States of Jersey

Property Tax Review Green Paper

July 2014

TREASURY & RESOURCES

Foreword – Minister for Treasury and Resources

A well-functioning housing market is fundamental to the Island's economic, social and environmental well-being. Property and housing is of great significance to Islanders, and policy changes, either on the supply side or fiscally, rightly provoke strong reactions.

Weak supply hinders the ability of people to achieve the dream of home ownership and restricts the supply of rented accommodation available to those who choose to rent, or who cannot afford to buy.

Housing has become increasingly unaffordable for many. The Council of Ministers has made a number of significant changes to deal with the supply side including by establishing Andium Homes, by raising £250 million to refurbish the existing social housing stock and increase the supply of new homes, and by rezoning land.

This is not just about homes, but also about the vital supply of commercial properties – offices, shops, and all the other business spaces that are vital to the well-functioning of the economy.

The other side of the equation is the need to look at the impact the tax system has on property and housing. From an economic and public policy perspective, property taxes have a number of significant features that can and should be considered, including:

- Property taxes are an important source of revenues
- When carefully judged and researched they can act as helpful economic tools by, for example, helping to stimulate or restrain housing markets as appropriate
- Taxes can contribute to the functioning of a healthy property market

Given the importance of this area, the Corporate Services Scrutiny Panel has rightly indicated that the Treasury should consider how the Island's property tax system works in the round. This green paper, and the expert report accompanying it, represents the first stage of this review.

For the avoidance of doubt, the primary purpose of this review is not to raise additional revenues. Rather, it aims to ensure that Jersey's property tax system is put on a sound footing, by identifying principles to help shape the development of a modern, efficient, coherent property tax system. These principles will then help to inform future States decisions about property taxes. If future States Assemblies choose to use an improved property tax system to raise additional tax revenues or change the blend of taxes in the Island, they can be confident that it can be done as efficiently and as effectively as possible.

We currently tax property in a number of ways, including:

- Stamp duty and Land Transaction Tax are charged when property is transferred and when debts are secured against property

- Parish rates and the Island-wide rate are charged annually on both owners and occupiers of most properties in the Island

- Income tax at 20% is paid by landlords on the rental income they receive, and by property developers on their profits

Jersey's property tax system should be joined-up, balanced and have no unintended consequences, while also supporting the States strategic objectives. To help us achieve this, the review outlines six proposed principles, based on the independent advice received, which could be used to shape any future changes to the property tax system. It then explains what adopting these principles might mean in practice, by describing potential changes that could be made to three areas of Jersey's property tax system. These are included as examples of the way in which the proposed principles could be applied.

This is a public consultation, which will be open to responses until the end of 2014, and it is an opportunity for taxpayers to shape future changes in the Island's property tax system from the very beginning of the change process. Fundamental change to the way we tax property will take time and further consultation on specific changes will be necessary in due course.

I encourage all Islanders and investors in the Island to give their views on this fundamentally important issue for the future of Jersey.

Philip Ozouf

Senator Philip Ozouf
Minister for Treasury and Resources
18 July 2014

Section 1: Introduction

Background to the property tax review

As a small island without significant mineral resources, Jersey's principal natural asset is its land. It is in the best interests of Islanders, current and future, that land is used in the most efficient way possible, to ensure that Jersey continues to meet the needs of those who make their lives here.

Jersey's existing tax system however, does not reflect the importance of land to Islanders. It has grown up over the years in response to many pressures and lacks a set of clear unifying policies. What we do and do not tax has never previously been considered in the round.

In 2012, the Minister for Treasury and Resources announced a broad review of the taxation of property (land and buildings) in Jersey. This review acknowledges the importance of land to Jersey, and for the first time, attempts to look at what property we tax, how we tax it and who pays it. This green paper forms part of that review.

Why should we consider property taxes?

From an economic perspective, taxes on immoveable property are generally considered to be desirable for a number of reasons:

- The supply of property and especially land is not very responsive to its price, which means that it can be taxed without significantly distorting people's behaviour

- The ownership and occupation of property is generally visible and easily established, which makes it relatively straightforward to identify who should be paying the tax

- Taxes on property are difficult to avoid because the geographical location is fixed

By contrast, economic theory suggests that taxing income and profits may act as something of a disincentive to people and businesses to earn profits, and they may be encouraged to find ways to minimise their taxes. An example of this could be an individual choosing to invest in a product which generates only a tax-free capital gain at the end of its life, instead of one which generates taxable income throughout.

Jersey has undertaken considerable efforts in recent years to stabilise its public finances by broadening its tax base. Steps already taken include:

- <u>Increasing the number of taxpayers</u> by introducing GST, so that all Islanders contribute to the cost of running the Island, while still protecting the least well-off through targeted benefit payments

- Strengthening <u>the personal income tax base</u> to reduce the reliance on income from corporate taxpayers, through the implementation of 20 Means 20 and the gradual withdrawal of most personal tax deductions, allowances and reliefs from higher earners

This review supports these steps and seeks to further stabilise the tax base through establishing a modern, efficient property tax system.

Structure of the green paper

In preparing this green paper, we have looked at all taxes, fees and duties charged in respect of land and buildings in the Island, together with the tax reliefs available for the same.

We have taken advice from PwC LLP ("PwC") regarding the most current economic thinking about property taxation and the experience of other jurisdictions[1]. Drawing all of this information together, this green paper outlines the aims of the property tax review, indicates some possible changes to three areas of the existing property tax system that are consistent with those aims, and seeks the public's views.

The three areas of the existing property tax system identified as potentially benefiting from reform are:

1. Modernising the basis for charging annual property taxes

2. Ensuring the public share in the benefit arising from increases in property values that they helped to create

3. Modernising the treatment of property financing

These are discussed in greater detail both in this green paper and PwC's report. It must be stressed that these are not firm proposals but are intended to show what form changes could take.

This green paper should be read in conjunction with the PwC report, "Property Tax Review", which informs and supports this document and discusses the issues raised in greater detail.

Next steps

The aim of the property tax review is to identify features of a modern, efficient property tax system, and to consider how Jersey could better adopt these features, not to raise additional tax revenues from property *per se*. However it is acknowledged that any changes to a tax system, whilst maintaining the same amount of overall revenue, will alter where the burden of taxation falls. Furthermore, a future States assembly may choose to use an improved property tax system to raise additional tax revenues.

Fundamental change to the way we tax property will take time. Shifting the burden of who pays tax, changes to the way taxes are calculated and potentially introducing new taxes would

[1] "Property tax review", PwC, 2014: www.gov.je/consult

have to be a gradual process to limit the impact on taxpayers. Before any specific changes could be determined, it would first be necessary to have a better understanding of who would be affected and how.

This paper should be seen as a first step along the road to reforming our property tax system and so it is very important that as many Islanders and businesses as possible read this paper, consider the issues and feedback their views.

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Section 2: The aim of the property tax review

The aim of the property tax review is to ensure that Jersey has a property tax system that is:

- **Modern:** The property tax system should reflect current economic thinking. It should be flexible enough to allow appropriate tax reliefs to be built into the system, while still recognising Jersey's overall commitment to having a tax system that is low, broad and simple

- **Coherent:** All taxes on property should, as far as possible, fit within the overall aims of the system

- **Transparent:** Everyone should understand what tax they pay and how it is calculated

- **Minimises distortions:** Where the tax system encourages taxpayers to act in a particular way, this should be changed, particularly where the behaviour is undesirable. The property tax system should support competitiveness and not act as a barrier to business growth

- **Acknowledges the contribution made by the public to increases in property value:** Where the value of property increases and it is not due to the actions of the owner, the public should share in that increase

- **Appropriate for Jersey:** The property tax system should reflect Jersey's particular economic circumstances and the competing pressures on land that arise from being a small island

The purpose of this review is not to raise additional revenues at this time. Rather, it is to ensure that Jersey's property tax system is put on a sound footing so that if future States Assemblies wish to increase taxes, or change the blend of taxes whilst maintaining the same overall revenue, they can be confident that it can be done as efficiently and effectively as possible.

Question 1: Do you consider that the aims of the review provide the right framework for the future development of Jersey's property tax system?

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Section 3: Principles of Jersey property taxation

Taxes on property, in some form, are a feature of most territories' tax regimes. However, in many places they have made a relatively minor contribution to overall tax revenues in the past. They are now coming under increasing scrutiny, as economists recommend that they should play a more important part in the makeup of national tax bases, while governments are keener than ever to diversify their tax systems.

We have sought advice from PwC about the principles that should be used to inform our thinking about the Jersey property tax system. These draw on the most current economic theory, international best practice and the Principles of Jersey Taxation approved by the States in the Medium Term Financial Plan 2013-2015[2], and are:

- **Consultation:** Property tax reform proposals should be the subject of wide consultation. There is always strong public interest in property tax proposals. Every household will potentially be affected. Policy measures should be based on informed consent. Transparent consultation should therefore be undertaken to inform and test public opinion and to enhance public confidence in the process of reform as well its direction. Communication should be detailed enough to allow individuals to see the impact on their own situation.

  Public engagement is key to ensuring the success of any fundamental change. For this reason, the States of Jersey is committed to consulting the public on any important matter that affects them. Any changes to the property tax system would have to be fully consulted on before being implemented, to ensure that as many people as possible understood how they were likely to be affected.

- **Coherence and certainty:** Reform should build on the current framework of taxation of land and property, providing greater coherence, clarity and certainty to owners, occupiers and financiers, using up-to-date valuations as a base. Property tax reforms should, as far as possible, fit with the existing principles and practice of taxation in Jersey. Proposals should be consistent with current legal and fiscal frameworks. New laws should be based on familiar concepts such as ownership and occupation and certain in their application. Liabilities should be easy to calculate and framed around transparent and up-to-date valuations. The political economy of property taxation makes certainty a key consideration.

  It is a principle of the Jersey tax system that both taxpayers and the tax administration should be able to understand how tax is calculated and how to pay it. Any reform of the property tax system should improve the transparency of the system, and not introduce undue complexity.

[2] http://www.gov.je/Government/PlanningPerformance/StrategicPlanning/Pages/StatesAnnualBusinessPlan.aspx

- **Efficiency and growth:** The choice of property tax instruments should favour economically efficient taxes such as recurrent taxes on land and residential property over taxes that distort behaviour such as stamp duties. Property taxes should be designed to be economically efficient and supportive of economic growth. Wherever possible, within a balanced framework of taxation in Jersey, they should replace taxes that are less efficient. However, the economic efficiency of property taxation is not homogenous so more efficient property tax instruments, such as recurrent taxes on land, should normally be considered in preference to taxes that distort behaviour, for example transaction taxes. New property taxes should support the achievement of the priorities of the States Island Plan 2011, including the efficient use of scarce resources such as land to protect and enhance the natural and built environment and the bringing into prompt use of land zoned for development to provide adequate housing for the population.

Taxes charged on property transactions, such as stamp duty, can be economically inefficient in that they affect taxpayer decisions. This is especially the case where the transaction tax is charged at high levels so that any transaction in land carries a potentially heavy cost. Other forms of taxes, such as recurrent taxes on residential properties, are less distorting of taxpayer behaviour.

In addition, recurrent taxes are a more stable source of revenues for the public purse than taxes on transactions, which are volatile and difficult to budget for since they are subject to factors outside the control of the Treasury.

Where appropriate, the tax system can be used alongside other measures to support the States key objectives, such as the efficient use of land and the availability of affordable housing.

- **Support for the competitive environment**: The design of property taxes, including recurrent taxes on ownership and taxes on realisations, should continue to support and encourage inbound investment. Jersey's prosperity today is, to a large extent, a reflection of its ability to attract capital and investment from the international business community. Property tax reform should recognise and take account of the competitive pressures that businesses face and the choices of location that are available to international investors. The selection of property tax instruments, the way in which they are used and their place within the overall framework of tax in Jersey should be factored into decisions about property tax reform so that Jersey remains an attractive and competitive destination for investment.

The tax system should support the competiveness of Jersey's economy and should not make Jersey a significantly less attractive a place to invest than our key competitors.

- **Fairness**: The benefits of occupancy and the rewards of ownership should be taxed in a balanced way that deals fairly with windfall profits and also recognises ability to pay. Where appropriate, the incidence of property taxation should be designed to enhance the fairness of the tax system as a whole. The equity and incidence of property taxation is highly contested in many countries. Care should therefore be given to ensuring that property taxes are balanced in their incidence, based on up-to-date information (including valuations), reflect the ability of taxpayers to pay and are readily collectable. In principle, taking property taxes as a whole, everyone should take some part of the burden, their share depending on legal, financial and economic factors. This does not mean that each instrument should treat all economic agents in the same way but that the system as a whole should deal fairly and even-handedly with the interests of tenants, home owners and investors. Where necessary, measures should be taken to protect the system from abuse.

Windfall profits are those caused by factors outside the control of the landowners, such as buoyancy in the property market or the States agreeing that a piece of agricultural land may be used instead for residential housing. It can be argued that where the public has helped to create this profit, they should share in it. There is also a "cost" to the public in the form of the loss of the environmental benefits provided by undeveloped land.

Taxes on property are often unpopular, because a tax that does not take into account the ability of taxpayers to pay can cause hardship, particularly for those with valuable property but low incomes. Before any change are made to property taxes, it is important that work is done to identify and understand who could be affected and how. This will also aid the incorporation of appropriate tax reliefs in the design of any changes.

It is important that taxpayers understand how their tax is calculated. If the tax is based on the value of their property, then there should be regular revaluations to ensure that the tax continues to reflect the current value. If not, then it can become increasingly difficult for taxpayers to see how their tax arises. Regular revaluations also mean that if the balance of the property market changes, so that the value of one sector changes significantly compared to other sectors, then the system can adjust to ensure that the more valuable sector bears more of the total tax due.

- **Fiscal stability and sustainability:** Well-designed property taxes, particularly recurrent taxes, and the related system of reliefs should be used to improve macro-fiscal management, including the level of debt in the economy, and to dampen the volatility of tax receipts. Property taxes should be designed to generate revenues that are stable and sustainable in order to contribute to the effectiveness of macro-fiscal management in Jersey. Attention should be given to the volatility associated with particular property tax instruments, to the potential buoyancy of revenues and to ensuring that allowable reliefs are rational and not over-generous, do not encourage undesirable outcomes such as the excessive use of debt finance and do not undermine the integrity of the tax base. Sustainability includes the concept of using taxation instruments that are readily understood and enjoy broad public support.

One of the reasons why recurring property taxes are an appealing source of revenues is that the tax base can be relatively stable and does not reflect the same fluctuations that other types of taxes do. We can see this in Jersey, when stamp duty revenues (charged on property sales) have been volatile in recent years, reflecting the wider economy, while Parish and Island-wide Rates revenues (based on a fixed property value) have been stable.

As a small, open economy, Jersey does not have the same range of macro-economic levers that other jurisdictions may apply, such as the ability to centrally control interest rates or exchange rates.

However, taxes which are more stable and predictable allow the Treasury to better manage Jersey's public finances.

Question 2: Do you consider that the principles proposed for Jersey's property tax system are adequate? Is there anything else you think should be included? Is there anything that should be excluded?

The remainder of this green paper highlights how these principles could be applied to the Jersey property tax system, and asks for the public's views.

Section 4: Modernising the basis for charging annual property taxes

This section considers how the current rates system could be changed to better meet the principles proposed above.

Summary table

Issue	Modernising the basis for charging annual property taxes.
What might this involve?	Moving to taxing the consumer (i.e. the owner or the occupier) of land/property on its current value. Making the basis for annual property taxes more transparent. Building appropriate reliefs into the system to protect those who would struggle to pay.
Why is this necessary?	The basis for the current rates assessment is poorly understood. Changing from the current system to one based on the value of property would make the system more transparent to taxpayers. Taxing the occupier of property instead of the owner and occupier as now would remove the effect of double taxation, whereby landlords are charged income tax on the rents they receive and rates on a value based in part on an imputed rental value of the property. Alternatively, taxing only the owner of land on its value would encourage landowners to use land in the most economically efficient way possible, which is important in a small Island like Jersey.
Examples of how this could be achieved	Domestic properties – the tax could be based on the current market value of the property – potentially based on either the sale value or annual rental value – and charged to the occupier only. Commercial properties – the tax could be based on either the value of the land occupied and charged to the owner only, or on the value of the property as a whole and charged to the occupier only.
Who would be affected?	Primarily landlords and tenants, although if a revaluation of the Island's property base as a whole was carried out, it could affect most ratepayers.

Why is this necessary?

Most individuals and businesses in the Island pay annual property taxes through the parish and Island-wide Rates ("IWR") systems. The parish rates system was developed over many years to allow the parishes to fund their activities. When, in 2005, the States took over responsibility for the social welfare element of the work previously carried out by the parishes, the IWR was introduced to contribute to this cost.

The current rates system has a number of advantages, namely:

- **Efficiency of assessment and collection:** Both the parish rate and the IWR are assessed and collected by the individual parishes, who rely heavily on the work of rates assessors who volunteer their time and expertise to support their parish. As a result, the cost of administering the rates system to both the parishes and the States is very low.

  The number of appeals against rates assessments has also fallen since the changes introduced in 2005, when the rates assessment was decoupled from the notional rental value of properties. In part, this is due to the 2005 changes making rates assessments more consistent across the Island, but there is also a case that some of the reduction is due to a lack of understanding of the way in which rates assessments are calculated (see below).

- **High levels of compliance:** Compliance levels are very high, at approximately 98%. To a large extent, this is because the overall rate charged is low – the average rates assessment for a domestic property was approximately £350 in 2010, compared with the average UK Council Tax bill at the time of £1,100.

However, the current rates system also has a number of flaws:

- **Lack of transparency:** The decoupling of rateable values from rental values in 2005 means that it is increasingly difficult for ratepayers to understand the basis for their rates assessment. Although the parish rate element of the assessment is voted on by parishioners annually, the IWR element is much less well understood. It is not clear how many taxpayers are even aware that they pay the IWR, as the annual rates assessment is issued by their parish and does not distinguish between the parish and IWR elements.

- **Does not provide for revaluations:** The rateable value of all properties in Jersey is based on their notional rental value in 2003 adjusted, first, to ensure that similar properties had the same rateable value, and then adjusted to reflect any significant changes to the properties that have taken place since 2003. Under the Rates Law, it is not possible to undertake a mass revaluation of all properties in the Island.

  This means that for many ratepayers, the rateable value of their properties has not changed since 2005. While this does provide a degree of certainty for ratepayers, it also means that rateable values in 2014 do not reflect changes in relative property values over the past eleven years.

A revaluation exercise, in itself, would not be intended to raise revenues. The Rates Law is very clear that a parish may only raise enough funds through the parish rates to pay for the services it provides. The total amount to be raised through the IWR each year is also restricted by the Rates Law.

A revaluation exercise would however allow an adjustment to the proportion of total rates paid in respect of different types of property to reflect the current value of those properties. If, for example, offices are proportionally more valuable now in comparison to other commercial properties than they were in 2003, then the proportion of rates paid by offices could be increased while the rates paid on other types of commercial property would fall.

- **Is not set up to raise significant revenues:** The current rates system allows a low level of revenue to be raised in an efficient way, but it would struggle to collect significantly higher sums, if the States decided to increase the amount of tax raised from property.

  The current system allows for very few reliefs for those who cannot pay, and it is left to the discretion of the parish authorities to waive or reduce the rates assessment in the case of genuine hardship. This is possible when rates are set at very low levels, but would be more difficult to apply in a consistent manner if rates assessments were higher and more people found it difficult to pay. A modern property tax system would build in targeted reliefs, so that those on the lowest incomes were protected from the effects of the tax.

  The current rates system is efficient and cost-effective to administer. However, if a larger amount of revenue was to be collected, it may not be possible or appropriate to continue to rely on the goodwill of volunteer assessors and parish authorities.

Question 3: Our aim is to make the rates system more transparent; what are your views on this? Are there any other ways in which the rates system could be improved?

How could this be achieved?

This section discusses examples of how the property tax system could be changed to better meet the principles outlined in Section 3. They are included to help the public understand what a modern property tax system could look like, but other options could be considered.

Domestic properties

Changes could either be made to the existing rates system, or a new annual property tax could be introduced. It is acknowledged that rates are the responsibility of the Constables to administer, and much of the total rates revenue is paid to the individual parishes. It is intended that Treasury and Resources would work with the Constables on any possible changes.

The basis of the tax could be changed to reflect the value of the property. This could be based on either the sale value or the annual rental value, as was the case under the rates system before 2005.

PwC suggest that taxpayers could be asked to assess the value of the property themselves. Another option could be to undertake a revaluation exercise of all domestic properties in the Island on a regular basis, such as every five or ten years, and base assessments on that.

The payer of the annual property tax could change so that only the occupier of the property paid the tax. This change would not affect owner-occupiers, but would mean that landlords of residential property paid less while tenants paid more.

It would be important that the system included a clear basis for tax reliefs for those who would struggle to pay. PwC suggest that consideration could be given to including a provision that cash-poor owner-occupiers could carry forward some or all of their annual property tax bill until the property was sold, when the outstanding tax would be recovered. This would not assist tenants of rented properties who would not have an asset to sell, and could result in large unpaid tax bills accumulating year after year.

Question 4: What are your views on an annual property tax based on the sale value or the rental value of domestic properties? What are your views on a self-assessment basis for establishing the value of property, or a periodic revaluation? Do you have a view on the types of relief that could be applied to owner-occupiers and to tenants who were unable to pay the tax?

Commercial properties

An annual property tax for commercial property could be based on either the unimproved value of the land only (i.e. ignoring any buildings), or on the value of the property including buildings.

Tax on land value

A land value tax ("LVT") would have the advantage of encouraging landowners to ensure that their land was put to the most economically efficient use. LVT only looks at the value of the land, not the use to which it is put, so owners would be encouraged to make sure that high-value land was put to a use making the greatest possible returns, while lower value activities would move into lower value areas. For example, if an individual owned a car park in the middle of a high-rent office area, an LVT might encourage him to move the car park to a lower value area and replace it with higher-yielding offices.

However, land values are difficult to ascertain and regular valuations would be required in order to keep them current. Landowners with properties already built on the land are unlikely to know the value of their bare land, so the valuation would have to be carried out by specialists at a cost to either the landowner or the States.

It follows that a tax on land value would be levied on landowners, as they would have the control over the use to which the land was put. This would mean that commercial tenants would no longer pay annual property taxes, although in practice it would be likely that landowners would pass some or all of their additional cost on through increased rents. This is more likely in areas of high demand.

Tax on property value

An annual property tax based on property value would not encourage efficient use of commercial land in the same way that a LVT would, but it would have other advantages, namely:

- It would be more easily understood, as the basis would be either the sale value or rental value of the property
- It could therefore include an element of self-assessment, reducing the cost of administration
- It would be assessed on a similar basis to residential properties, reducing the administrative burden of assessment and collection

A tax based on the consumption value of property would be logically assessed on the occupier of the property, i.e. the businesses using it. In practice, businesses would have to consider whether to absorb the additional cost or seek to pass on the increased cost to the public. This is discussed further below.

Question 5: What are your views on an annual property tax based on the unimproved value of land or on the value of the property as a whole? What are your views on a self-assessment basis for establishing the value of property, or a periodic revaluation? Do you have a view on the types of relief could be applied to those who were unable to pay the tax?

Who could be affected?

Domestic properties	
Positive impact	Landlords of rented properties: A move to a consumer pays basis of tax for domestic properties would mean that landlords would no longer pay owners' rates as they do at the moment. However, at the lower end of the market, landlords may absorb some or all of the additional cost to their tenants in order to ensure demand for their properties.

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Neutral	Owner-occupiers: Owner-occupiers already pay the full set of rates. Shifting the burden to occupiers only would not change the total rate due, although if the balance of taxes shifted as a result of a revaluation exercise, the owners of properties whose value had increased or decreased at a faster rate than other properties could find their tax bill changing.
Negative impact	Tenants of rented properties: As the consumers of rental properties, tenants would find their annual property tax bill increased, though at the lower end of the market, landlords may choose to reduce rents to reflect the increased cost in order to ensure they can continue to attract tenants. Those on lower incomes, particularly those occupying large or valuable properties: It would be important that any new system built in protections for those who would genuinely struggle to pay.

Commercial properties – based on land value and charged to landowners only	
Positive impact	Tenants of rented properties: A move to an owner pays basis, based on land values, would mean that tenants of commercial properties would no longer pay occupiers' rates as they do at present. However, in practice, it is likely that landowners would pass their additional cost on to their tenants in the form of increased rents, particularly in the commercial sector where there is less competition between landlords to keep rents low.
Neutral	Owner-occupiers: Owner-occupiers already pay the full set of rates. Shifting the burden to occupiers only would not change the total rate due, although if the balance of taxes shifted as a result of a revaluation exercise, the owners of properties whose value had increased or decreased at a faster rate than other properties could find their tax bill changing.
Negative impact	Landlords of rented properties: A system based on land values would see landlords pay more tax than they currently do. However, given the limitations on the supply of commercial property in Jersey, it is likely that landlords would pass their additional cost on to their tenants in the form of increased rent. The extent of the impact will depend to a large extent on the size of any tax increases.

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Commercial properties – based on property value and charged to occupiers only	
Positive impact	Landlords of rented properties: A move to a consumer pays basis, based on property value would mean that landlords of commercial property would no longer pay owners' rates as they do at the moment. However, at the lower end of the market, landlords may absorb some or all of the additional cost to their tenants in order to ensure demand for their properties. This may be less marked in the commercial property market due to the relative lack of rental stock.
Neutral	Owner-occupiers: Owner-occupiers already pay the full set of rates. Shifting the burden to occupiers only would not change the total rate due.
Negative impact	Tenants of rented properties: As the consumers of rental properties, tenants would find their annual property tax bill increased. The businesses would have to decide whether to absorb the extra cost or to pass it on to their customers or to their staff . The impact would depend to a large extent on the size of the increased cost base – a smaller base could be more easily borne with relatively minor knock-on effects. Reliefs could be built into the system to protect some of those who might struggle to pay.

Section 5: Ensuring the public share in uplift in land values which they have helped to create

This section considers how the tax system could seek to ensure that the public receives some of the benefit when the value of a property increases through no action of the owner.

Summary table

Issue	Ensuring the public share in uplift in land values which they have helped to create.
What could this involve?	Taxing property owners on “super-normal profits” – that is profits on the sale of investment properties which reflect a general increase in the property market over and above investments generally, rather than any work done by the owner. It is unlikely that this would apply to owner-occupied residential properties. Other reliefs may be necessary. Taxing the uplift in the value of land when the States changes the use to which it can be put.
Why is this necessary?	Investors in property benefit from a number of factors when they come to sell, some of which are entirely outside their control. The tax system currently allows the public to share in profits they help to create in a limited range of circumstances. Broadening this would enable the benefits to be shared more easily.
Examples of how this could be achieved	Charging all property owners, apart from owner-occupiers of residential properties, on the uplift in the value of their property which is not attributable to their own efforts when they sell, subject to the introduction of a rate of return allowance or some other measure to limit the amount charged to tax. Introducing a land development tax to tax the owner of land which has increased sharply in value as a result of a States decision to change the use to which it can be put.
Who would be affected?	Primarily, the owners of investment properties apart from homeowners and/or the owners of land a change in whose use is approved by the States

Why is this necessary?

If we accept that part of the value of property is attributable, not to actions of the property owner, but to wider issues such as the performance of the economy and other factors created by the public, then it follows that the public should receive some of the benefit that accrues to the property owner.

Our tax system currently reflects this to an extent, in that property developers are taxed on their profits at 20%. However, this principle could be extended further.

Question 6: Do you think that the public should share in the profits on disposal of property that has not been created by the owner? Please explain any reasons for your answer.

How could this be achieved?

This section discusses examples of how the property tax system could be changed to better meet the principles outlined in Section 3. They are included to help the public understand what a modern property tax system could look like, but other options could be considered.

Taxing "super-normal profits" on disposal of property

In this context, super-normal profits are those made on the disposal of properties which reflect a general increase in the property market over and above the normal return on investments generally, rather than any work done by the owner. One way of doing this could be to give the owner relief for the initial capital cost of the property, increased to reflect a "normal" rate of return, and to tax the remaining profit made on disposal.

PwC suggest that the normal rate of return could be established by creating a "rate of return allowance" (RRA), which could be set at a level to reflect the normal expected rate of return on the value input by the owner.

To mitigate the effect of the tax for property owners in the short term, the base cost could be set at the market value of the property as at the date on which the tax came into effect. Disposals occurring soon after the tax came into effect would show very little taxable profit. However, if property prices increase above the RRA over the longer term, this type of tax has the potential to raise significant revenues in the future.

PwC has suggested this could be applied to all properties, or to rental properties only, or to all properties apart from owner-occupied domestic properties.

It would seem reasonable that losses arising from disposal of properties should be eligible to offset against other income under the normal rules applying to property income.

Question 7: What factors do you think should be considered in designing a system of taxing gains not attributable to the actions of the owner? Do you think that a rate of return allowance would be a reasonable way to establish the super-normal element of profits on disposal of property? To whom do you think this tax should apply? If it should just be applied to landlords, how do you think they could be identified?

Development gains

Using the same principles discussed above, there is an argument that the public should share in the benefit accruing to landowners from the uplift in the value of land where that uplift comes about because of decisions of the States to approve the development of land.

Most frequently, an uplift in value would be triggered by the Planning Minister granting an application for planning permission. It could also come about through the Island Plan process, whereby the States votes that particular parcels of green- or brown-field land may be used instead for housing purposes. The land immediately becomes more valuable once the decision has been made, without the owner having done anything to cause it *per se*.

A discussion of taxes on development gains must reflect the States' intention to ensure the supply of affordable housing for Jersey's population. Viewed in this light, the tax system offers one way of supporting development while also producing direct benefit to the public at large through increased tax revenues.

Considerable work has been done on introducing a specific tax on development land in the past (see Oxera's paper on Land Development Tax from 2008[3]). PwC agrees that it would in theory be possible to levy a tax on this uplift in land values.

They propose that the tax could be charged on the difference in value immediately before and after the change of use. They suggest that in order to encourage development to take place quickly (which presumably would be the intention of the States when approving a change of use), that the tax could be collected evenly over a five year period, starting from the date of the decision, or on the point of sale of the land, whichever is sooner.

Issues remain with this sort of tax. Some are technical – no territory that we are aware of has ever successfully implemented a tax of this type and there would be significant design issues to consider, including how to treat part disposals, mixed-use properties or transfers on death.

Other issues are practical, such as the fact that although charging tax from the date of the change of use may encourage speedier development, in practice the landowner will not receive any money from the property until it is sold, and so may well not be in a position to pay the tax.

[3] "Further analysis of land/development-based environmental taxes: What is the impact on Jersey?", Oxera, 2008: www.gov.je/consult

A Land Development Tax as described above could be used to encourage sites approved for development to be built on more quickly. However, there are other measures which have a similar economic effect, but could more directly promote the supply of affordable homes.

One of these measures could involve the introduction of a scheme similar to the UK's Community Infrastructure Levy, whereby developers are required to make a contribution to local authorities as a condition of planning approval. This was intended to partly reflect the cost of new development to the public, in the form of increased demand on infrastructure like roads, drainage systems etc. Funds raised are used to support local infrastructure and improve the local environment.

The planning system can also be used to encourage swifter development while also boosting the benefit to the public in other ways, including by requiring that a proportion of new developments be set aside for affordable housing.

From an economic perspective, both taxes on landowners and levies or other measures which affect property developers have similar effects. Oxera found that in a small economy like Jersey, developers are unlikely to accept measures that could affect their profitability, and that they would therefore seek to pass them on, either to the public in the form of increased property prices, or to the original owners of the development land, by reducing the prices they are prepared to pay. Landowners are much less able, Oxera say, to pass additional cost to developers.

Perhaps the most important issue with any measure intended to increase the benefit the public obtain from the development of land is to do with credibility. Jersey has tried to ensure a public benefit from the rezoning of land in the past, most recently through the H3 proposals in the 2011 Island Plan. This would have seen developers being required to set aside part of developments for affordable housing, or to pay a contribution to a social housing fund. In the face of vocal opposition, proposals before the States at the time of writing of this report (July 2014) would see Policy H3 being withdrawn and a further review to be undertaken.

The result is that landowners and developers may reasonably be sceptical about the likelihood that proposals of this type will be implemented and maintained, and while waiting for them to be withdrawn, may sit on property rather than develop it. This can have a negative effect on development and the provision of new houses in particular, which runs counter to public policy.

It is clear that if a measure like this is to succeed, it will require strong public and political support.

Question 8: Do you think that windfall gains arising from decisions of the States should be taxed? What are your views on Land Development Tax or the use of the planning system, or another mechanism, as an effective way of achieving this?

States of Jersey

Who could be affected?

Tax on super-normal profits on disposal	
Positive impact	The public would share in the profits on disposal of properties.
Neutral	Owner-occupiers of residential property, who we would generally not expect to be taxed on disposals.
Negative impact	Depending on how far the tax was applied, owners of all commercial property and/or landlords of residential properties would be taxed on the super-normal profits (if any) arising on disposal of their properties. It is possible that landlords would factor the potential tax into the rent charged.

Land development tax	
Positive impact	A tax designed to encourage swift development of properties following States decisions could support the provision of increased housing stock in the Island.
Neutral	Property developers: Investigations previously undertaken by Oxera have identified that in a small housing market like Jersey, additional tax levied on the seller of land to developers is generally borne by the landowner, and is not passed on to the developer through an increased purchase price. Any increase that was accepted by the developer would almost certainly be ultimately passed to the consumer through the sale price of the developed properties.
Negative impact	Owners of land approved for development: Oxera has previously indicated that the landowner will generally bear the cost of taxes on disposal of land for development purposes. Levying the tax from the point at which the development is approved could mean that the landowner was liable to tax before they had sold or developed the property. There could, therefore, be a tax liability before the landowner had received any return on the property to pay it. Consideration would have to be given to whether some form of tax relief was required in this situation.

States of Jersey

Section 6: Modernising the tax relief for the cost of buying property

This section considers how the tax system supports the financing of property purchase and the removal of distortions within the system which can adversely affect property prices and/or taxpayer behaviour.

Summary table

Issue	Modernising tax relief available for the cost of buying property.
What could this involve?	Rolling back actions of the States which were meant to make home ownership easier, but in practice only increase the cost of property. Putting beyond doubt that abusive claims for tax relief on interest used to buy rental properties will not be accepted.
Why is this necessary?	This could modernise the tax system, remove distortions, and improve the economic efficiency of the system.
Examples of how this could be achieved	Phasing out mortgage interest tax relief for home owners. Introduce a statutory limit on the amount of tax relief available to landlords.
Who would be affected?	Current and future home owners who borrow to fund the purchase. Landlords.

Why is this necessary?

The current system of reliefs for the cost of financing property purchase has inadvertently led to some negative consequences. Rolling back these reliefs could help to redress this position.

Mortgage interest tax relief for domestic properties

Mortgage interest tax relief ("MITR") acts as a public subsidy for home ownership. The relief currently costs the Jersey taxpayer approximately £12 - £14 million per year. No equivalent to MITR exists for those who cannot afford to buy, or who are not allowed to buy, and who are therefore required to rent their homes. In effect, this means that those on the lowest incomes and struggling the most to get on the housing ladder are subsidising the ownership of those who can afford to buy.

From an economic perspective, the existence of MITR merely acts to increase the price of properties, as it means that prospective buyers are in a position to afford to borrow more, as the additional repayments will be met through tax relief. Again, the unintended consequence of MITR is to push up property prices, which does not help people to afford to buy homes. In the majority of circumstances the tax system is an extremely blunt tool with which to seek to advance social policy. If the intention of policymakers is to use public funds to support home ownership, the extent to which MITR achieves this is questionable. As with most tax reliefs, most of the benefit of the relief is felt by those on higher incomes who can afford to borrow more (although those on the highest incomes who are not taxed at the marginal rate are not entitled to MITR). The effect of MITR on the ability of those on lower incomes to access the property market seems to be marginal at best if it does push up prices. The removal of MITR would represent a transfer of funding from homeowners to government, which could perhaps be better targeted to assist with housing affordability.

The question of withdrawing tax relief on mortgage interest is an emotive one. Many jurisdictions, including the UK, have withdrawn tax relief for mortgages on residential property, on the basis of the arguments set out above. However, their experience has been that it can be a challenging process and best achieved slowly and gradually to minimise the impact on taxpayers.

Regarding the timing of any withdrawal of MITR, PwC says a gradual approach is best:

> *"The lesson learned from the UK is that the removal of this relief is possible and that it is best achieved over a relatively long period of time."*[4]

Where there is a body of taxpayers who have recently purchased properties on the assumption that MITR will be available, withdrawing the relief too quickly could cause financial difficulties. At the same time, it would be unreasonable for anyone to assume that just because MITR is currently available, that it will always be available. Just as the interest rates charged on mortgages may fluctuate over the life of a debt, so may tax relief.

It should also be noted that the availability of MITR has been reduced over the last decade. In 2004 a cap was introduced on the total amount of borrowing in respect of which interest relief was available. At the time, the limit of £300,000 represented the average price of a three-bedroom house and the introduction of the upper limit affected a relatively small number of taxpayers. By the first quarter of 2014, the average price of two-bedroom apartments was £340,000, whereas the average price of a three-bedroom house was £458,000.

With the introduction of 20 Means 20 from 2007, MITR was gradually phased out for standard rate taxpayers over a period of five years. Only marginal rate taxpayers are now able to benefit from MITR.

The draft 2015 Budget proposes that a £15,000 cap should be placed on the maximum amount of interest available for relief annually. This measure is intended to place a reasonable cap on the amount of interest that can be deducted, based on the £300,000 borrowing limit (i.e. £300,000 x 5%). However, a decision has not been made to withdraw MITR.

[4] PwC, page 58

There are a number of options for withdrawing MITR, if that was decided. This could include gradually reducing the current limit of £300,000 in respect of which relief is available, or slowly reducing the maximum amount of interest that can be claimed in any one year. The impact of these on taxpayers would be broadly similar.

Withdrawal of MITR in the UK took over thirty years from start to finish. Even given the presumption that this is best achieved gradually, it would be assumed that the process would be somewhat shorter in Jersey.

For the avoidance of doubt, the following are **not** being considered:

- The abrupt withdrawal of MITR
- Grandfathering MITR so that it continues to be available for current homeowners only

Question 9: What are your views on the use of Jersey's tax system to support home ownership? Do you think that there are other options which should be considered to support housing affordability in Jersey and what are they? What are your views on the options for phasing out MITR and do you have any other suggestions?

Interest tax relief for landlords

It is important that those who own Jersey property as a business should pay the amount of tax that we expect on the income they earn from those properties. Concerns have been expressed in the past that some landlords might be abusing the tax system and claiming too much relief on interest paid. This was considered to be a particular risk where the funds to acquire the property were borrowed not from a commercial lender, but from a connected party.

In light of these concerns, a review has been carried out to examine the tax returns of corporate landlords, who are best placed to enter into borrowings with connected parties. The findings of this review were that tax abuse was not widespread in this population, although there were a handful of cases that warranted further investigation.

Like other businesses, landlords are only permitted to claim tax relief for expenses that are incurred wholly and exclusively for the purposes of their business. It is assumed that businesses are carried on with the intention of generating the most profit for the owner. Claims for expenses – including interest – which are considered excessively high will be challenged by the Taxes Office and may be disallowed when calculating the income tax due.

This general principle was strengthened in last year's Budget, which amended the Income Tax Law to give the Comptroller specific powers in respect of interest relief. Where the Comptroller determines that a loan has been made in circumstances in which the terms of the loan (including the amount lent and/or the rate of interest charged) are not in line with what a commercial lender would agree to, he can determine for himself what the market would have charged and make an appropriate adjustment to the tax computation.

Feedback has been received that suggests that there is some disquiet at the degree of discretion given to the Comptroller, and which suggests that businesses would prefer to have a greater degree of certainty around what level of debt financing is considered acceptable for tax purposes. Against this, however, is the desire for the tax system to be as simple and straightforward as possible, particularly when analysis of debt incurred by corporate landlords does not indicate widespread abuse.

PwC suggests that a potential solution to this could be to prescribe in law the proportion of gross rents on which a landlord is expected to pay tax. This could operate in a way similar to the marginal rate calculation for personal taxpayers, except with the opposite effect so that the taxpayer would calculate their liability under both the normal rules and the prescribed proportion basis, and would then pay whatever liability is the greater. The system could be administered quite simply by landlords as the prescribed proportion would be advised by the Taxes Office on a regular basis.

PwC suggest that this approach could be used to limit both the maximum interest deductibility and also other factors, such as including a factor for wear and tear.

A system like this would have to be designed very carefully to reflect a range of issues, not least the treatment of lease premiums, temporarily reduced rents and losses.

Question 10: What are your views on introducing a statutory limit on the amount of interest and other costs a landlord may claim against his tax liability? Do you think that the Comptroller should have discretion in this area? What factors do you think should be considered when setting the prescribed proportion?

Who could be affected?

Phasing out of mortgage interest tax relief	
Positive impact	Future home buyers: In the long term, removing MITR should remove that element of property prices which has increased to reflect the current availability of tax relief. However, it must be acknowledged that this could be difficult to definitively identify, as so many other factors also have an impact on property prices.
Neutral	Property owners with no, or low mortgages.
Negative impact	Acquirers of property financed by mortgages. Marginal rate taxpayers who claim MITR, taxpayers who are exempt from income tax due to MITR.

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Restricting excessive claims for relief by landlords	
Positive impact	Discouraging landlords from setting up structures to claim abusive amounts of tax relief could help to improve competitiveness in the rental market between those who are and are not in a position to enter into these type of arrangements.
Neutral	N/A
Negative impact	Landlords claiming abusive amounts of tax relief.

States of Jersey

Section 7: Stamp duty and Land Transaction Tax

The logical conclusion from a decision to move away from a system of charging relatively high tax on property transactions in favour of lower but recurring taxes on property value, is that stamp duty and Land Transaction Tax ("LTT") should be abolished.

The most up-to-date economic thinking indicates that charging stamp duty on property transactions is inefficient and, ideally, would not form part of a modern property tax system. At the same time, it must be acknowledged that stamp duty is a reasonably straightforward way for government to raise revenues, as it is difficult to avoid, easy to collect and a relatively stable source of revenue.

There is also an argument that stamp duty/LTT can be used as a mechanism through which to place a limited amount of control over the property market, where rates can be used to spur or restrain the market as appropriate. Evidence for how well this works in practice is, however, limited.

For these reasons, it seems impractical to consider abolishing stamp duty on property transfers in its entirety. However, it is also possible that changes could be made to the regime to mitigate some of its ill-effects, particularly at the lower end of the market.

It is proposed that a full review of the stamp duty regime for land and buildings be undertaken, with a view to rationalising and modernising the duties payable and the Stamp Duties Law itself.

Any changes made may also require consequential amendment to the LTT Law in order to ensure it mirrors the stamp duty position. A review could include:

- Considering, in the light of other proposals, whether there may be scope to reduce revenues from stamp duty by reducing rates or increasing the value of the bands

- Considering the position of first-time buyers and whether there might be a way of phasing in first-time buyers' relief so that there is less of a cliff-edge effect for purchases just over the first-time buyer relief threshold

- Looking to abolish the requirement to pay duty on the registration and re-registration of mortgages, subject to "user pays" principles

- Considering the introduction of relief for transfers of properties between connected parties

- Considering the alignment of the rates of stamp duty on death for moveable and immoveable property, where the moveable property consists of shares in companies holding Jersey land and buildings

The stamp duty regime reflects Jersey's property law, and the complexity of the one mirrors the intricacy of the other. It may be difficult to undertake a review of the one without also considering the other. Aspects of the way in which the Public Registry functions are currently being reviewed by the Jersey Legal Information Board, but the two reviews could be carried on in parallel.

Question 11: Do you think that a review of the stamp duty regime is required? If so, what issues should be included? What areas do you think should be prioritised?

States of Jersey

Section 8: Summary of questions asked

Question 1: Do you consider that the aims of the review provide the right framework for the future development of Jersey's property tax system?
Question 2: Do you consider that the principles proposed for Jersey's property tax system are adequate? Is there anything else you think should be included? Is there anything that should be excluded?
Question 3: Our aim is to make the system more transparent; what are your views on this? Are there any other ways in which the rates system could be improved?
Question 4: What are your views on an annual property tax based on the sale value or the rental value of domestic properties? What are your views on a self-assessment basis for establishing the value of property, or a periodic revaluation? Do you have a view on the types of relief that could be applied to owner-occupiers and to tenants who were unable to pay the tax?
Question 5: What are your views on an annual property tax based on the unimproved value of land or on the value of the property as a whole? What are your views on a self-assessment basis for establishing the value of property, or a periodic revaluation? Do you have a view on the types of relief that could be applied to those who were unable to pay the tax?
Question 6: Do you think that the public should share in the profits on disposal of property that has not been created by the owner? Please explain any reasons for your answer.
Question 7: What factors do you think should be considered in designing a system of taxing gains not attributable to the actions of the owner? Do you think that a rate of return allowance would be a reasonable way to establish the super-normal element of profits on disposal of property? To whom do you think this tax should apply? If it should just be applied to landlords, how could they be identified?
Question 8: Do you think that windfall gains arising from decisions of the States should be taxed? What are your views on Land Development Tax or the use of the planning system, or another mechanism, as an effective way of achieving this?
Question 9: What are your views on the use of Jersey's tax system to support home ownership? Do you think that there are other options which should be considered to support housing affordability in Jersey, and what are they? What are your views on the options for phasing out mortgage interest tax relief (MITR) and do you have any other suggestions?
Question 10: What are your views on introducing a statutory limit on the amount of interest and other costs a landlord may claim against his tax liability? Do you think that the Comptroller should have discretion in this area? What factors do you think should be considered when setting the prescribed proportion?
Question 11: Do you think that a review of the stamp duty regime is required? If so, what issues should be included? What areas do you think should be prioritised?

General question

Are there any other issues associated with the taxation of land and buildings which should be considered as part of this review?

States of Jersey

Section 9: Next steps including how to respond

The deadline for responses is **5pm on 31 December 2014**.

There are a number of ways to get involved with this consultation.

Focus groups will be arranged later in the year. These are organised by an independent market research company. Details of how to get involved will be announced on www.gov.je, in the local media and on social media.

An **online survey** will be launched shortly, and will be available on www.gov.je/consult. The launch of the survey will be announced in local media and via social media and www.gov.je.

Public meetings will also be held. Details will be publicised well in advance.

Email your response to this paper to tax.policy@gov.je.

Send your written response to:
Tax Policy Unit
Cyril Le Marquand House
PO Box 353
St Helier
Jersey
JE4 8UL

Your submission

If you are writing or emailing please provide the following information with your response:

- Your name and contact details
- Whether you are responding on behalf of a voluntary and community sector organisation, a financial services organisation, another company or organisation or as a member of the public

Please note that consultation responses may be made public (sent to other interested parties on request, sent to the Scrutiny Office, quoted in a published report, reported in the media, published on www.gov.je, listed on a consultation summary etc.). You need to tell us if you:

- Agree that your comments may be made public and attributed to you
- Agree that your comments may be made public but not attributed (i.e. anonymous)
- Do not want your comments made public

Next steps
All responses will be considered carefully, and a summary of responses will be published in the spring of 2015, with an indication of how the Minister for Treasury and Resources intends to proceed.