Treasury and Resources
Tax Policy Unit

Report on Jersey's Business Tax Regime

1 Purpose of the review

1.1 The purpose of this report is to set out the key findings and recommendations from the Business Tax Review undertaken by the Tax Policy Unit during 2010 and 2011.

1.2 The report is structured as follows:

2 Executive summary

2.1 The Business Tax Review was started in January 2010 following concerns raised by the EU Code of Conduct Group.

2.2 A public consultation was completed in September 2010. The review was however put on hold pending the outcome of the Code Group's assessment of Jersey's business tax regime.

2.3 In May 2011 the Treasury Minister proposed, and the States then agreed, legislative amendments which aimed to remove elements of our legislation that were considered harmful by the Code Group.

2.4 At its meeting on13 September 2011, the Code of Conduct Group accepted that Jersey's rollback proposal would remove the harmfulness of the company tax regime. This has still to be ratified by ECOFIN in December at the end of the Polish Presidency.

2.5 Accordingly, no further substantial changes are envisaged with the exception of the continuing review of how we tax or charge non-financial services companies. The Business Tax Review has therefore been substantially completed.

2.6 For completeness, this report is being issued now to summarise the findings of the various aspects of the review which were undertaken and in particular to publish the responses to the consultation.

3 Scope of the review

3.1 In 2009 the Minister for Treasury and Resources announced a review of Jersey's business tax regime as part of the wider Fiscal Strategy Review.

3.2 The purpose of the review was threefold:

- To understand the nature and focus of the international pressure then being applied to change Jersey's corporate tax system;
- To protect existing corporate tax revenues; and
- To determine whether an alternative regime or changes to the existing regime could result in an increase in tax revenues, while addressing international concerns and protecting the finance industry.

3.3 The review started in January 2010. Given the importance of understanding the nature and focus of the international pressure to make changes to the regime, this review could not be completed until the EU Code of Conduct (Business Taxation) Group's assessment had been completed.

3.4 The Code Group reviewed the regime including the deemed distribution and attribution provisions and reported to ECOFIN in June 2011. The conclusion of that part of the review was that elements of the regime gave rise to harmful effects. This has already been fully reported and is therefore not covered in detail in this report.

3.5 Action was taken to deal with the harmful effects and the deemed distribution and attribution rules were repealed with effect from 31 December 2011.

3.6 The Code Group considered the action taken by Jersey at its meeting on 13 September 2011 and accepted that the rollback proposal would remove the harmfulness of the regime. This is subject to ratification by ECOFIN in December 2011.

3.7 An amendment to Budget 2011 requested the Minister for Treasury and Resources to bring forward proposals to raise additional revenues from certain non-financial services companies trading in Jersey, provided that to do so would not jeopardise the integrity of Jersey's business tax regime or its international competitive position. This issue forms part of the wider business tax review and the outcome of a review into this is set out in this paper.

3.8 The work undertaken in this review falls broadly under the following headings, which have been carried out simultaneously

- Understanding the nature and focus of the international pressure to change the regime, involving close engagement with HM Treasury, the EU Commission and the Code Group.
- Engagement with the public and business through full consultation[1].

[1] Business Tax Review, A Public Consultation on Corporate Taxation, June 2010. See Appendix 1.

- Research into other types of corporate tax regimes and changes that could be made to the existing regime.
- Detailed research into methods for raising additional revenues from certain non-financial services companies.
- Full economic impact review of the options, including those in relation to non-financial services companies.

3.9 It should be noted that the review of other company tax regimes did not progress to detailed design stage, as early in the process, in light of the consultation responses and early indications from the Code Group, it was clear that the review should focus on whether maintaining zero/ten was feasible and sustainable.

4 Key findings

4.1 The clear outcome of the Code Group's assessment was that the personal tax anti-avoidance rules, the deemed distribution and attribution provisions, fell within the scope of the Code and gave rise to harmful effects.

4.2 There was nothing in the Code Group's findings to indicate that the concept of zero/ten in itself would give rise to harmful effects. This is further supported by the findings of the Code Group in 2003, confirmed by ECOFIN at that time, which concluded that zero/ten did not give rise to harmful effects. This was prior to the introduction of the deemed distribution and attribution provisions.

4.3 The overwhelming response to the public consultation was that before considering any changes to the regime, the Government should fully understand the focus of the international pressures to change.

4.4 The majority of responses to the consultation also stated that zero/ten was preferable to any of the other options and should be maintained, amended if necessary to ensure it is compliant with the Code.

4.5 The majority of respondents to the consultation supported the principles set out in the consultation document, particularly those of simplicity, certainty and the provision of tax neutrality.

4.6 A review of the alternative corporate tax regimes, including the economic impact analysis, concluded that moving to an alternative regime, when Jersey's key competitors were not moving to a similar regime, would not increase tax revenues. In most cases, it would reduce tax revenues, and in some cases this would be significant, either due to the complexity of the regime, perceived instability in the tax regime or the uncertainty in providing tax neutrality in some key sectors.

4.7 In respect of non-financial services companies, distinguishing between locally and non-locally owned companies would likely have an adverse economic impact and could be seen as discriminatory.

4.8 Introducing a charge instead of a tax for non-financial services companies would have an adverse economic impact, particularly in terms of Jersey's ability to attract new business, and is not an efficient or effective method of raising revenues. This would be a cost to business and would not be based on ability to pay.

4.9 Subjecting non-financial services companies to corporate tax at 10% is also, in some circumstances and particularly for UK-owned companies, an additional cost of doing business although it would be based on profits and therefore the ability to pay.

4.10 In order to protect zero/ten from future challenge by the EU Code Group it is critical that the general rate of tax for companies in Jersey is demonstrably 0%.

4.11 The recent business tendency survey[2] suggests that while financial services companies are optimistic about the future and seeing signs of recovery, the same does not apply to non-financial services companies for which 9 out of 10 of the indicators were negative. In addition, there is a risk that increasing the cost of doing business in Jersey through either charges or corporate tax would result in increased prices of goods and services for Jersey companies.

5 Recommendations

5.1 Based on previous recommendations, the Council of Ministers decided that it was important to continue to engage with HM Treasury, the EU Commission and the Code Group to fully understand the nature and focus of the international pressure to change. The outcome of this was that the Code Group carried out its assessment which indicated that there was concern with the deemed distribution and attribution rules.

5.2 Based on this, and full consideration of the financial implications, it was recommended to the Council of Ministers in February 2011 that the deemed distribution and attribution rules were repealed. The Income Tax (Amendment No. 38) (Jersey) Law which repealed these rules with effect from 1 January 2012 was approved by the States on 7 July 2011.

5.3 The subsequent review of the rollback proposal by the Code Group resulted in acceptance that the repeal of the deemed distribution and attribution provisions removes the harmfulness of the regime.

5.4 A move away from zero/ten is not recommended for a number of reasons which are set out more fully in Section 8. The key reason is that fundamentally changing the regime so soon after its introduction, and with no demonstrable reason for doing so, would damage Jersey's reputation for stability and fiscal independence and would create uncertainty, hindering Jersey's ability to attract new business.

5.5 Additional revenues should not be raised from non-financial services companies in a way that discriminates between locally and non-locally owned companies. Therefore any changes must apply to all companies regardless of ownership.

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[2] Jersey Business Tendency Survey June 2011
http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=601

5.6 Given the current economic climate and the risk that introducing a charge or tax for non-financial services companies will result in an increase in prices of goods and services for Jersey consumers, it is strongly recommended that the corporate tax position of these companies is not changed for the time being.

5.7 It is recommended that raising revenues by means of a charge is not considered further as it is likely to have the most detrimental economic impact, particularly given the current economic climate for non-financial services companies.

6 Outcome of the Public Consultation on Business Taxation

6.1 A summary of responses is included in Appendix 2.

6.2 The key points arising from the consultation responses are[3]:

- Zero/ten, in compliant form, is considered to be the most appropriate regime for Jersey.
- A territorial system was the favoured option of the others proposed in the consultation document, although reservations were noted.
- It was premature to consider other tax regimes without knowing the outcome of the Code Group assessment.
- Some features of zero/ten were considered to be unfair with particular note made of the deemed distribution and attribution rules which only affect Jersey resident shareholders.
- There was limited support for negotiating double tax agreements in preference to maintaining a tax neutral system.
- The principles of simplicity, certainty and tax neutrality were considered the most important.

7 Economic impact analysis

7.1 A review of the economic impact analysis was carried out which examined the different options for corporate tax regimes explored in the consultation and the impact of alternative ways of raising revenues from non-financial services companies.

7.2 The analysis focused on the impact on the financial services industry, given Jersey's high dependence on this sector and the indirect effect this has on the rest of the economy.

7.3 Consistent with views expressed before the introduction of zero/ten, non-resident customers of the finance industry are highly sensitive to the taxation of Jersey companies. In addition, there is a high degree of sensitivity to the complexity of achieving tax neutrality and perceived stability.

7.4 In particular it was noted that the absence of a relatively simple tax-neutral corporate vehicle for the customers of the international financial services

[3] These comments represent those which reflect the majority of views. Other comments which do not are included in Appendix 2.

industry would have a significant impact on the provision of trust services from Jersey. Long-term stability of the corporate tax regime is also important. In the absence of these characteristics most, if not all, of this part of the finance sector would disappear over a relatively short time period resulting in job losses of up to 10,000[4] and tax revenue losses of more than £100m.

7.5 In addition, the absence of a tax-neutral corporate structure for some providers of financial services would lead to some, but not necessarily all, of that business relocating to another jurisdiction.

7.6 The overall conclusion of this analysis was that the zero/ten regime is the only regime that maintains the existing level of financial services activity. All other regimes, in pure form, are likely to result in significant loss of employment ranging from approximately 600 to 10,000 jobs.

7.7 Although the overall tax revenues may be marginally higher with a territorial or transparent regime (£5-10m), this is based on the assumption that Jersey's key competitors move to a similar regime and so Jersey's competitive position is maintained.

7.8 The analysis further recognises that undertaking a fundamental change to the tax regime would likely introduce further uncertainty which would have, at least in the short term, a negative impact on Jersey's competitive position.

7.9 In order to provide the level of tax neutrality that zero/ten delivers, and which is important to maintain the current level of activity within the financial services sector, all of the other regimes would need some form of differentiating factor from the pure form. Again this leads to complexity and in some cases the differentiating factor may not be acceptable internationally and therefore not achievable.

7.10 The impact of introducing a charge or increasing the level of corporate tax on non-financial services companies has also been analysed.

7.11 In both cases, the effect is to increase the cost of doing business in Jersey.

7.12 Consideration was given to the potential impact on prices. It is difficult, if not impossible, given all the other factors that affect prices which have been particularly acute in recent years, to determine whether the move to zero/ten reduced prices (or reduced the increase in prices) and therefore whether increasing the cost of doing business by introducing a charge or increasing corporate tax would increase prices further.

7.13 The effect of introducing a charge is particularly negative in relation to start-up businesses which are unlikely to be profitable. Such a mechanism would therefore work to stifle economic growth through deterring new business.

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[4] This refers to both finance industry jobs and those reliant on the success of the finance industry.

8 Maintaining zero/ten

8.1 Maintaining zero/ten has a number of advantages. Primarily it maintains the current level of financial services activity and therefore protects the Island's tax revenues.

8.2 From the outcome of the Code Group assessment there is no indication that Jersey cannot maintain a general rate of 0%.

8.3 There is no international standard which determines a minimum rate of corporate tax.

8.4 The responses to the consultation are overwhelmingly supportive of maintaining zero/ten in a compliant form.

8.5 Further to the removal of the deemed distribution and attribution rules, and based on all of the evidence, zero/ten is considered to be compliant with the Code. The repeal of these provisions also removes a particularly complex piece of legislation which was perceived to create an unfair difference between locally and non-locally owned companies.

8.6 Removal of these rules therefore addresses both the international and domestic concerns.

8.7 The financial implications of removing these provisions have been reviewed in detail. It is extremely difficult to determine the tax effect as there has not yet been a full year of tax returns showing the effect of these rules. In addition, much will depend on taxpayer behaviour.

8.8 For a number of reasons, the primary effect is expected to be a deferral of tax rather than an absolute loss of tax. Those reasons include less incentive to reduce tax liabilities since the tax rate is relatively low, the likelihood that many profits will be distributed in taxable form over time, and the use of Jersey's general anti-avoidance rule to counter non-commercial tax structuring.

9 Moving to a different regime

9.1 A summary of the advantages and disadvantages of each option is set out in Appendix 4.

9.2 In all cases it is possible to provide a form of tax neutrality, which is a key principle of Jersey's corporate tax regime.

9.3 However, in all cases, this is provided in a way which is more complex and sometimes less transparent than with a general rate of 0%.

9.4 In some cases, tax neutrality can only be provided in very specific circumstances which would result in the loss of substantial activity in the finance sector.

9.5 Evidence suggests that a move to an alternative regime, particularly in the absence of an international standard and so soon after introducing zero/ten, will result in uncertainty in the future tax regime which will have a detrimental impact on the finance industry and hence to the economy of Jersey.

9.6 A number of the options would require an extensive double taxation agreement network which is subject to other jurisdictions being willing to negotiate and so, to a great extent, is outside the control of the Jersey authorities. Also, even with a willing party, such agreements can take several years to negotiate.

Wendy Martin
Director of Tax Policy
23 September 2011

Appendix 1: Consultation questions
(Extract from Business Tax Review – A public consultation on corporate taxation)

Responses are invited to the following questions from all business sectors, whether or not directly affected. Please provide as much detail as possible to support your response.

1. Introduction and background

a. Page 3 refers to the presumption that our good neighbour policy would be reciprocated by EU Member States. What reciprocal benefits would you attach highest priority to in return for continuing to be a good neighbour if such reciprocal benefits were achievable?

b. A level playing field is important to protect Jersey's international competitive position. What barriers are there to achieving this and who are the key players on that field?

2. Why review Jersey's business tax regime?

a. Page 10 refers to the business limitations Jersey sometimes faces in the absence of an extensive double tax treaty network. Are the potential benefits to be gained from a comprehensive DTA network greater than maintaining a 0% rate of tax or another form of tax neutrality?

3. Business tax: Key principles for the future

a. In your view, how will international standards on business tax develop in the future and should Jersey seek to lead the way on developing and implementing such standards?

b. Are there any key principles other than those set out on page 11 that need to be met?

4. Examples of alternative structures

a. Other than those examples included in this consultation document, are there any other alternative structures that meet all of the key principles and so should be considered?

b. What do you consider to be the key risks of moving away from our 0/10 regime generally?

c. What would be the best regime to maintain, diversify and grow business (financial services and non-financial services) in Jersey and what business would benefit?

In respect of each of the examples set out in this section:

1. Flat rate of corporate tax
2. Treatment as transparent
3. A territorial system of tax
4. Repayable tax credits
5. Abolition of corporate tax

d. What impact would the regime have on Jersey as a place to do international business and on the business you do?

e. What features of the regime would be problematic and what features would be beneficial to your business?

f. What would your business's response be to a move to each regime?

g. What do you consider to be the key risks and opportunities of moving to each regime?

h. What opportunities for new business would each regime present?

5. Any other comments

a. Please provide any other comments you may have in respect of this review.

Appendix 2 : Summary of consultation responses

Summary of consultation details

This report summarises the responses to the Green Paper on Business Taxation, which was issued on 21 June 2010. The consultation period ran until 13 September 2010.

In total, there were 47 responses to the Green Paper, of which 10 were from individuals, 26 were from businesses and 11 were from representative bodies. Of the 37 responses from businesses or representative bodies, 9 were from organisations that are not involved in, or do not have an interest in, the finance industry. 17 were from accountancy and law firms with a mixed clientele of financial services and non-financial services, or from their representative bodies. 10 of the remaining organisations were either directly involved in the financial services industry or are representative bodies of sectors of that industry. One respondent is a body with an interest in tax matters generally.

Generally the submissions from those entities that are not involved in the finance industry do not differ to any great extent from the submissions from the finance industry.

A list of the organisations which responded to the Green Paper is included at Appendix 3.

This report summarises the main thrust of the opinions submitted.

Overview of consultation responses

1. The majority of respondents feel that 0/10 is the most appropriate company tax regime for Jersey.

2. They consider that the States should engage with the EU Code Group in order to identify what, if anything, is harmful about 0/10 and if necessary make changes to make 0/10 compliant.

3. Many respondents consider that 0/10 in its current form has deficiencies; in particular it is unfair that non-Jersey owners of non-financial services companies do not pay Jersey tax on the profits generated in Jersey.

4. Respondents also note that the deemed distribution regime is complex and difficult to administer and understand.

5. Most respondents felt that until the precise nature of any objections by the Code Group are understood, it would be premature to evaluate the impact of any other company tax regime. Most respondents did not therefore offer any evaluation of the impact of each potential regime.

6. Those who did evaluate the alternative tax regimes discussed in the green paper indicated that a territorial system of taxation would, on balance, be the preferred option. Respondents were not asked to evaluate 0/10 but many who responded on this point volunteered the opinion that despite this, a territorial system was less preferable than the 0/10 regime.

7. However certain industries, in particular the fund management industry, would be likely to be adversely affected by a territorial regime and there are a large number of technical issues that would need further investigation.

Minister's response to the consultation

I would like to thank all those who took the time to respond to the Green Paper. All of the responses are being considered carefully and will influence the outcome of the Business Tax Review.

In particular, I appreciate the view expressed in the responses that Jersey should ensure that it is seen to offer a stable and certain tax system.

Background to the review

In the 2010 Budget speech the Minister for Treasury and Resources committed to review Jersey's business tax regime in conjunction with the Fiscal Strategy Review.

The review was prompted by a number of factors, including:

Jersey's continued commitment to international standards
Jersey remains committed to complying with international standards as is evident from the recent IMF and Foot Reports and Jersey's inclusion on the original OECD white list. International standards are by their nature fluid and Jersey needs to ensure that its corporate tax regime can accommodate future developments.

International focus on lower tax jurisdictions
International views on tax are changing rapidly, with increased focus on lower tax jurisdictions. This has manifested itself in a number of forms, including the EU Code of Conduct Group's review of the 0/10 tax regime, unilateral measures taken against Jersey by other territories, and barriers being presented to Jersey's ability to negotiate Double Tax Agreements (DTAs) with other territories.

Increasing international competition
Jersey is an international business centre and so competes for business on a worldwide basis. The use of competitive tax rates and regimes as a policy and economic tool is commonplace in many jurisdictions.

Jersey's fiscal strategy
The outcome of the Business Tax Review should support the work of the Fiscal Strategy Review, by ensuring that tax revenues are not materially disadvantaged and if it is sustainable and commercially feasible certain businesses should contribute more to Jersey's economy.

Summary of responses

A summary of the responses to each of the 12 questions asked is included here.

Question 1a: "Page 3 refers to the presumption that our good neighbour policy would be reciprocated by EU Member States. What reciprocal benefits would you attach highest priority to in return for continuing to be a good neighbour if such reciprocal benefits were achievable?"

Most responses to this question said that the following should be of the highest priority:

- Negotiation of Double Tax Agreements (DTAs)
- Removal of all discriminatory practices including removal from official and unofficial blacklists
- Being treated like any other reputable third country wanting to trade with the EU
- Access to EU directives such as the Parent-Subsidiary Directive and UCITS Directive

Question 1b: "A level playing field is important to protect Jersey's international competitive position. What barriers are there to achieving this and who are the key players on that field?"

Most respondents did not answer this question. Those who did indicate that there is a perceived lack of desire on the part of key markets such as the EU and US to grant Jersey access on a level footing.

Key players frequently identified included:

- EU member states generally, and in particular Malta, Luxembourg, Ireland and the UK
- Switzerland
- Liechtenstein
- Hong Kong
- Singapore
- Guernsey
- Isle of Man
- British Overseas Territories
- Government officials and key policy makers

Question 2a: "Page 10 refers to the business limitations Jersey sometimes faces in the absence of an extensive double tax treaty network. Are the potential benefits to be gained from a comprehensive DTA network greater than maintaining a 0% rate of tax or another form of tax neutrality?"

Only one unqualified positive response was received to this question, which indicated that the funds industry would benefit from a comprehensive Double Tax Agreement (DTA) network, while it could also allow new business opportunities to develop such as in the area of intellectual property holding companies.

Most of the other responses either answered in the negative or were unsure. Respondents generally said that while a DTA network could potentially improve Jersey's competitiveness, this should not be done at a cost to Jersey's ability to offer tax neutrality.

Concern was also expressed over the length of time needed to negotiate a DTA network.

Question 3a: "In your view, how will international standards on business tax develop in the future and should Jersey seek to lead the way on developing and implementing such standards?"

Many respondents to this question felt that there were no international standards in tax generally, or in tax rates in particular. Amongst those who felt that some common practices could be identified, the following were suggested:

- Moves towards a more territorial system of taxation, though some respondents felt that larger countries would seek to ensure that as many profits were recognised in their country as possible
- Lower company tax rates generally
- Increased transparency and exchange of information

The majority of responses said that Jersey should not seek to lead the way on developing and implementing international standards, with only one response suggesting that Jersey should take an active lead in this area.

Respondents generally felt that Jersey should be prepared to react and respond to new developments, but concern was expressed that Jersey should not make itself uncompetitive by adopting measures before its competitors. Respondents felt it was important that a level playing field should exist before Jersey adopted new standards.

A number of respondents felt that it was unrealistic for Jersey to expect to be in a position to lead in developing new standards because of its relative lack of influence in the bodies that create these practices. Some questioned whether it was appropriate for Jersey to continue to engage with developments in which it could have no hand in creating. One respondent suggested Jersey should join the OECD to address this perceived lack of influence.

Question 3b: "Are there any key principles other than those set out on page 11 that need to be met?"

Most of the responses to this question indicated agreement with the principles identified in the Green Paper. Respondents said that the key features of any new tax regime should be that it should be simple to understand and administer, and that it should offer businesses certainty regarding their tax treatment. The ability to offer tax neutrality was considered important, and the regime should be one that allowed access to international markets provided that neutrality was not compromised.

Question 4a: "Other than those examples included in this consultation document, are there any other alternative structures that meet all of the key principles and so should be considered?"

The majority of respondents felt that the current 0/10 regime was the most appropriate regime for Jersey. A small number of alternative types of tax regime were suggested and these have been considered.

Question 4b: "What do you consider to be the key risks of moving away from our 0/10 regime generally?"

Respondents were mostly concerned about the message that changing the tax system so soon after the introduction of 0/10 would create among businesses. It was felt that Jersey's reputation for stability would be damaged and the uncertainty this would create would hinder Jersey's ability to attract new business. Some respondents said that the speculation regarding the mere possibility of moving away from 0/10 had already caused some damage.

A number of responses said that there was a potential risk in Jersey being seen to make a change as a result of pressure from the EU or outside agencies.

There was a strong message that any new regime that could not allow Jersey to provide a tax neutral vehicle would be extremely damaging to the Island.

Respondents noted that mobile international businesses may move their business away from Jersey relatively easily and that any increases in their tax rates is likely to cause those without strong ties to the Island to leave. One respondent noted that Jersey's ability to provide the high level of public services which it enjoys would be damaged by the loss of tax revenues from this international business.

Two responses said that there would be no risks associated with changing the tax system provided the new regime was clearly understood by clients and potential clients.

Question 4c:"What would be the best regime to maintain, diversify and grow business (financial services and non-financial services) in Jersey and what business would benefit?"

A strong preference was expressed for retaining 0/10, amended to satisfy the Code Group if necessary, over introducing any other tax system.

Many respondents considered that it was premature to consider other tax regimes when the outcome of the EU Code of Conduct Group's review of 0/10 was incomplete. They felt that it was important to understand what objections, if any, the Code Group had to 0/10 and if possible to amend 0/10 so as to satisfy the Code Group.

Of those who expressed an opinion on the five alternative regimes identified in the Green Paper, most favoured a territorial regime although they noted reservations which are discussed further below.

One respondent expressed a preference for a flat rate of tax regime.

Questions 4d – h: "In respect of each of the examples set out in this section:

1. ***Flat rate of corporate tax***
2. ***Treatment as transparent***
3. ***A territorial system of tax***
4. ***Repayable tax credits***
5. ***Abolition of corporate tax***

d. What impact would the regime have on Jersey as a place to do international business and on the business you do?

e. What features of the regime would be problematic and what features would be beneficial to your business?

f. What would your business's response be to a move to each regime?

g. What do you consider to be the key risks and opportunities of moving to each regime?

h. What opportunities for new business would each regime present?"

A significant number of respondents felt that it was premature to consider the impact of introducing a new company tax regime until the EU Code of Conduct Group had completed its assessment of 0/10. As a result, not all respondents to the Green Paper gave their views on the individual tax regimes identified in the consultation document.

Most of the respondents who did comment on this section did not reply to the specific questions posed, preferring instead to write about the regimes in broader terms.

On balance, the respondents considered that the territorial regime could be the most appropriate of the five examples presented in the Green Paper, though they identified a number of technical and practical issues that will require further consideration. The other types of regime were considered to have significant disadvantages.

Question 5a: "Please provide any other comments you may have in respect of this review."

A range of views were expressed in this section. Some of the common themes were:

- It is premature to consider moving away from 0/10 until the result of the EU Code of Conduct Group's review of 0/10 is complete
- Speculation on the possibility of changing the tax system so soon after the introduction of 0/10 has caused damaging uncertainty among the business community
- This uncertainty should be resolved as quickly as possible
- 0/10 should be retained if possible, though if necessary with amendments to satisfy the Code Group
- Some features of 0/10 are unfair
- All companies that carry on a business in the Island through a permanent establishment here should pay tax here
- The deemed distribution rules are unnecessarily complex
- Jersey should not consider tax increases until it controls government spending
- If it is decided to change the tax system, existing companies should be permitted to continue to use 0/10 for a set period of time in order to allow them to adapt to the new regime. Suggestions of the length of time that might be appropriate varied from six to twenty years
- Consideration should be given to how the tax system as a whole meets Jersey's needs
- Any changes to the tax system should support a vibrant and diverse finance industry

Comments made by individual respondents which did not reflect the majority of views noted above included:

- Fundamental concessions should not be made in return for reciprocal tax benefits
- Jersey should join the OECD in order to improve its bargaining power
- All taxpayers, companies and individuals, should pay tax at the same rate
- A flat rate of tax system would be beneficial as it would be easier to administer than 0/10
- The three Crown Dependencies should act in unison regarding their corporate tax systems

Appendix 3: List of organisations responding to the consultation

Accountancy Shop
BDO Alto
Bedell Group
Carey Olsen
Chartered Institute of Taxation, Jersey branch
Collins Stewart
CPA Global
Deloitte
ETF Securities
Ernst & Young
Grant Thornton
HLB Jackson Fox
HSBC
IFC Forum
Institute of Directors
Jersey Chamber of Commerce
JEC
Jersey Farmers' Union
Jersey Finance Limited
Jersey Hospitality Association
JSCCA
Jersey Small Business Forum
JTC Group
KPMG
New World Trust
Ogier
Petrofac
PricewaterhouseCoopers CI LLP
PWA Limited
RBS International
Romerils
Standard Chartered Jersey Limited
Tax Research LLP
VerrasLaw
Volaw
Walkers

Appendix 4 : Summary analysis of the options

A form of territorial system

Overview

Companies would only be subject to tax on income that has its source in Jersey. Non-Jersey source profits would not be subject to Jersey corporate tax.

Detailed description

In a territorial system, the concept of residence becomes largely irrelevant[5]. A company's tax liability is calculated by reference to the source of its income, with only profits sourced from that jurisdiction being subject to tax in that jurisdiction.

Variations of this regime operate in a number of territories, including France, Gibraltar, Cyprus, Hong Kong and Singapore. The UK is also moving towards a partial territorial system with the introduction of an exemption from UK tax on foreign profits.

There are broadly three recognised variations of a territorial regime.

i) The first model taxes all income "arising in or derived from" a territory. The nature of the income is not relevant and so this would capture all types of income, including trading, rental and investment income arising in or derived from that territory. This regime is largely employed by Gibraltar[6], although Gibraltar also exempts most investment income regardless of its source.

ii) The second model, employed in Hong Kong, taxes companies only on the income arising in and derived from "business activities carried on" in the territory. Profits that arise in a territory but are not earned by a company carrying on a business – for example certain investment income[7] and rental income – are not subject to tax there.

iii) A third model taxes companies on the income derived from business carried on through a permanent establishment in a territory. In this model, a company that did not have a permanent establishment in Jersey would not be subject to Jersey tax on any of its profits. A company with a permanent establishment in Jersey would only be subject to tax on Jersey source profits which are directly attributable to that permanent establishment. Certain investment income, such as passive bank deposit income, could therefore fall outside the scope of Jersey tax even if it is Jersey source.

Below is a summary of the main advantages and disadvantages of this regime.

Advantages

- All businesses that have a genuine trading activity in Jersey would be subject to Jersey tax.
- Companies with no Jersey source income should be able to achieve tax neutrality under any form of a territorial system.

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[5] Residence is only relevant in a territorial system in determining the source of income paid by that company.

[6] Gibraltar also currently taxes income "received in" Gibraltar although revised law appears to have removed this condition for companies.

[7] Locally sourced investment income directly related to the carrying on of business activities is subject to tax.

- Recent changes to a number of jurisdictions' tax regimes suggest a move away from taxing on a residence basis and towards a territorial basis and so arguably a territorial basis of taxation might be internationally acceptable.
- More businesses will be subject to tax, which could result in a small increase in tax revenues. The economic impact analysis suggests that this is only likely if Jersey's key competitors moved to a similar regime. It is far from certain that this could be achieved.

Disadvantages

- As experienced in Hong Kong, which has developed a substantial body of case law, a territorial system which relies on ambiguous definitions may be open to interpretation, creating a lack of certainty about tax treatment. If such a regime was introduced in Jersey, the application of the legislation would need to be clear and easy to interpret.
- Under the territorial model employed by Hong Kong, income derived from Jersey such as bank interest, dividends from Jersey companies and transactions between Jersey entities would be treated as arising in Jersey and therefore subject to tax. Specific exemptions for certain investment income, such as those operated in Gibraltar, would be needed to ensure local source passive income falls outside the scope of Jersey tax.
- The economic impact analysis concludes that moving towards a more complex regime, which this clearly represents, will create uncertainty and in the short term will likely have a negative effect on Jersey's competitive position.

<u>Flat rate of corporate tax on worldwide income</u>

Overview

The corporate tax rates currently imposed would be replaced with one positive standard rate of tax applicable to all companies.

Detailed description

A standard rate of corporate income tax would be imposed on the worldwide income of all Jersey companies and on the profits of Jersey branches of foreign companies. This regime is similar to the regimes operated in numerous countries.

The following features could be incorporated into such a regime:

- An exemption for dividends received from participating holdings in subsidiary companies;
- An exemption for income, profits and gains of funds and securitisation vehicles;
- A tax transparent vehicle, whether by election or not, which still provides corporate protection for shareholders. Any profits arising from a permanent establishment would however still be subject to tax.

A number of EU jurisdictions have tax transparent vehicles, such as the UK Limited Liability Partnership (LLP), the French Société en nom collectif (SNC) and the Luxembourg SICAR (when established as an SCS).

Other exemptions may be required to provide the extent of tax neutrality which exists under zero/ten. In the absence of such exemptions, and hence tax neutrality, significant financial loss is likely to arise.

Below are the main advantages and disadvantages of this regime.

Advantages

- This regime is operated in most countries and as such would be internationally acceptable.
- This regime may enable Jersey to negotiate double tax agreements in the longer term which might mean Jersey could attract certain business activities which it currently cannot. Note however the potential limitations of this below.

Disadvantages

- Those highly mobile financial and other service providers and their customers that are currently taxed at 0% are likely to be deterred from establishing themselves in Jersey, and existing businesses are likely to move to lower tax jurisdictions in the absence of a specific exemption for their activities or a DTA.
- Double tax agreements can take considerable time to conclude and so it could be several years before Jersey has a significant network of double tax agreements in place. In the meantime Jersey would be at a significant disadvantage to other jurisdictions including a number of EU Member States that compete in financial services.
- In the absence of an extensive network of double tax agreements, tax paid in Jersey would represent an absolute cost in many instances. This would make Jersey significantly less competitive than other territories with a similar rate of tax but with access to a treaty network and with those with a no or a lower rate of corporate tax.
- Most EU jurisdictions that operate participation and other exemptions from tax do so in conjunction with a raft of anti-avoidance rules designed to prevent profits escaping tax. Jersey may need to introduce similar measures, which would have an attendant administrative burden and cost.
- This system can be complex due to the need for anti-avoidance and a range of exemptions to maintain competitiveness. As such, it would entail a significant amount of time and cost to administer correctly.
- The economic impact of this regime would be significantly negative, with the potential loss of jobs in the region of 10,000 and decrease in tax revenues in the region of £80m.

<u>A refundable tax system</u>

Overview

Jersey resident companies would be subject to tax on their worldwide profits at the standard rate, with a credit for overseas tax suffered. On distribution, shareholders could reclaim a proportion of the tax suffered, leading to a lower effective rate of tax overall.

Detailed description

Maltese model

This regime is operated in Malta, where resident companies are subject to tax at the standard rate of corporate income tax of 35% on the majority of their profits.

Companies are required to divide their income into five separate accounts, as follows:

Class	Source of profits
Final tax account	Profits that benefit from special exemptions under Maltese law such as qualifying income derived from overseas subsidiaries and income derived from the transfer of immovable property situated in Malta
Immovable property account	Profits derived from local immovable property and dividends paid out of profits allocated to the immovable property account of another company
Foreign income account	Foreign-source passive income and income derived from a foreign permanent establishment
Maltese taxed account	Profits that do not fall into the classes above
Untaxed account	Any difference between distributable profits per the accounts and the sum of the four classes above

When a distribution is made, the company is required to state out of which class of profits it has been paid. The class then determines the treatment in the hands of the shareholder. For foreign shareholders, an effective rate of between 0-5% is often achieved through a tax repayment mechanism although the repayment is not made until there is a distribution. Until the distribution is made, the effective rate of tax is 35%. The tax repayment is made within 14 days of the claim.

Potential model for Jersey
The Maltese tax system in general is more complex than that which could be operated in Jersey, with a number of features which are not considered necessary. It would not be appropriate, for example, to import rules distinguishing between resident and domiciled companies, nor to introduce capital taxes.

If Jersey were to adopt a tax repayment system similar to that operated in Malta, it is envisaged that it would have the following distinguishing features:

- Profits of utility companies and domestic property investment/development income would continue be taxed at 20% and no repayment of that tax would be made.
- Some form of statutory double tax relief would be available in respect of foreign tax paid.
- There would be no tax refund in respect of trading profits arising from a permanent establishment in Jersey.
- A participation exemption would be provided for in the law in order to exempt dividends received from subsidiary companies from tax.
- Consideration would be given to whether Jersey intended to operate the untaxed account.

While Malta has a separate system for taxing funds and their investment holding companies, this would be unnecessary in Jersey as such vehicles should be able to benefit from the new fund and securitisation vehicle exemption regime, introduced in 2010

Below are the main advantages and disadvantages of this regime.

Advantages

- The tax repayment regime has been reviewed by the EU and found to be in accordance with the Code of Conduct in Malta's case.
- International businesses that use Malta are familiar with the regime.
- The regime allows foreign owned investment vehicles to achieve tax neutrality or a very low effective rate of tax.

Disadvantages

- The system is complicated to understand and expensive to administer for both taxpayers and the tax authorities.
- Businesses that have not operated in Malta previously are believed to be deterred by the regime's complexity and the need to depend on the tax authorities issuing refunds in a timely manner, despite the authorities having a proven track record of doing so within 14 days of request.
- The tax has to be paid up-front and can only be refunded following a distribution. Certain businesses are reluctant to suffer the cash-flow disadvantage arising and this is perceived by some observers to act as a barrier to Malta's development as a financial services centre.
- The regime would subject the trading profits of all companies to tax which may result in the profits of certain financial services clients being subject to tax.
- Following the Maltese model would likely result in a lower rate of tax for Jersey residents on foreign income earned through a company than if earned directly. This could be resolved by aligning the corporate and personal income tax rates. However, a comparatively high standard rate of corporate tax would be detrimental to Jersey's perception as a low-tax regime, while lowering personal income tax rates would have a potentially significant negative impact on the Island's tax revenues.
- The financial implications could be a loss of jobs of up to 10,000 and a decrease in tax revenues of up to £130m depending on the extent to which tax neutrality can be achieved.

<u>Abolition of corporate tax</u>

Overview

Jersey resident companies would no longer be subject to income tax on their profits. In order to compensate for the loss of tax revenues arising as a result, it would be necessary to increase or introduce other taxes or fees.

Detailed description

Income tax for companies would be abolished. This would lead to a loss of tax revenues for the Island which would need to be recovered through other means.

Other territories that do not operate a corporate tax regime include the Cayman Islands, Bermuda and the British Virgin Islands. These territories instead have a range of alternative taxes and charges. Not all the measures used by these islands to raise revenues would be appropriate to adopt in Jersey, in particular those fees levied on the tourism industry which is in a significantly stronger position in the Caribbean than in Jersey.

Potential revenue raising measures targeted on businesses that could be introduced include the following. Please note that these are illustrative based on measures adopted by other jurisdictions which have low or no corporate tax. The extent to which these are appropriate to Jersey would need to be further considered as part of the economic impact analysis:

Payroll taxes	A charge payable by employers calculated by reference to the number of people employed and/or the wages they are paid.
Business licence fees	Companies wishing to carry on a business activity in Jersey are required to apply for a business licence fee annually. A fee for this licence would be payable, potentially based on the type of business undertaken.
Bank transaction taxes	A charge payable for each transaction undertaken through a Jersey bank.
Property taxes	Taxes levied on occupiers of property calculated by reference to the notional rental value of the property.

Below are the main advantages and disadvantages of this regime.

Advantages

- This is a very simple regime to understand.
- Predicting public revenues will be simple as they will not be as volatile as a tax on profits.
- It would enable Jersey to compete on a level playing field with other financial centres with no corporate tax.

Disadvantages

- The financial implications for this regime are significant. There would be a reduction in corporate tax revenues of approximately £80-85 million annually based on 2010 figures[8], with total revenues decreasing by up to £100m.
- Although the replacement forms of revenue generated are arguably stable, they do not provide an opportunity for Jersey to benefit from periods of high profitability and so limits its ability to protect against economic downturns unless the policy can be adjusted.
- Payroll taxes were considered prior to the introduction of 0/10 and rejected on the basis that it was undesirable to increase the already high cost of employing staff.
- Taxes and fees that are not calculated by reference to the level of a company's profits cannot be credited against tax arising to a foreign parent on receipt of a dividend. Therefore other taxes or fees represent a direct cost of doing business in Jersey, regardless of the level of profit. Some countries however, including the UK, do not tax certain foreign profits in which case corporate tax suffered in Jersey is not creditable and is already a real cost of doing business.
- Abolishing corporate tax may have a negative impact on how Jersey is perceived internationally.

[8] States of Jersey, Annual Financial Report and Accounts 2010