# REVIEW OF PERSONAL TAX

## STAGE 1 – DATA ANALYSIS

## EXECUTIVE SUMMARY

The Review of Personal Tax was commissioned by the Council of Ministers in September 2016. It has been undertaken by Jersey's Civil Service, supported by external economists; and was steered by a group of five Assembly Members (including three Ministers).

The Review has not primarily included appraisal or evaluation of tax policies (except with regard to proposals for new sanctions and penalties to modernise tax law and improve taxpayer compliance).

The Review Team was largely tasked with collating data – with the aim of creating an agreed and readily accessible body of information for policy makers and legislators; the media; and the general public.

The Review Report is presented in four parts.

- Part 1 is a report from external economists (Oxera) describing the impact on seven Jersey household types of the main changes in tax and contributions over the period 2006 to 2015.
- Part 2 examines changes in the number and type of personal income-taxpayers since 2007.
- Part 3 discusses the merits and demerits of "profit retention" within company structures. It goes on to seek to establish the extent to which Jersey-resident individuals who own "0%" companies (that is, companies liable to corporate income tax at the standard rate of 0%) may be retaining profits in those companies and consequently deferring the payment of personal income tax (until such time as those profits are distributed).
- Part 4 contains a final draft of a Consultation Paper to be issued by the Taxes Office proposing the modernisation of a large part of Jersey's tax law relating to tax-compliance matters covering both individual and business taxpayers.

The remainder of this Executive Summary highlights key points from each part.

### Part 1 : Assessing the distributional impact of key changes in taxes and contributions between 2006 and 2015

The report by independent economic consultants Oxera looks at the key tax and contribution changes between 2006 and 2015 and their impact at different levels of household income. This is the first time such analysis has been conducted for the whole of this period and Oxera summarise the findings in their executive summary. This new and detailed information should be informative for all States members as we discuss our approach to tax and contribution policy in coming years.

## Part 2 : Changes in the Number and Type of Jersey's Personal Income Taxpayers

This paper analyses Taxes Office produced data regarding the number and type of personal income taxpayers over the period from 2007 to 2015. It identifies the "Taxpayer Base" (broadly equating to everyone issued with a personal tax return); and then analyses that population between: (i) "Personal Taxpayers" (those who actually pay personal income tax); and (ii) "Personal Non-Taxpayers" (those who have been issued with a tax return but do not have a positive tax liability based on their income compared to the allowances, reliefs and deductions they are entitled to).

The paper further analyses the population of "Personal Taxpayers" into: (i) "Standard Rate Taxpayers"; and (ii) "Marginal Rate Taxpayers".

Personal Taxpayer Base

Over the relevant period the "Personal Taxpayer Base" increased by around 1,100 from 60,400 in 2007 to 61,500 in 2015. The paper concludes that the "Personal Taxpayer Base" is broadly driven by two factors: (i) changes in the Island's resident population; and (ii) decisions taken by the Taxes Office regarding who should, and who should not, be issued with a tax return.

This paper does *not* attempt to reconcile the "Personal Taxpayer Base" to the Island's resident population per the Statistics Unit; this is the subject of a separate exercise.

The paper identifies that the Taxes Office routinely seeks to reduce the number of tax returns it issues in cases where it is highly unlikely that the recipient of the return will have a positive income tax liability. A specific, one off exercise was undertaken by Taxes Office staff to close c.700 "Non Productive Cases" in 2014, reducing the "Personal Taxpayer Base" by c.700 in 2014 and later years.

Split between "Personal Taxpayers" and "Personal Non-Taxpayers"

Over the relevant period the proportion of "Personal Non-Taxpayers" has grown slightly. In 2007 "Personal Non-Taxpayers" comprised 22.2% of the "Personal Taxpayer Base", by 2015 this had grown to 24.1%.

The paper concludes that the split of the "Personal Taxpayer Base" between the "Personal Taxpayers" and "Personal Non-Taxpayers" is broadly driven by the following two factors: (i) changes in tax rules – in particular changes in income tax exemption thresholds; and (ii) decisions taken by the Taxes Office regarding who to, and who not to, issue tax returns to.

The paper identifies that over the relevant period the majority of tax rule changes agreed by the States Assembly should have had little or no impact on the split of the "Personal Taxpayer Base" between the two categories. However where rule changes have impacted on the split, they have tended to increase the proportion of "Personal Non-Taxpayers".

It is likely that the one off exercise undertaken by Taxes Office staff in 2014 to close "Non Productive Cases" was a contributory factor in the reduction of the proportion of "Personal Non-Taxpayers" from 27.2% in 2013 to 24.7% in 2014.

Split between "Standard Rate Taxpayers" and "Marginal Rate Taxpayers"

Over the relevant period the proportion of "Marginal Rates Taxpayers" has grown from 68.3% in 2007 to 88.0% in 2015. The paper identifies that the split between "Standard Rate Taxpayers" and "Marginal Rate Taxpayers" is broadly driven by changes in tax rules. Over the relevant period the vast majority of tax rule changes agreed by the States Assembly have tended to increase the proportion of "Marginal Rate Taxpayers".

The marked increases in the proportion of "Marginal Rate Taxpayers" in 2008, 2009, 2010 and 2011 were most likely a result of the "20-means-20" policy. The marked increase in the proportion of "Marginal Rate Taxpayers" in 2014 was most likely a result of the reduction in the marginal tax rate from 27% to 26%.

**Part 3 : Profit Retention in Companies Liable to Tax at the Standard Rate (0%)**

Paper outlining legal and policy considerations around the (dis)incentivisation of profit retention

The existence of "0% Companies" in together with a 20% rate of personal income tax creates two broad incentives amongst Jersey resident individuals:

- Incentive 1: there is an incentive to incorporate trading and investment activities, provided the individual is in a financial situation to distribute less than the annual trading profits/investment income accruing in the company
- Incentive 2: for those whose trading/investment activities have been incorporated, provided that they are in a financial situation to do so, there is an incentive to distribute less than the annual trading profits/investment income accruing in the company

From the introduction of "0% Companies" in 2008/09 until 31 December 2011 these incentives were reduced through the application of the "deemed dividend" and "full attribution" rules. In 2010 these rules were found to be harmful by the EU under the Code of Conduct for Business Taxation and, under the good neighbour policy, a decision was taken that the rules should be repealed. They were repealed with effect from 31 December 2011.

With effect from 1 January 2013 rules have been introduced which: (i) broaden the definition of "distribution"; and (ii) ensure that the distributions made by "0% Companies" are matched first and foremost against any profits arising in the company and subject to tax at 0% . These rules seek to prevent "0% Companies" from being used for the avoidance or inappropriate deferral of Jersey income tax by Jersey resident individual shareholders; but they only apply where a distribution has actually been made.

International comparison indicates:

- Jersey is not unusual in maintaining a standard corporate tax rate that is lower than the top rate of personal income tax; this is the positon in most OECD countries. The largest differential in the OECD between the standard rate of corporate income tax and the top rate of personal income tax is 33% in Slovenia.
- There is no globally accepted approach as to whether tax systems should encourage the retention of profits within companies or alternatively encourage the distribution of profits to shareholders. Different jurisdictions have adopted different approaches at different times depending on the specific policy considerations applicable at that time. Different jurisdictions may also adopt a different approach to trading companies than they adopt to investment companies; particularly closely-controlled investment companies.
- Despite a larger differential in the UK than Jersey between the top rate of personal income tax and the standard corporate income tax rate, since 1 April 2015 there are no anti-avoidance rules operating in the UK to prevent the retention of profits in companies.

The high-level advice from leading economic institutes to policy makers is that corporate income taxes are harmful to economic growth and hence corporate income tax rates should generally be reduced. However this advice is qualified by the need to maintain the integrity of the overall tax system and avoid creating the opportunity for individuals to avoid personal income.

Policy makers need to balance competing objectives when setting corporate tax rates. In determining the Island's standard corporate income tax rate, policy makers have been strongly influenced by the need for the corporate income tax regime to support the Island's economy. In order to support the Island's economy, Jersey needs to offer tax neutral corporate vehicles in an internationally compliant manner. The zero/ten regime delivers that offering in a simple, transparent way and has been found to be internationally compliant.

When the "deemed dividend" and "full attribution" rules were found to be "harmful" by the EU, policy makers determined that maintaining the zero/ten regime without the "deemed dividend" and "full attribution" rules was the best course of action irrespective of the challenge to the integrity of the overall tax system this created,

Both Guernsey and the Isle of Man have adopted similar policy responses on the introduction of zero/ten, initially implementing measures that sought to maintain the integrity of the overall tax system but removing, and not directly replacing, them when those measures were subsequently found to be "harmful".

Scope for estimating the quantum of profits retained within “0% companies” and owned by Jersey resident individual (natural person) shareholders

In order to produce an estimate of the quantum of profits retained within 0% companies ultimately owned by Jersey resident individual shareholders (“Relevant Companies”) two pieces of information are required:

- The amount, or a reasonable estimate of the amount, of profits accruing in “Relevant Companies” for each year of assessment; and
- The amount, or a reasonable estimate of the amount, of distributions made by “Relevant Companies” from the profits identified in the bullet point above where the recipient is subject to Jersey personal income tax

In terms of the first piece of information (the amount of profits accruing in “Relevant Companies”) the paper concludes that:

- The Taxes Office does not hold *complete* data on the amount of profits accruing in “Relevant Companies” since the 2008 year of assessment;
- In light of the period of time that has elapsed, it is considered that this 2008 profits data is too out of date to be used in this context;
- The profits data the Taxes Office does hold on “Relevant Companies” for subsequent years of assessment is incomplete and is not held in a format that is easily retrievable or analysable; and
- The “deemed distribution”/”full attribution” data held by the Taxes Office in relation to the years in which those rules were in operation is an unreliable estimate for the profits accruing in “Relevant Companies”, is increasingly out of date and is not held in a format that is easily retrievable or analysable

Therefore the first piece of information required to estimate the quantum of profits retained within “Relevant Companies” is not currently available and, as such, a reasonable estimate of profit retention cannot be completed at this time.

However the paper goes on to note that the Taxes Office amended the corporate income tax return for the 2015 year of assessment (and all subsequent years of assessment) such that “Relevant Companies” are now required to declare their taxable profits on an annual basis.

The corporate income tax returns for the 2015 year of assessment were due on or before 31 December 2016. Work is ongoing to verify and cleanse the profit data received through the 2015 corporate income tax returns by the end of March 2017, whereupon work on producing an estimate of profit retention will recommence.

## Part 4 : Proposals to Modernise Aspects of Jersey's Tax Law to Improve Voluntary Compliance

The Taxes Office will be consulting over the next three months on its proposals to modernise Jersey's tax law with regard to sanctions and penalties – to improve voluntary compliance with tax obligations.

Subject to the outcome of consultation, refined proposals will then be put to the Minister for Treasury & Resources for his consideration and in time for inclusion, where appropriate, in his Budget 2018 proposals. The draft law would then be debated by the States Assembly towards the end of 2017 as part of the Budget 2018 debates.

An important aspect of the proposed changes is to substitute criminal sanctions with civil ones which will make the tax system less expensive to run; easier to administer; and will reduce pressures on the time of criminal investigators and the Courts.

Penalties addressed in the proposals include those relating to failure to file tax returns; late filing of returns; late payment of taxes; and mis-declaration, for example of income earned.

Proposals are based on international best practice and include, for example, differentiated penalties according to the behaviours exhibited by taxpayers. So, for example, where it was clear that a taxpayer had deliberately hidden income from the Taxes Office the taxpayer would receive a greater penalty than someone who had accidentally forgotten to declare income.

It is proposed that penalties would increase for those who persistently failed to comply with their various tax obligations.

The changes being consulted upon include – for the first time – the introduction of interest being charged on overdue and outstanding tax debts.