Zero/Ten Corporate Tax Regime

A statement from the Chief Minister

As Members may be aware, the EU Code of Conduct Group was set up in 1998 to assess business tax measures in Member States. Those Member States with dependent and associated territories were committed, within the framework of their constitutional arrangements, to ensuring the principles of the Code are applied to those territories.

In 1999 the Code Group began its assessment of tax measures which could affect the location of business activities and which offer a significantly lower level of taxation than the general tax rates in the Member State in question. Such measures were assessed on whether or not they are harmful, using 5 criteria.

The Code of Conduct Group began a formal assessment of Jersey's 0/10 corporate tax regime at its meeting in September 2010 and this was continued when the Group met again in November. Following that meeting, the Group reached a consensus that 0/10 gives rise to harmful effects. It recommended that the ECOFIN Council should review this, on the basis of the conclusions of the Council's High Level Working Party's examination of the scope of the Code. The Group's view, and this recommendation, were noted by ECOFIN at its meeting on the 7th December.

The Working Party's report is due to be completed before the end of the Hungarian Presidency of the EU Council in June 2011. When the report is completed States Members will be informed of its conclusions and of their possible impact. We will then be in a better position to judge whether, and if so what, changes we need to make to our existing business tax regime to meet the requirements of the Code.

While Jersey is not an EU Member State, we made a voluntary commitment to abide by the Code of Conduct for Business Taxation in 2002, as we are committed to being a good neighbour within Europe**.** We intend to remain a good neighbour and to continue meeting international standards and will work with Europe to that end.

Any revisions to Jersey's corporate tax system will take into account the need to maintain tax neutrality, to remain competitive and to meet relevant international standards. During his recent visit, Lord McNally confirmed that the UK recognises, and will respect, Jersey's constitutional status and fiscal autonomy.

Members may be aware that the Treasury Minister and I have just returned from discussions in the Isle of Man and London, and will continue to ensure that Jersey maintains a good understanding with the UK and other Crown Dependencies.

Introduction of 0/10

Throughout the development of 0/10, Jersey worked with HM Treasury, and liaised regularly with the EU Code of Conduct Group before its introduction.

After announcing our intention to introduce 0/10, the report of an ECOFIN meeting in 2003 stated that the measures had been reviewed by the Code Group and were not considered to be harmful in the meaning of the Code. This was before the details of deemed distribution had been formalised.

In 2007 we were advised that the UK's view was that the deemed distribution provision, as an anti-avoidance measure, was personal and not business taxation and therefore did not fall within the scope of the Code.

However, by 2009 it was understood that some EU Member States considered 0/10 to be in conflict with the "spirit" of the Code, if not with the actual Code criteria.

Throughout the process of adapting our corporate tax regime to changing international views on tax, Ministers have tried to explain this complicated issue as clearly as possible. When the EU announced it would formally assess 0/10, we said we would consider its outcome when it is completed. That is still the case. We will consider the impact of the Working Party's report when it is completed.

Business Tax Review

Jersey's review of business taxation undertaken by the Treasury earlier this year consulted businesses, organisations and individuals on a number of alternative corporate tax regimes. This review was put on hold while our business tax regime was being formally assessed, but we recognise that fiscal structures change over time and we are ready to respond to those changes. The results of the business tax consultation will be published shortly.

We will carefully consider the views of the EU, the business community and other stakeholders, in order to find the right solution for Jersey when the assessment is complete. In doing so we will ensure that any changes needed will maintain our competitive position and protect Jersey's economic interests.

Glossary

0/10 tax regime	The corporate tax regime implemented in 2008 whereby the majority of corporates, whether owned by residents or non-residents, are subject to zero tax; and regulated financial institutions pay tax at 10%
Code of Conduct Group	A Group of tax officials drawn from each of the 27 EU Member States, which met for the first time in 1998
Code of Conduct for business taxation	The Code is the basis upon which the Code of Conduct Group assesses whether a business tax measure that comes within its mandate is deemed to be harmful
ECOFIN	Economic and Financial Affairs Council of the European Union
High Level Working Party	A high level group of tax officials set up by the ECOFIN Council

Background information

A full summary of the history of 0/10 is also attached

March 1998 - the EU ECOFIN Council established a Code of Conduct Group to assess business tax measures

1999

The Code Group began its assessment of: -

1. Business tax measures which could affect, in a significant way, the location of business activity in the Community
2. Tax measures which offer a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question
3. Whether such measures are harmful, taking into account 5 criteria

2002

- Jersey made a voluntary commitment to abide by the Code
- The Code criteria have not changed since 1999, and it is against these criteria that the Island's zero ten corporate tax regime has been assessed.

The Code Group's reaction to the introduction of zero/ten

In **2002** the Code Group was informed of the introduction of a zero/ten regime in Jersey. The Group's report states:

"Jersey proposes, following agreement in the EU of the Tax Package, to introduce legislation to establish a reform of business taxation to be completed within five years from the time of the agreement. Jersey intends to abolish the measures by introducing a general reform of its corporate tax system.
Under the proposed new corporate tax system the standard rate will be zero for all business activities, with a special higher rate (yet to be determined) to apply to regulated entities, including financial services businesses, and to public utilities. The standard rate will apply to approximately 21,500 of the 22,000 companies in Jersey, representing approximately 65% of the Island's income."

2003

- The report of an ECOFIN meeting on 3 June stated that the replacement measures had been reviewed by the Code Group and were not considered harmful in the meaning of the Code.
- No information on the deemed distribution provisions had been put before the Code Group or ECOFIN at this stage.

June 2007

- We are advised of the UK's view - that the deemed distribution provision, as an anti-avoidance measure, was personal and not business taxation and therefore did not fall within the scope of the Code.

October 2009

- It is understood that some EU Member States consider 0/10 may be in conflict with the "spirit" of the Code rather than with the Code's criteria.

2010

- **May -** the Code Group announces it will formally assess zero/ten
- **June -** Jersey's Treasury department launches a consultation on a number of alternative business tax regimes as part of a full review of the island's fiscal strategy, recognising the importance of responding to changes in fiscal structures over time
- **September -** the Code Group begins its formal assessment
- **November** – the Code Group meets for a second time

<u>The European Commission's current view of 0/10</u>

- The Commission is of the view that 0/10, combined with the deemed distribution and attribution provisions for residents, means an effective 0%

rate for Jersey business profits is not available to a Jersey company with resident shareholders holding a share interest of 2% or more.

- Such shareholders are taxed on both distributed and undistributed business profits
- The Commission believes the effective tax rate for Jersey companies is difficult to determine, but is not 0%
- The Commission judges that there is discrimination between the tax position of non-resident shareholders and that of Jersey shareholders in a Jersey company.

23 September 2010

The Code Group met and received a description of the zero tax regime from the Commission

Jersey made a presentation and answered questions at the meeting. This was the first time that a non-EU jurisdiction had been invited to attend a Code Group meeting.

Jersey's presentation made a number of points:

- deemed distribution and attribution arrangements are part of the Island's personal tax anti-avoidance measures, and are a reinforcement of anti-avoidance measures that have been in place for many years
- They are not part of the business tax regime and so should be considered distinct from the business tax regime
- Jersey is not a member of the EU but has pursued a "good neighbour policy" with the EU on tax matters
- If the Code is to have any bearing on any change in our tax structure the Code Group needs to make it clear why the regime is in conflict with the Code so that any replacement measure can be properly considered
- There will need to be a clear unequivocal acceptance by the Code Group that any proposed future change is not in conflict with the Code before we consider start work on changing the present tax structure

In summing up the meeting the Commission asked the Code Group to consider whether the deemed distribution provision was personal taxation or a way of maintaining a 20% tax rate for Jersey companies owned by Jersey residents.

The Commission was then asked by the Code Group to prepare an assessment of the zero/ten tax regime as a whole on the basis of the Code criteria.

Jersey has recognised the concerns of Code Group members and is prepared to work on a scheme that meets these concerns.

19 November 2010

Code Group meeting accepted the view of the Commission and agreed that the 0/10 regime as a whole gives rise to harmful effects.

7 December 2010

The ECOFIN met and the Code Group's report was noted. The Council High Level Working Party, under the Hungarian Presidency, will now be asked to address the scope of the Code of Conduct and to report back to ECOFIN by the end of the Presidency in **June 2011**.

We are advised that the High Level Working Group will focus on the scope of the Code generally and not the 0/10 regime per se.

What now?

- We will be seeking to engage with the High Level Working Party through the EU Council Secretariat.
- As soon as the report of the High Level Working Party is completed, States Members will be informed of the conclusions reached, and of their possible impact on our business tax regime
- When the High Level Working Party's report is completed we expect to be in a better position to consider whether there need to be changes, and if so, how best to change the corporate tax regime
- It is assumed that if there were to be any revisions, they would need to be evaluated by the Commission on behalf of the Code Group before any changes are made
- A clear decision from the Code Group would be required before starting work on the consultative and legislative process required to make any changes in the tax structure
- Any changes required would need to be carefully designed, consulted on and effectively implemented. This would take time and should not be rushed. However we recognise that businesses need clarity and certainty. We would consult fully with industry on the optimum balance to be struck. Taking all of this into account, while changes to the deemed distribution rules could be effected relatively quickly, anything more significant would take a number of years.