may elect, by written notice delivered to the Comptroller, for separate assessment in accordance with Article 121B.
(2) Subject to paragraph (3), an election delivered before 31st October in any year of assessment shall have effect for that year and ensuing years, unless revoked.
(3) In the year of assessment in which a husband and wife marry, an election delivered –
(a) before 31st October in that year; or
(b) within one month following the day of their marriage,
shall have effect for the part of that year during which they are married and for ensuing years, unless revoked.
(4) The husband or wife who made the election may revoke it, by written notice delivered to the Comptroller.
(5) A revocation of an election delivered before 31st January following a year of assessment shall have effect for that year and ensuing years, unless a further election is made.
(6) The Comptroller shall inform a husband or wife of the delivery by his or her spouse of a notice under paragraph (1) or (4).
(7) In this Article and in Article 121B, "election" means an election under paragraph (1) of this Article.

121B Effect of election for separate assessment433
(1) Subject to this Article, an election shall have the effect that –
(a) the wife's income is not deemed, for the purposes of this Law, to be her husband's income; and
(b) the husband and wife are separately assessed and charged under this Law.

(2) The husband and wife's incomes shall be aggregated for the purpose of determining their entitlement to any allowances, exemptions and reliefs. Income Tax (Jersey) Law 1961 Article 122

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3) The sum of the allowances, exemptions and reliefs to which the husband and wife are entitled shall not exceed the sum of such amounts to which they would have been entitled if the election had not been made.

(4) Subject to paragraph (5), any allowances, exemptions or reliefs (notwithstanding Articles 92B(2), 95(4) and 98A(4)) shall be apportioned between the husband and wife in proportion to the amounts or their respective incomes.434

(5) The husband and wife may jointly, in accordance with paragraph (6), notify the Comptroller in writing that any allowances, exemptions and reliefs to which they are entitled, by virtue of the election, are to be apportioned and transferred between them in the manner specified in the notice.

(6) An apportionment notice delivered to the Comptroller before 31st January following a year of assessment shall have effect for that year and, unless replaced by a further apportionment notice or revoked, for ensuing years.

(7) The husband and wife may jointly revoke an apportionment notice by written notice delivered to the Comptroller.

(8) A revocation of an apportionment notice delivered before 31st January following a year of assessment shall have effect for that year and ensuing years unless a further apportionment notice is delivered.

(9) The husband or the wife may prepare and deliver the statement required by Article 16 on behalf of both of them, unless the Comptroller requires otherwise.

(10) An election shall not affect the operation of Article 74.

(11) In this Article, "apportionment notice" means a notice under paragraph (5).

The Taxes Office published guidance

"If you are a married couple or a couple in a civil partnership you can request separate assessments - but there is no financial advantage to this.

There is no independent taxation in Jersey. However, if you are a married person or a person in a civil partnership and you currently complete a joint tax return, you may elect for separate assessment. This also applies to couples who marry or register a civil partnership during the year. Separate assessments allow spouses and civil partners to have autonomy and privacy in conducting their tax affairs.

How do I request a separate tax assessment?

Either spouse or civil partner can make a request in writing to the Comptroller of Taxes by the end of October and it will then apply for that year of assessment onward. If you marry or register a civil partnership later in the year and wish to apply, you have one month from the day of your marriage or civil partnership registration. The claim can be revoked by the end of January following any year of assessment, but only by the spouse or civil partner who made it originally.

How will it work?

Two separate tax returns are issued and it is your individual responsibility to declare income received in your own right and any joint income, which should be split. You will each receive a bill and will be solely liable for the tax due.

Marginal relief is calculated by reference to your joint income and proportioned between you in accordance with that income. Two single exemption limits are not available.

Is there a financial benefit to separate assessments?

There is no cash advantage to separate assessments. In other words, there is no difference to the total income tax liability had you not made the election.

What if I have now permanently separated from my spouse or civil partner?

If you have permanently separated you need to advise us and let us know the separation date. There is no need to make an election for 'separate assessments'. "

States of Jersey

Appendix 3: The marginal rate band

Extract from the Taxes Office website regarding the operation of the marginal rate tax band:
“Tax exemption thresholds

There are tax exemption thresholds to prevent liability to tax for individuals or families on low incomes. These are as follows for 2012:

single person	£13,370
married persons / civil partners	£21,440
single person over 63 years of age	£14,920
married persons/civil partners over 63 years of age	£24,540

These exemption thresholds are increased if the single person or married couple is entitled to any of the following allowances or reliefs:

- lower child allowance (child at school) £3,000
- higher child allowance (child in higher education) £6,000
- additional personal allowance (single parent) £4,500
- wife’s earned income allowance (wife working) £4,500
- civil partner earned income allowance £4,500
- child care tax relief £6,150
- enhanced child care tax relief (pre-school age children) £12,000 max per child
- qualifying maintenance payments
- qualifying interest tax relief

Low and middle earners - marginal band

Taxpayers who are sometimes called low and middle-income earners whose total income is in excess of their exemption threshold fall into what is termed the 'marginal band'. The calculation of their liability to tax at the marginal rate of 27% ensures that there is no disproportionate increase in their tax bill if their income exceeds their exemption threshold.

Because of these exemption thresholds being used in the calculation of tax (increased as appropriate by the above allowances or reliefs) it is only those with high incomes who do not benefit from them.

This means that if in any year your total income is less than the exemption threshold, the percentage of tax you will pay on that income will be 0%. As your income increases or your circumstances change, the percentage of tax you pay will increase as the marginal relief gradually tapers away until you are paying the maximum 20%."

Appendix 4: Rationale for the existing allowance

Extract from the proposition lodged in 2006 regarding the introduction of the '20 means 20' concept.

"INCOME TAX: ALLOWANCES, RELIEFS AND
EXEMPTION THRESHOLDS ("20 MEANS 20")
Lodged au Greffe on 19th May 2006
by the Minister for Treasury and Resources

Concerns have also been expressed by taxpayers about the loss of certain allowances and reliefs to which they had been accustomed and which they had taken into account in their financial planning.

In the light of those concerns, and the higher yield, it is now proposed that the earlier proposals for raising more tax from those on higher incomes are amended in the following manner –

"Tax relief for children, including those in higher education, will be retained for all taxpayers.

Retaining tax relief for children will ensure that all taxpaying families will continue to receive allowances in respect of their children. Furthermore, bearing in mind the growing cost of higher education, tax relief will continue to be provided for all taxpayers with children receiving full time higher education at universities or colleges of further education."

Appendix 5: Comparative illustrations of married vs cohabiting couples under existing regime

(NOTE: Based on 2013 income tax thresholds and allowances. Married couple: assumes 'wife's income' is always 'earned' income. Cohabiting couple: assumes higher earner claims allowances.)

Part 1 – aged under 63, no children,

Scenario 1: married

Marginal rate taxpayer

Husband's income	Wife's income	Child allowance	Joint tax liability
£25,000	£10,000	£0	£2,271

***Scenario 2:* cohabiting**

Marginal rate taxpayers

Partner 1 income	Partner 2 income	Child allowance	Household tax liability
£25,000	£10,000	£0	£3,029

Married couple is £758 better off

***Scenario 3:* married**

Marginal rate taxpayer

Husband's income	Wife's income	Child allowance	Joint tax liability
£45,000	£45,000	£0	£17,121

***Scenario 4:* cohabiting**

Marginal rate taxpayers

Partner 1 income	Partner 2 income	Child allowance	Household tax liability
£45,000	**£45,000**	**£0**	**£16,859**

Cohabiting couple is £262 better off

Scenario 5: **married**

Marginal rate taxpayer

Husband's income	Wife's income	Child allowance	Joint tax liability
£10,000	£70,000	£0	£14,421

Scenario 6: **cohabiting**

20% taxpayer and exempt taxpayer

Partner 1 income	Partner 2 income	Child allowance	Household tax liability
£10,000	£70,000	£0	£14,000

Cohabiting couple of £421 better off

Scenario 7: **married**

20% taxpayer

Husband's income	Wife's income	Child allowance	Joint tax liability
£100,000	£0	£0	£20,000

Scenario 8: **cohabiting**

20% taxpayer and exempt taxpayer

Partner 1 income	Partner 2 income	Child allowance	Household tax liability
£100,000	**£0**	**£0**	**£20,000**

Neutral

Part 2 – aged under 63, 2 children,

***Scenario 9:* married**

Marginal rate taxpayer

Husband's income	Wife's income	Child allowance	APA	Joint tax liability
£25,000	£10,000	£6,000	£0	£651

***Scenario 10:* cohabiting**

Exempt and marginal rate taxpayers

Partner 1 income	Partner 2 income	Child allowance	APA	Household tax liability
£25,000	£10,000	£6,000	£4,500	£194

Cohabiting couple £457 better off

***Scenario 11:* married**

Marginal rate taxpayer

Husband's income	Wife's income	Child allowance	APA	Joint tax liability
£45,000	£45,000	£6,000	£0	£15,501

***Scenario 12:* cohabiting**

Marginal rate taxpayers

Partner 1 income	Partner 2 income	Child allowance	APA	Household tax liability
£45,000	£45,000	£6,000	£4,500	£14,024

Cohabiting couple £1,477 better off

***Scenario 13:* married**

Marginal rate taxpayer

Husband's income	Wife's income	Child allowance	APA	Joint tax liability
£10,000	£70,000	£6,000	£0	£12,801

***Scenario 14:* cohabiting**

20% taxpayer and exempt

Partner 1 income	Partner 2 income	Child allowance	APA	Household tax liability
£10,000	£70,000	£6,000	£4,500	£11,900

Cohabiting couple £901 better off

***Scenario 15:* married**

20% taxpayer

Husband's income	Wife's income	Child allowance	APA	Joint tax liability
£100,000	£0	£6,000	£0	£18,800

***Scenario 16:* cohabiting**

One 20% taxpayer

Partner 1 income	Partner 2 income	Child allowance	APA	Household tax liability
£100,000	£0	£6,000	£4,500	£17,900

Cohabiting couple £900 better off

Appendix 6: Taxes Office data showing married couples claiming the single person's tax exemption

	Revised		no of T/Ps	no of T/Ps	no of T/Ps	subtotal																		
	Tax payable		paying less	paying more	paying the same		0-500	501-1000	1001-1500	1501-2000	2001-2500	2501-3000	3001-3500		0-500	501-1000	1001-1500	1501-2000	2001-2500	2501-3000	3001-3500	3501-4000	4001-4500	
Over 63 Wife no income marginal	1,250,829		0	537	0	537	0	0	0	0	0	0	0	0	0	12	12	10	22	479	1	1	0	537
Over 63 Wife no income 20%	0		0	0	66	66	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Over 63 Wife no income exempt	353,905		0	289	80	369	0	0	0	0	0	0	0	0	0	66	53	59	55	56	0	0	0	289
Over 63 Marginal	2,203,966		901	1531	0	2432	705	85	76	19	15	1	0	901	0	194	220	198	228	639	33	10	9	1531
Over 63 20%	-411,222		312	10	55	377	78	48	51	45	52	38	0	312	0	6	2	2	0	0	0	0	0	10
Over 63 exempt	639,615		5	564	252	821	5	0	0	0	0	0	0	5	133	126	128	100	71	1	3	1	1	564
			1218	2931	453																			
Wife no income marginal	1,657,010		0	901	255	1156	0	0	0	0	0	0	0	0	0	47	54	50	65	685	0	0	0	901
Wife no income 20%	0		0	0	591	591	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Wife no income exempt	334,745		0	324	409	733	0	0	0	0	0	0	0	0	0	80	72	76	74	22	0	0	0	324
marginal	3,160,689		5840	2884	0	8724	5175	310	206	106	33	10	0	5840	563	459	422	411	451	259	172	103	44	2884
20%	-1,649,594		1349	237	331	1917	296	228	256	228	219	82	40	1349	108	105	19	5	0	0	0	0	0	237
exempt	717,732		0	546	359	905	0	0	0	0	0	0	0	0	0	134	97	102	100	48	33	23	9	546
			7189	4892	1945																			
	8,257,677		**8407**	**7823**	**2398**	**18628**	**6259**	**671**	**589**	**398**	**319**	**131**	**40**	**8407**	**804**	**1229**	**1079**	**1013**	**1066**	**2189**	**242**	**138**	**63**	**7823**

Appendix 7: Current income tax registration form

Comptroller of Taxes
P.O.Box 56, St.Helier
Jersey, JE4 8PF

Tel: 01534 440300
www.gov.je/taxmoney

Income Tax Registration Form

If you have already received an Income Tax Return, Effective Rate Notice or Payment on Account request, then you do need not complete this form.

SECTION 1: PERSONAL INFORMATION

1.1 SELF:

Title: .... Surname: ....
(Mr/Mrs/Miss/Ms/Other)

First Name(s): ....

Former name: ....
(maiden name)

(please enter all dates as DD/MM/YYYY)

Address

Postcode

Date of Birth: ..../........../..........

Social Security No: ....

Please indicate: Male: ☐ Female: ☐

Tax Reference: ....
(if known)

Number of Dependent Children: .... **(please supply certified photocopies of birth certificates)**

1.2 SPOUSE OR CIVIL PARTNER:

Date of Marriage or
Registration of Civil Partnership: ..../........../.......... **(please supply a certified photocopy of your marriage certificate or civil partnership registration)**

Title: .... Surname: .... Former name: ....
(Mr/Mrs/Miss/Ms/Other) (maiden name)

First Name(s): ....

Date of Birth: ..../........../..........

Tax Reference: .... Social Security No: ....
(if known)

Contact details: Daytime Number: .... Ext. .... Mobile: ....

SECTION 2: EMPLOYMENT

SELF:

Name of main employer / contractor

....

Occupation: (nature of job)

....

SPOUSE OR CIVIL PARTNER:

Name of main employer / contractor

....

Occupation: (nature of job)

....

IT_REG(08)

PLEASE CONTINUE OVERLEAF:-

IMPORTANT: You must provide accurate estimated income figures, including overtime or other part-time work. Please also notify this office if your circumstances change.

Incorrect information could result in shortfalls in the payment of your tax liability. This could also mean an increased effective rate in the future.

DATE OF ARRIVAL: ..../......./....... **DATE OF DEPARTURE:** ..../......./.......

Contract period: ....

Estimated Income for current year. For all sources of income, please indicate after each amount whether the payment is per week (pw), per month (pm) or per annum (pa).

	SELF	SPOUSE OR CIVIL PARTNER
Employment		
Tips		
Business Profits		
Pensions		
Bank Interest		
Rental Income		
Other Income		

Is your accommodation provided by your employer? Yes: ☐ No: ☐

Do you contribute towards the accommodation? Yes: ☐ No: ☐

If yes please state the total amount: £ ....

Please enter any additional information below such as Jersey employment in previous years, or anything else relevant to your circumstances. Please include details of any Benefits in Kind provided by your employer, other than accommodation.

____

____

____

____

____

____

Signed: .... Date: ..../......./.......
(please enter date as DD/MM/YYYY)

please do not write below this line

Appendix 8: Long term tax policy principles – as per 2012 Medium Term Financial Plan

Appendix Eleven - Long Term Tax Policy for Jersey

Introduction

1453. The Tax Policy Unit has been asked to consider Jersey's long-term tax policy. In this case, "long-term" is taken to mean longer than five years. Advice from the Fiscal Policy Panel is that fiscal policy needs to be focussed on the medium term. The same should apply to tax policy, which forms part of the overall fiscal policy.

1454. It is difficult to be certain about Jersey's long term economic needs and hence tax policy, particularly in such an unstable economic environment. Further, tax policy should be designed to support rather than drive economic and political policy. This paper is therefore based on the current economic and political desires, further details of which are set out in the background section.

1455. It is not the place of a long-term tax policy in itself to be highly prescriptive about the types and proportions of taxes applied. Even in less economically uncertain times, it would be impossible to be able to determine precisely what taxes Jersey should apply in a decade's time. As such, it would be unhelpful to stipulate, for example, the percentage of States revenues which should come from different types of taxes. The policy should set out the principles and objectives on which future tax reform, if any, should be based to achieve the economic and political aims. The policy must also be flexible enough to deal with unexpected future changes.

1456. This paper looks at the recommended principles and objectives of Jersey's long term tax policy, as shaped by economic and political policy objectives. It also goes further to recommend the way forward based on those principles and objectives.

Background

1457. Jersey is a small island economy on the periphery of a large economic power, the European Union. Traditional industries have been agriculture and tourism, and since the mid-1960s, the provision of financial services. As both agriculture and tourism are relatively low value added, successive States have decided that the Island's economic well-being is best served by focussing resources on the financial services industry, on the basis that this is one of the few industries which is high value added with a low requirement for geographical resources. As such, it is suited to a small island with a small population.

1458. In the immediate future it seems unlikely that the balance of industries in the Island will shift dramatically away from finance as it currently exists. This is of course barring any external events which caused the industry to leave, but in such case the Island's economic base would be so fundamentally altered as to render current policy obsolete.

1459. Although Jersey's tax system was, until the zero/ten reform, stable and unchanged over a long period of time, this is unusual. Economic theory on tax has evolved over time – for example the gradual, but inexorable, move away from taxes on income only, to taxes on income and capital including inheritance and capital gains taxes (direct taxes). More recently, globally, states are moving away from a reliance on taxes on income and capital towards taxes on consumption (value added taxes such as GST) and immovable resources (such as taxes on land), known as indirect taxes. Tax bases are broadening rather than narrowing and having a mix of direct and indirect taxes is now considered to make revenues more stable.

1460. Indirect taxes are generally considered to be more efficient for a number of reasons:

- *Difficulty of avoidance. Indirect taxes are more difficult to avoid than taxes on income because they are charged at the point of transaction. There is no onus on the taxpayer to record and report the taxable event.*
- *Ease of collection. Revenue is assessed on and collected by a small number of businesses and not from the population as a whole. There is no onus on the taxpayer to record and report the taxable event.*
- *Broad tax base. Indirect taxes are paid by the whole population, unlike other taxes. As such, rates can be lower because they are more broadly applied. However, where territories exempt a wide range of goods or services, then the tax base shrinks and the rate applied may have to increase in order to raise sufficient revenues.*
- *Less distortionary. Indirect taxes are considered to be less distorting than direct taxes in that they have less of an impact on taxpayer behaviour.*

1461. However, indirect taxes may be considered by some to be less equitable than direct taxes, as those on lower incomes may spend more of their annual income on taxed items and may pay a similar or slightly greater proportion of that income in tax than those on higher incomes. Indirect taxes tend not to contain the progressive element that is contained in most income tax structures. This was a factor Jersey was aware of when introducing GST and as a result the States took steps to minimise the impact on those on lower incomes through increases in Income Support and the introduction of the GST Food Bonus for those on lower incomes but not in receipt of Income Support.

1462. Recent reforms in Jersey have changed the mix of taxes away from reliance on direct taxes following the introduction of GST. Given the generally accepted view that a broad based tax regime which includes a mix of direct and indirect taxes is more efficient, stable and sustainable, GST, income tax and social security are likely to remain key to Jersey's revenues into the future. It should be noted that not all taxes in every category are necessarily required or desirable for every jurisdiction and economic model.

What is tax for?

1463. At its most basic, the purpose of tax is to raise sufficient revenues to meet government spending commitments. (A discussion of the relative merits of meeting spending commitments through tax, borrowing or disposal of capital assets is outside the scope of this paper, as is any discussion of how government should spend its revenues.) Governments of developed countries provide policing, a legal system, health, education, basic infrastructure such as roads and sewerage systems, social housing, a social welfare system etc. Different governments will have different priorities but some or all of the above will typically be provided.

1464. Taxes can also be used for other purposes:

- *Fostering a sense of communal identity. There is an argument that making a financial contribution to the society in which one lives helps individuals to feel more connected to that community, and to hold their government to account.*
- *Redistributing wealth. Taxation is a basic method of taking money from the wealthy and distributing it to the less-well off, whether directly through payments of pensions, child allowances, income support etc, or indirectly through the provision of public services which the wealthier tend to make less use of, such as public health services.*
- *Influencing taxpayer behaviour. Taxes can be used to encourage certain actions or discourage undesirable actions. Examples are duties on health-damaging products such as alcohol or tobacco products or environmental taxes. However, tax is a blunt*

instrument and its effects are unpredictable. Higher taxes which make, for example, imported goods more expensive than their domestically-produced counterparts can make the imports appear of a higher cachet and therefore more desirable.

- *Discouraging avoidance of other taxes. Some taxes are introduced not so much to raise revenue as to discourage avoidance of others. For example, Capital Gains Tax was introduced in the UK to discourage taxpayers from avoiding income tax by converting taxable income into untaxed capital, although in itself raises comparatively little revenue.*
- *Supporting government fiscal policy. Tax policy does have a role, in conjunction with other fiscal policies, in helping getting the balance right for the economic conditions, support counter cyclical policy and possibly to strengthen automatic fiscal stabilisers.*
- *Supporting government social policy. Tax policy can have a role in supporting social policy such as through the provision of tax reliefs and incentives. As with influencing tax behaviour, this can be a blunt instrument unless properly and effectively targeted.*

Jersey's long term economic and political policies

1465. As a small island economy, Jersey's tax policy should support the economic and political aims of the States.

1466. There is no single comprehensive statement which sets out the long term economic and political aims and so these have had to be drawn from a number of sources. Reference has been made to the following in determining the current long term economic and political aims:

- *Recommendations of the Fiscal Policy Panel on Jersey's fiscal policy.*
- *The States approved Strategic Plan 2012 entitled 'Inspiring Confidence in Jersey's Future'.*
- *The draft States Economic Growth and Diversification Strategy.*
- *The States decisions in recent months and years on tax reform including:*
  - *Introduction and defence of the zero/ten tax regime for companies.*
  - *Introduction and retention of a low and broad GST regime, with limited exemptions but with direct measures to protect those on the lowest incomes.*
  - *Introduction of '20 means 20' ensuring those on the highest incomes pay tax at the highest rate*
  - *Retention of the 20% personal tax rate.*
  - *Introduction of a new tax regime to encourage inward migration of wealthy individuals and their businesses.*
  - *Introduction of enhanced child care relief to support working families.*
  - *A desire, as indicated in States debates, to modernise and simplify the personal tax regime, for example through independent taxation and other measures described in recent Budget Statements.*
- *The outcomes of the Fiscal Strategy and Business Tax reviews undertaken in 2010.*
- *Jersey's commitment to comply with international standards on tax matters.*
- *Current financial forecasts.*

Jersey's tax policy must support these aims.

1467. The policy objectives indicated by each of these sources are summarised below.

1468. The key message from the Fiscal Policy Panel relating to tax policy, based on the current state of the Island's finances and the economic climate, is that any change which permanently reduces taxation or increases spending should be accompanied by a compensating measure.

1469. The most urgent priority of the Strategic Plan is getting people into work. This will require economic growth to assist job creation and continued inward investment. It is important that the tax regime encourages economic growth and inward investment and also does not create disincentives for people to take up work when it is available, for example through high marginal rates and in particular where income tax interacts with income support.

1470. The recently published draft States Economic Growth and Diversification Strategy contains the following strategic aims:

- *Encourage innovation and improve Jersey's international competitiveness.*
- *Grow and diversify the financial services sector, capacity and profitability.*
- *Create new businesses and employment in high value sectors.*
- *Raise the productivity of the whole economy.*

1471. The States decided some time ago to focus on the provision of financial services as the Island's main economic activity. Tax reform since then has supported that, through the existence of "corporation tax" companies in the 1970s, the development of the exempt company in the 1980s, International Business Company in the 1990s and currently the zero/ten (0/10) company tax regime.

1472. Until the introduction of 0/10 Jersey was in the fortunate position that a high proportion of its tax revenues came directly from taxes paid by companies. The decision to comply with the European Union's Code of Conduct on Business Taxation, abolish the exempt company and International Business Company regimes and introduce 0/10 has meant that position has had to change. Individual Islanders have been required to contribute more of Jersey's tax revenues, though the introduction of "20 means 20" and GST. ITIS was also introduced which, among other things, allowed tax to be collected from individuals who came to live and work in Jersey for short periods of time and so ensure that more taxpayers paid the tax that was due.

1473. The alternative to introducing 0/10 was either to maintain the former 'non-compliant' regime and face the international consequences or to introduce a single, positive rate of tax for all companies in Jersey. Advice obtained at the time, and subsequently in the 2009 Business Tax Review, concluded that moving to a single, positive rate of tax would have a devastating effect on Jersey's ability to offer a tax neutral vehicle to clients of the finance industry, with a knock-on effect on the industry itself. Maintaining a 'non-compliant' regime would likely have resulted in unilateral action from other jurisdictions which could also have damaged the finance industry. It was estimated that introducing a positive rate of income tax for corporate "clients" of finance industry would result in the loss of up to 12,000 jobs. The financial burden on residents, whether individual or corporate, would have been significantly greater in that circumstance.

1474. This reform has inevitably changed the proportion of revenues raised from the taxation of individuals and the taxation of corporates. As highlighted above, there is a significant risk to the ongoing success of the finance industry, as well as other sectors, and hence a risk to economic activity and employment if there is a shift back in favour of taxation of corporates. Further information on this will be given in the forthcoming report on the taxation of non financial service companies.

1475. The more recent Fiscal Strategy and Business Tax review clearly demonstrated continued strong support to protect the financial industry.

1476. This support for the continued existence of the finance industry in Jersey has appeared to pay dividends. While the finance industry has been adversely affected by the ongoing global economic crisis, its existence still provides the greatest contribution, either directly or indirectly, to Jersey's economy.

1477. However, the risks of being highly reliant on one industry have also been felt. There may be benefit in diversifying the economy but there is also a need to balance diversification with the ability to raise revenues. A strong finance industry which contributes significantly to tax revenues will allow the Island to invest more in diversification.

1478. Current financial forecasts indicate that expenditure can be met from existing revenue sources but without substantial surpluses. This suggests that there is no need to raise any taxes but also there is little, if any, scope to reduce existing taxes. Further, based on the advice from the Fiscal Policy Panel, future surpluses should be used to rebuild the Stabilisation Fund.

What should Jersey's tax policy deliver

1479. Jersey's tax policy must support the economic and political policy objectives noted in the previous section.

1480. In order to do this Jersey's tax regime should have the following features:

- *Stability. Jersey has a reputation for stability in its tax regime, which is a key feature of its global offering. Investors, whether financial services related or not, considering the use of Jersey need to know how they will be taxed for the foreseeable future.*
- *Certainty. This is linked to the point on stability. Changes should be made infrequently, after careful consideration and consultation.*
- *Revenues. Jersey must raise sufficient revenues to meet its spending requirements.*
- *Flexibility. Where a need is identified, whether to attract new business or to defend existing business, Jersey must be able to move quickly.*
- *Competitiveness. In all things, Jersey must ensure that it does not damage the Island's ability to effectively compete for business. In this, the Island must keep aware of events in its key competitors and in the broader world which may affect it.*
- *Efficiency. Any tax changes should distort taxpayer behaviour as little as possible, unless that is one of the reasons for introducing the tax in the first place.*
- *Cost effective. The Fiscal Strategy Review, and resulting decisions by the States to increase GST and social security and retain a maximum income tax rate, suggest that in addition to the factors noted above, taxes should be cost effective for both the States and for taxpayers.*
- *Fairness and equity. These are extremely difficult to define and mean different things to different people. Recent decisions on introducing '20 means 20', the desire to modernise and simplify the tax regime and the introduction of GST 'protection measures' indicate that fairness and equity includes ensuring that the wealthiest pay a greater proportion of their income in tax while those on the lowest incomes are protected. It has also been recognised in recent decisions that the introduction of a competitive tax regime to encourage wealthy individuals and their businesses to Jersey is beneficial to the economy. In the absence of the direct and indirect revenues raised and economic activity derived from this inward migration the burden on taxpayers would be greater.*

Key tax policy principles

1481. With the above in mind, the following principles are recommended:

- *Taxation must be necessary, justifiable and sustainable.*
- *Taxes should be low, broad and simple.*
- *Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected.*
- *Taxes must be internationally competitive.*
- *Taxation should support economic development and, where possible, social policy.*

Taxation must be necessary, justifiable and sustainable.

1482. Taxes should not be raised for the sake of raising taxes, but with an identifiable spending need in mind. For example if a potential new source of revenues is identified, it should not automatically be adopted without considering whether the States has a specific requirement for more revenues, or if existing taxes should be reduced in response.

1483. It should be clear why any new tax is being introduced, and if any one sector or type of taxpayer is more affected, the reasons behind that should be made clear. Where the tax system discriminates between taxpayers, the rationale behind that should be clear.

1484. Taxes should also be sustainable in the long term. As such, it should be clear that revenues can be projected forward with a reasonable degree of certainty. Taxes should also not affect taxpayer behaviour such that the revenue stream dries up, unless that is the intention of introducing that tax to change behaviour, for example where a decision is made to intentionally increase the cost of unhealthy items like alcohol or tobacco.

Taxes should be low, broad and simple.

1485. Much of the output of Jersey's main industries (finance, tourism and agriculture) is exported. As a result, most businesses in the Island depend directly or indirectly on their ability to sell into the global market place. Jersey faces a high degree of competition in all of these sectors, and must remain competitive in order to continue to attract business. Low rates of tax are a feature of this.

1486. Simplicity is also a key selling point for international business, though this is more important for finance than for other sectors. Where a low or zero rate of tax can be obtained in a competitor jurisdiction with relative ease, international business will not be prepared to achieve the same result in Jersey through a number of complicated steps. Complexity adds cost and risk to a transaction, and business may not be prepared to accept either.

1487. Taxes should also be broad; an economy which relies too heavily on one particular sector or type of taxpayer or tax base for revenues will be at risk if that sector, taxpayer group or tax base falters. A broader based tax system, where as many sectors and individuals as possible contribute over a wider taxable base, is a more stable one.

1488. A broader tax base also supports the principle that tax rates should be low, as the greater the number contributing to revenues, the lower the rate of tax that each will be required to pay.

1489. Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest incomes are protected.

1490. The people who live in Jersey should contribute to the cost of the services they receive to the best of their ability. There have been many debates by the States in recent months, including those relating to the rate of income tax, the tax regime for wealthy individuals and the GST regime. The outcome of those debates suggests that the States broadly supports the current structure.

1491. This principle can be viewed from another equally relevant angle i.e. that all taxpayers should pay the tax which is rightly and properly due. To do this both the tax law and the application of that law must be robust.

Taxes must be internationally competitive.

1492. Jersey's tax system must enable it to compete with its key competitors to attract and retain business. This must apply not only to the types of business which currently use Jersey, but also to new business which the Island would wish to attract.

1493. It is important to monitor developments in competitor onshore and offshore jurisdictions and to ensure that there is good communication between government and industry on the best way to ensure Jersey's continued competitiveness.

1494. Compliance with international standards may be needed to ensure that international competitiveness is maintained as to do so can reduce the risk of action being taken against Jersey to deter investment. This is not the only reason for complying with international standards but is an important one.

1495. Taxation should support economic development and, where possible, social policy.

1496. While the tax regime cannot create economic growth in itself, it can work to support economic growth and it is important that it does not hinder it.

1497. Tax policy can support economic growth by reducing distortions in taxpayer behaviour, thereby improving economic efficiency. It can act to encourage economic activity to flourish thereby encouraging growth in employment.

1498. Taxes should not serve to deter investment, employment or diversification or act as a barrier to economic development. For example, the tax treatment of new businesses and start ups should not impose an unnecessary cost which again could act to stifle business growth. In this respect, taxes on income, rather than flat fees or charges, may be less economically damaging.

1499. Tax reforms can also remove incentives to act in a way which is not intended or desired. For example, the interaction of the income support system and the personal tax system should not act to deter people from taking up employment.

1500. Similarly the tax system cannot, and arguably should not, define social policy but where there is a clearly defined objective, and where it can be objectively demonstrated that the tax regime can affect taxpayer behaviour, then it may be appropriate to set taxes accordingly. One example of this may be environmental taxes, where taxes are set to encourage or deter a specific type of environmentally damaging behaviour, and the revenue collected is used to further encourage taxpayers to make "good" choices. Another may be the linking of increases in impôts to the States strategy on deterring alcohol abuse.

The way forward

1501. A direct comparison of Jersey to other jurisdictions such as the UK or other large jurisdictions is not necessarily appropriate in all cases. Being a small island, Jersey does not have the ability to develop a highly diversified economy which includes sectors with substantial geographical resource requirements such as manufacturing. As such Jersey needs a tax policy suited to the economic activity which it can support. Not all taxes will therefore be suitable for or relevant to Jersey and while global trends should be considered, the relevance and suitability of each should be determined by reference to Jersey's economy.

1502. This section takes the tax policy principles, together with the economic and political policy objectives to develop tax policy objectives and a recommended way forward.

1503. Based on the principles set out above, and taking into account the economic and political objectives, the recommended key tax policy objectives are:

- *Supporting economic growth, and hence employment growth, through providing a simple, stable and certain tax regime.*
- *Further supporting growth in employment by ensuring there are no barriers to people taking up employment.*
- *Maintaining international competitiveness through providing a low, broad and simple tax regime which complies with international standards.*
- *Ensuring taxpayers pay the taxes properly and rightly due to ensure that the current tax regime is sustainable and meets the Island's fiscal requirements. This may require simplification of the personal tax regime, enhancing the robustness of the tax legislation and improving enforcement.*

1504. This is not intended to be an exhaustive list of the objectives but those of primary importance.

1505. To meet these objectives the recommended focus of tax policy development in the medium to longer term, in the absence of any substantial factors which change the current policy objectives, is as follows:

- *No fundamental reform of key aspects of the tax regime. In the absence of any unexpected event, whether external or internal, there should be no fundamental changes to the key aspects of Jersey's tax regime being 0/10, a low, broad and simple GST regime and a stable personal tax rate. Fiscal certainty and stability are critical to encouraging economic growth.*
- *Continuing protection of 0/10 for the foreseeable future. This will include not only ensuring that it remains compliant with international standards but also ensuring that tax revenues are safeguarded so that the provision of a tax neutral environment, which is so important to the success of the finance industry, can be sustained.*
- *Ensuring the tax law applies as it is intended. To ensure that all taxpayers pay the amount of tax rightly and properly due, the tax law has to be robust and be drafted to achieve the policy intention.*
- *Consideration of the relationship between tax and social security contributions and benefits to ensure there are no barriers to people returning to work.*
- *Simplifying the personal tax system. Individuals need to understand their tax affairs in order to understand what they are being asked to pay. As Jersey considers the introduction of self assessment for personal tax, it will be necessary to simplify the current complicated regime. This will also help to safeguard tax revenues which in turn*

will assist in achieving a number of the economic and political objectives.

- *Ongoing monitoring of international developments. Jersey does not exist in a vacuum and does not have complete control over the direction its economy takes. International pressures, both governmental and regulatory, will continue to affect the Island and it will be important that these are prepared for, identified and responded to appropriately.*
- *Removal of barriers to competitiveness. Where these are identified, they should be removed. This will continue to be monitored and opportunities to improve competitiveness will be assessed on a regular basis. Flexibility is key. Where opportunities and threats exist, the Island must be alert to identify them and to act quickly in response.*
- *Consideration of the potential to widen the tax base. This would not be undertaken to raise a specific amount of additional revenues but to determine whether there is scope to make Jersey's tax regime more efficient and effective. There may also be opportunities to enhance competitiveness and ensure that everyone makes an appropriate contribution. This will initially focus on the way in which Jersey taxes property as taxes on property are coming under increasing focus globally and is an area which has not been fully explored.*
- *Changes to future tax revenues and States expenditure. The implications of the aging population on Jersey's future revenue and expenditure requirements are an important factor on which a substantial amount of work has already been done. The Tax Policy Unit, as part of Treasury, is linked in to this process and will, if necessary, consider the extent to which tax reform can or should be used to address the funding needs.*