P.2022/112

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE

THE TAX REVIEW: PHASE 2

The States are asked to decide:

Whether, after consideration of the Policy Letter "The Tax Review: Phase 2" dated 28 November 2022, they are of the opinion:-

1) To agree that the projected financial position of the States of Guernsey is unsustainable and that measures must be implemented before the end of this political term to address the issue.

2.

A) To approve the development and implementation of a package of revenue raising measures designed to increase States' revenues by £50-60m by no later than the end of 2025 through:

   i. A restructure of the Social Security Contributions system, as outlined in section 8, including that all contributors be entitled to an allowance set at the same level as the personal income tax allowance and be liable for contributions on all income regardless of source;

   ii. The introduction of a broad-based GST at a rate of 5%, as laid out in section 6, with minimal exemptions and zero rating;

   iii. The introduction of a lower rate of income tax at 15% that applies to the difference between the first £30,000 of an individual's income, as calculated for the definition of "gross household income" under the Family Allowances (Guernsey) Law, 1950, and the personal and other tax allowances, mortgage interest relief and deductions for pension contributions they are entitled to; and

   iv. An increase in the Personal Income Tax Allowance of £600;

   and to direct the Policy & Resources Committee to include appropriate transitional proposals in future States of Guernsey Annual Budgets if required to implement the above package of measures.

AND:

B) To direct the Policy & Resources Committee to:

  i. Prepare the States of Guernsey Annual Budgets for 2024 and 2025 to include no real-terms growth in revenue expenditure, excepting the budget of the Committee *for* Health & Social Care; and

  ii. Include proposals within the Government Work Plan 2023 to reprioritise initiatives for which funding has not yet been released to the extent necessary to limit the additional expenditure to deliver these initiatives over the remainder of this term to a maximum of £5.7m, being 1% of the 2023 General Revenue budget.

AND:

C) To agree that, prior to the implementation of a GST:

  i. Income support benefit rates are increased by the percentage equal to the rate of GST applied to pre-empt the expected impact of the GST on low income households;

  ii. The States Pension and other benefit rates are increased by a rate equal to the forecast impact of the GST on RPIX;

  iii. A cost support scheme is made available to households with a gross income of less than £28,000 who are not in receipt of income support at an initial rate of £450 a year for a single adult and £675 for a couple;

  and to incorporate within the uprating of such benefits in the subsequent January, any adjustment necessary to align the change in benefits with the actual impact of GST on inflation should this prove greater or less than the forecast amount.

AND:

D) To note the intention of the Committee *for* Employment & Social Security to adjust the ten year plan for increasing contributions each year, in light of the resolutions following the debate on the Tax Review, in its annual Policy Letter on Contributory Benefits and Contribution Rates.

3) If the package of measures approved in proposition 2 is not sufficient to raise at least £50-60 million per annum, to direct the Policy & Resources Committee to prepare the States of Guernsey Annual Budgets for 2024, 2025 and 2026 to reduce States' expenditure on public services by such amount

necessary to put States finances in the position they would have been if that £50-60 million had been raised

4) To direct the Policy & Resources Committee to engage with industry and the other Crown Dependencies in order to develop proposals for raising further revenues from the corporate sector without unduly negatively impacting Guernsey's competitive position or compliance with international standards; this work to include developing proposals, which should be presented to the States for consideration no later than November 2023, for an alternative corporate vehicle or other appropriate form of entity or taxing structure which will be subject to income tax at 15% or such other rate or basis as the review may determine.

5) To endorse the intention of the Policy & Resources Committee to approve funding from the Budget Reserve to implement the proposals as outlined in section 11.

6) To direct the preparation of such legislation as may be necessary to give effect to the above decisions.

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE

THE TAX REVIEW: PHASE 2

The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

28 November2022

Dear Sir

1. Executive Summary

1.1 The States of Guernsey faces a growing structural deficit. As our population ages and the demand for pensions, health and care services grows, the gap between income and expenditure will continue to widen. This Policy Letter presents a package of measures which seek to address a significant part of the identified funding gap. At the same time, it takes the opportunity to address some of the key weaknesses within our current tax base, including the over reliance on direct taxes charged against personal income and the inequities inherent in the current Social Security Contributions system.

1.2 The key objectives and principles of this project were agreed by the States Assembly (Billet d'État I, Jan 2020) as follows:

The revised tax system must:

- be capable of raising revenues of up to 24% of GDP in a way that is economically and socially sustainable;
- be diversified between different forms of taxation;
- be transparent, simple and credible;
- be resilient to demographic change and economic shocks;
- support and facilitate sustainable economic growth and employment;
- comply with international tax standards;
- maintain alignment on corporate tax policy with Jersey and the Isle of Man;

- overall, reflect people's ability to pay and be generally progressive, while accepting that a balanced tax system will include some elements (such as excise taxes) which are considered regressive in nature;
- not discriminate on the basis of age, gender, marital status or employment status in assessing or determining the amount an individual must pay; and,
- support the delivery of environmental and social objectives if there are opportunities to do so without breaching the previous principles.

1.3 The total size of the funding gap identified was estimated at £80m to £90m by 2040 in the Tax Review Green Paper presented on this issue (Billet d'État XIX, September 2021). In the intervening period various risks have manifested which suggest that, without intervention, the funding gap could become as large as £100m. For example, the savings incorporated into the forecasts from Public Service Reform are now expected to be very significantly less than the £10m a year previously assumed, and the assumption that demand on health services would create an additional £3m of expenditure each year is unlikely to be sufficient.

1.4 However, there are also several potential opportunities which may contribute to a long-term solution. Some of these, such as the implementation of the OECD Pillar 2 rules and a change in the assumptions around migration, are dependent on external factors which government cannot directly control. Others, including wider reforms in corporate income tax, the future of how we tax motoring and exploration of taxation to support environmental issues, are still relatively early in their development. There maybe further opportunities to enable companies who wish to contribute more to the islands, perhaps for Environmental, Social and Governance ("ESG") purposes, to easily convert to an alternative corporate vehicle which will be subject to income tax at 15% on their profits. How much these factors might contribute is difficult to estimate, but it is hoped that combined they might contribute £40m to £50m.

1.5 Given that these opportunities exist, the Policy & Resources Committee recommends a lower revenue raising target of £50m to £60m to be achieved from the measures presented in this Policy Letter.

1.6 All of the alternative options and routes to closing the funding gap identified come with significant uncertainty. It cannot be guaranteed that they will deliver the expected financial benefit. If they do not, or if further cost pressures manifest beyond those incorporated into the forecasts, then subsequent Assemblies will face these difficult decisions again. Therefore, the structure proposed in this Policy Letter also needs to be capable of raising more if those other initiatives do not deliver.

1.7 Raising more revenue in total is the fundamental purpose of the measures presented and the recommended package raises an estimated £55m from a combination of businesses, visitors and households. However, the principles agreed require that how we raise revenues reflects people's ability to pay.

1.8 The Committee is conscious that the poorest in our community struggle financially and so the package of measures presented is designed to protect lower income households. The proposals, if adopted as a package, are not regressive, despite the inclusion of a GST. They are designed to ensure that the poorest households pay less than they do today and place the burden of additional revenue raising on those more able to pay. In fact, the analysis shows that more than 73% of the poorest third of households would be financially better off than they are today. This is made possible because the revenue raising is more widely distributed between households, businesses and visitors and non-residents and because the restructuring of the Income Tax and Social Security Systems will directly and deliberately help those on the lowest incomes.

1.9 The preferred package has a number of key elements:

- The introduction of a new 15% rate of income tax on income up to £30,000. This means that people will pay a lower rate on all income between the value of the personal and other tax allowances (including pension contributions, mortgage interest relief or transferred allowances) they are entitled to and the £30,000 threshold, which would provide a maximum reduction of over £800 a year (over £1,600 a year for a couple). Combined with the increase in the personal income tax allowance this will reduce personal income tax receipts by £29m.

- A progressive restructure of the Social Security Contribution system which reduces the liability of low- and middle-income households with a headline rate of 8.5% for employees and 8.0% for employers. This restructure raises £19m of revenues. This restructure will add an allowance for all classes of contributions which is aligned with the personal income tax allowance.

- An increase in the personal income tax allowance by £600 which reduces the income tax liability of low- and middle-income households by up to £120 per taxpayer (£240 per couple) with a further £1,150 (£2,300 for a couple) gained by applying the same higher allowance in full to social security contributions.

- A Goods and Services Tax (GST) at 5% which will form the primary mechanism for raising revenue estimated at £68m.

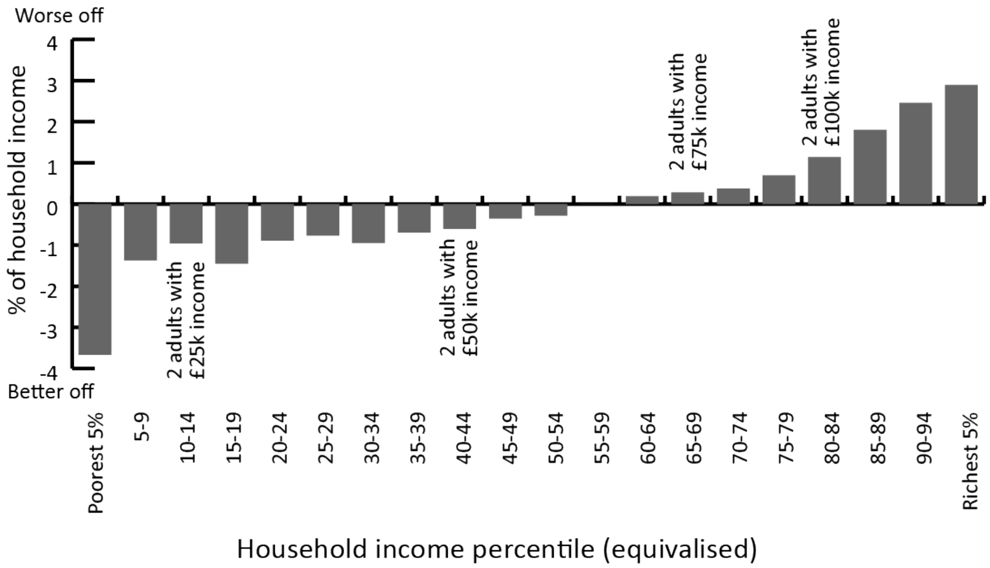
- A pre-emptive increase in the States pension and other benefits by 3.4% to reflect the increase in prices anticipated at the introduction of the GST.

- A pre-emptive increase in Income Support rates by 5% to reflect the increase in prices of items in the Income Support "basket of goods" anticipated at the introduction of the GST.
- A further package aimed at providing financial support for low-income households outside of the welfare system.

1.10 The package presented will provide an ongoing net gain of approximately £55m a year in income to the States. Because the revenue raising is split across social security contributions and a 5% GST combined with a reduction in revenues from personal income taxes, the net impact is split between households (41% or £23m), businesses (48% or £27m) and visitors and other non-residents (11% or £6m). As a result, this package has allowed a lower impact on households than could be achieved if the proposals were reliant solely on income-based taxes.

1.11 The proposals as a whole are designed so that, after allowing for inflationary increases in pensions and benefits, the overall change is progressive (Figure 1). On average, households in the bottom third by income would expect to be financially benefited by the proposals, the impact on the middle third of households should be, on average, less than 1% of their income either better or worse off and those in the most affluent third would be expected to pay more overall (up to an average of 3% for the top 5%).

Figure 1: Impact of proposed changes as a percentage of gross household income



1.12 The restructure of the social security system is central to these proposals and particularly beneficial for low income working families. The proposed changes have been designed so that they will raise £19m – just over half of the £34m of underfunding identified within the social security system which the States have previously agreed to address through the 10-year gradual increase in contributions.

1.13 For someone working 35 hours a week on minimum wage (about £17,400 a year) the proposed restructure would reduce their contributions liability by about £860 a year against what they would be expected to pay in 2022 and by £1,070 a year against what they would be paying if the increase in contribution rates under the current structure agreed in October 2021 proceeds unchanged (a net benefit of 5.0% or 6.2% of their income respectively). For those in low-income employment the change in the contributions system alone may be enough to compensate them for the increased prices as a result of a GST and they will be further supported by changes in personal income tax and benefits.

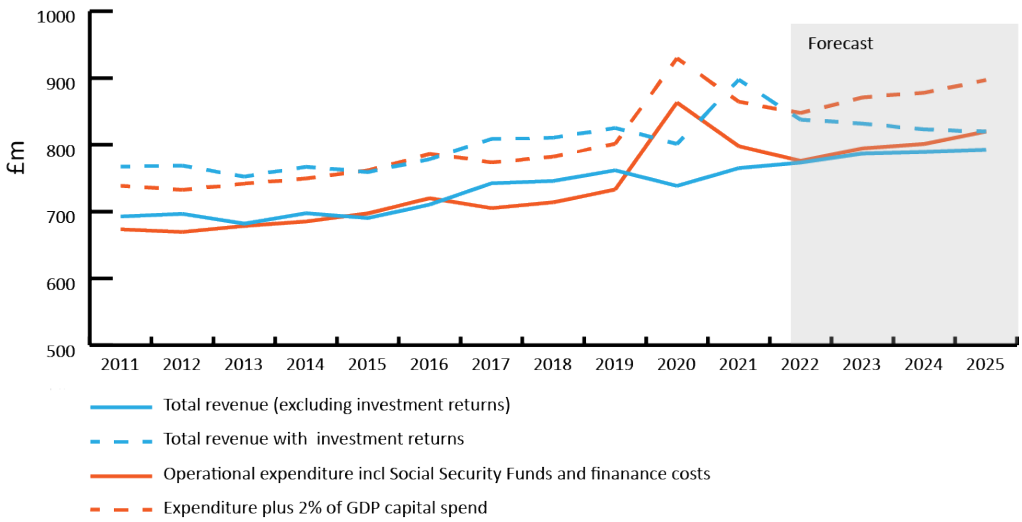
1.14 The proposals presented on income tax are intended to reduce the personal income tax liability for all uncapped taxpayers. By including both a 15% tax band on income up to £30,000 and a moderate increase in the personal tax allowance, households across the income profile will have the cost of GST at least partially offset, but this benefit will be focused on middle- and lower-income households.

1.15 Higher income households will pay more both through the restructure of the contributions system and via the GST.

2. The funding gap

2.1 The update to the Funding and Investment Plan (F&IP) included in the 2022 update to the Government Work Plan (Billet d'Etat X, June 2022, 2022) presented a reforecast of the States expenditure over the remainder of this political term.

Figure 2: States aggregate income and expenditure 2011-2025 (at 2021 prices)

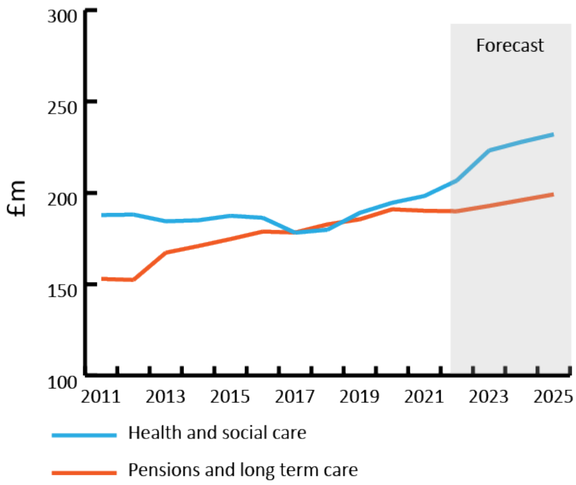


2.2 The much better than expected outturn for 2021 as the economy bounced back faster than anticipated following the COVID lockdown means that it is unlikely that the States will need to take out any further external borrowing in this term to fund the capital portfolio. However, the current tax system and rates do not generate enough revenue to cover both our increasing operational and capital requirements and the execution of the plan will still result in the large majority of the States' reserves (except those allocated to support the social security system) and the balance of the Bond issue being expended over the remainder of this term. The States' current accounting presentation also separates the financial position of General Revenue from the growing deficit carried by the Social Security Funds. The intention is to consolidate these accounts from 2023 and it is this aggregated position which is important when planning the States' finances in the long term.

2.3 Figure 2 shows both the history of States income and expenditure over the last decade and the financial position forecast over the lifespan of the F&IP (*note that investment returns have been averaged to make the interpretation easier*). This shows how the States' general financial position has changed over the last decade and how this is expected to progress over the next 4 years[1].

2.4 Between 2011 and 2025 operational expenditure is forecast to have increased by 22% in real terms. This is driven by increases in the total spend on health and social care services (24%) and States pensions and long-term care (30%) as the population ages (see Figure 3).

Figure 3: States expenditure on key services 2011-2021 (at 2021 prices)



2.5 It is anticipated that the States' revenues, before investment return, will also have increased but more slowly, as the balance of the population shifts towards a larger proportion of pensioners.

2.6 A structural deficit already exists – there is a mismatch between income and expenditure which is not a result of economic conditions but will persist, and worsen, over time. While the revenues generated are currently sufficient to fund

[1] These forecasts include the impact of any policy formally approved by the States. That includes the implementation of NICE drugs up to the end of stage 2, and secondary pensions. It does not include policy in development and not yet approved and/or fully costed. Potential policy changes not incorporated include the expansion of the LTCF to cover care in persons own home and the review of primary care.

the majority of day to day expenditure, they do not cover all of the costs of the social security schemes or the required investment in infrastructure and replacement of assets. The 2023 budget outlines a structural deficit (including an assumed 2% of GDP of capital spend) which already totals £43m, and which reaches £58m when the deficit on the Social Security Funds is included.

2.7 The Funding & Investment Plan (F&IP) outlines how the States' reserves will be used to support its capital programme over this term. This is a short-term solution. Once those reserves have been used an alternative source of funds will be needed to continue to meet all the States' funding requirements and invest in infrastructure.

2.8 The use of these reserves also means that investment returns will fall over the period[2]. Further the States have been planning for some time to use the reserves accumulated in the Guernsey Insurance (GIF) and Long-Term Care (LTCF) Funds to help smooth the additional cost impact of the ageing population on the benefits they fund. This means the investment returns on these funds are also expected to reduce over time. This loss of investment returns as the capital is depleted is itself a symptom of the structural deficit. When investment returns are included the increase in income between 2011 and 2025 is only 7% - just a third of the increase in expenditure over the same period.

2.9 The analysis shows the States' existing structural deficit is getting wider. Within General Revenue this is expected to amount to approximately £43m in 2023 if the States are to meet the requirement to spend an average 2% of GDP on capital (Figure 3). The Social Security contributory benefits schemes are expected to be running a combined deficit (including investment return) of £14m in 2023 bringing the total structural deficit in 2023 to £58m. However, the long-term actuarial forecasts show that, even with the managed drawdown of most of the reserves held, these schemes will need up to £34m of additional revenues each year so they can continue supporting pensions and long-term care services over the next 50 years. The States have already agreed a 10 year programme of increase to Social Security Contributions to address this should the Tax Review not deliver an alternative.

[2] If the States had opted to keep the reserves and borrow instead the annual repayments would be added to the operational expenditure. This amount would likely be of similar magnitude to the loss of investment returns.

Figure 3: Forecast structural deficit

	2023 Budget
General Revenue Income	582
General Revenue Expenditure (incl GWP)	(573)
Revenue Surplus/(Deficit)	9
Capital income	3
Investment Return	27
Provision for trading losses	(6)
Assumed capital requirement (2% GDP)	(76)
Overall General Revenue Surplus/(Deficit)	(43)
Combined deficit on States' pension and long term care scheme	(14)
Combined Surplus/(Deficit)	(58)
Changes anticipated between 2023 and 2040	
Secondary pensions impact (additional revenue impact to peak)	(9)
Health and Social Care increased demand	(45)
Additional funding required to balance States' pension and Long Term Care scheme (beyond £14m included to 2025)	(20)
Loss of investment return	(10-20)
Economic and revenue growth	60
Forecast Structural Deficit by c2040	(80-90)

Forecast risks and new pressures

- Higher than forecast pressure on Health and Care spend (up to £20m)
- Lower than forecast delivery of savings (up to £10m)

Adjusted Structural Deficit by 2040	£100-£120

Alternative routes to closing the funding gap

- Higher net migration, participation and/or productivity (c£10-£20m)
- Corporate income tax reform and application of OECD rules (up to £20m)
- Smaller revenue streams including environmental and motoring taxes (up to £10m)

Immediate revenue raising target	50-60

2.10 Beyond this horizon, this structural deficit is expected to widen further. The cost of providing health care services is likely to continue rising as the population continues to age. The baseline estimate is that this could add a further £45m to annual expenditure by 2040 (an increase of around £3m each year). In the very long-term Secondary Pensions is expected to be revenue neutral, but there is an extended transition during which time the lost revenues (estimated to peak at around £9m) will need to be replaced.

2.11 The States have utilised much of its reserves over the last 15 years for a variety of reasons. The States have a policy in place that the Core Investment Reserve should hold the equivalent of one year's worth of expenditure. It currently holds less than 30% of the forecast spend for 2023, but no allowance has been made in the forecasting for replenishing its value.

2.12 Combined, these factors imply a forecast structural deficit position of between £80m and £90m within the next 20 years.

Risks to the forecasts

2.13 The future is difficult to predict and, in any forecast, there are risks that the outcome will be better or worse than expected because of factors that may be difficult to predict or control. The factors listed below are those areas identified as most likely to negatively impact the outcome.

- ***Larger than anticipated demand pressure***

2.14 As outlined above, the forecasting in the F&IP assumed an average increase in the cost of health care services resulting in a real increase in health spending at a rate of around £3m each year. This assumption is based on an analysis of the spending baseline and the application of cost across the population and incorporates an increase in the proportion of people in older age groups who typically require more care.

2.15 However, the budgetary pressures evident over the last few years show that at present the cost pressures are significantly higher than this and there is a risk that this will persist.

- ***Savings delivery***

2.16 Failure to meet projected savings could widen the structural deficit. For example, the forecasts include £10m a year in savings by 2025 but progress with delivery of such savings has been slower than expected and those delivered have generally been lower than planned. Further significant efficiency savings may prove unrealistic, given that Guernsey's government is already small relative to its comparators.

- ***Future service development and unforeseen costs***

2.17 The forecasts incorporate only costs for which there is a clear political direction and formal cost estimates of provision. There will inevitably be other cost pressures which will arise outside of those currently foreseen. In recent years the most significant example of these is the introduction of NICE TA drugs, treatments and devices following a Requête laid in 2018. The forecast cost of this decision by 2025 is £5m a year.

2.18 There are also policy development workstreams within the GWP which have the potential to add additional on-going costs should that be the direction provided by the States when these are brought for debate. This may include further development of proposals around access to Primary Care or the long-term care services provided in people's homes. However, until this work has been completed and the States' have agreed a policy direction, the cost impact cannot be incorporated into the forecasting.

Alternative routes to closing the funding gap

2.19 There are a number of opportunities and measures which might help to address the deficit. These are discussed below, together with the Policy & Resources Committee's recommendations as to the extent to which the initial revenue raising target (that to be achieved in the first tranche of changes) should be reduced to reflect the possibility that additional financial gains might be made from these. Given that these other measures between them have the potential to close the funding gap by £30-40m, the proposals in this Policy Letter only seek to raise part of the overall funding needed.

2.20 None of these are certain. Any or all of them could ultimately fail in delivery of the level of financial benefit expected. Should that be the case then the first tranche of structural changes may need to be followed by further revenue raising by future Assemblies. An important element of the structure presented is that it could raise more revenue in a sustainable way if required.

- ***Population, participation, and productivity***

2.21 The forecasts presented, here and in the F&IP were presented on the assumption that in the short term, net migration would be above average but that in the long-term migration would average about +100 people per year – the average level of net immigration experienced since 2008. It also assumes that participation would remain constant and productivity growth would be relatively modest.

2.22 These assumptions have implications for Guernsey's finances, both in terms of revenue and expenditure. As outlined in the Policy Letter on the Population and Immigration Policy Review (Billet d'État XVIII, October 2022), a higher level of net migration of +300 people per year would mean more people in employment and more economic activity which would increase States' Revenues. However, it also implies a larger population and higher demand for public services and the need to provide more infrastructure (and a greater provision of housing in particular).

2.23 On balance, a higher level of net migration should be a net positive for Guernsey's finances in the medium-term. If net migration increased to on average 300 people per year, the financial position might be expected to improve, at a 20-year horizon, by between £14m and £23m a year (Billet d'État XVIII, October 2022). Much of this is likely to benefit the Social Security funds, where the additional revenue gained would help slow the drawdown of the funds supporting a greater level of investment return for longer. However, that net gain is likely to reduce in the longer term as these additional residents begin requiring a greater level of services as they themselves age. Additional revenue will also accrue to General Revenue, largely through personal income tax, but General Revenue will also bear additional cost for infrastructure and service provision to support a larger population, which reduces the net gain.

2.24 Guernsey's current level of net migration is higher than the long-term assumption of 100 people per year - net immigration in the year ending December 2021 was 585 and (excluding the period of lockdown in 2020) it has been above 100 since 2017. However, migration is cyclical and even within the last ten years Guernsey has experienced periods of net emigration peaking at a net loss of 464 people in the year ending March 2013. The current very high levels of net migration are likely to end when economic conditions, either domestically or externally, change so that Guernsey becomes less attractive as a place to live relative to competitor jurisdictions.

2.25 In October 2022 the States resolved to "…assume, for the purpose of planning future infrastructure and service provision, that net migration will average up to +300 per year over the next thirty years. This assumption will support the capacity of the Island's workforce so that it remains a desirable and competitive jurisdiction and will ensure that the Island can meet the needs of the economy with the necessary housing and infrastructure." (Billet d'État XVIII, October 2022)

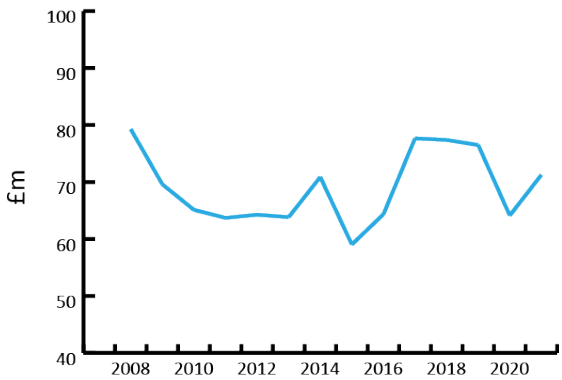
2.26 The agreed resolution specifically relates to the planning of infrastructure and service provision with the intention that the Island has the *capacity* to support a larger population and that a lack of capacity does not become a barrier to growth. It is not in any way a guarantee that in the long term a higher level of net migration will be achieved, particularly given that net migration is cyclical and largely driven by factors outside the States' direct control. None-the-less a higher level of net migration, participation or productivity, could ameliorate the financial gap.

2.27 The Committee notes that this gain is far from assured but does consider that some amelioration of the immediate revenue raising target is appropriate to reflect this opportunity.

- ***Corporate income tax***

2.28 Corporate income taxes make up approximately 10% of Guernsey's current revenues. Despite the headline 0% rate the proportion of government revenues they comprise is similar to the international average (although this varies considerably from country to country). Taxes on company profits tend to be volatile since they are very sensitive to economic conditions (Figure 4). This means few countries choose to rely on these as their primary source of revenue.

Figure 4: Corporate tax revenues incl. distributions (at 2021 prices)



2.29 The progression of the OECD's international agenda on anti-Base Erosion and Profit Shifting has resulted in an international move to ensure that the world's largest companies (those multinational groups with global revenues of more than €750m) pay a minimum effective rate of tax of 15%. The first Policy Letter on the Tax Review debated in September 2021 incorporated an assumption that responding to Pillar 2, would contribute an estimated £10m of additional revenue. This assumption remains unchanged at this stage, but final estimates will depend on how these new proposals are applied both here and elsewhere, what opportunities may arise from applying a "top-up" tax to subsidiaries of these businesses present in Guernsey, and how much of this income is already taxed in other jurisdictions.

2.30 It is evident that the international corporate tax environment is changing. Longer term it is possible that the OECD will seek to lower the threshold at which minimum effective tax rates apply to large multinational enterprises (currently global revenues in excess of €750m) and the international pressure on the Crown Dependencies is likely to continue.

2.31 During the phase of work on this project since September 2021, an exercise has been undertaken to examine what further options might be available to Guernsey to modify its corporate tax regime in a way that remains internationally acceptable and competitive. The report commissioned to investigate the available options is provided in Appendix 3. The high-level investigation into the possibilities of raising more revenue from corporate tax, beyond the £10m of revenue assumed from responding to Pillar 2, suggests that there are opportunities, but they are not sufficient to meet the funding gap. Any structural change is also likely to overlap with the £10m already assumed from responding to Pillar 2. Based on the analysis provided, the maximum level of revenues that could be raised through an expansion of the zero-10 regime is £20m. A move to a territorial tax system, with suitable provisions for those entities that require tax neutrality to operate effectively in an international market, would raise a similar amount.

2.32 Several options will be examined further including:

- a specific corporate vehicle which would enable companies otherwise taxed at 0% to pay a 15% tax rate for the purpose of fulfilling their Environmental, Social and Governance objectives.

- a fixed annual fee to companies that benefit from Guernsey's regulatory and judicial regimes.

2.33 The Policy & Resources Committee does believe there are opportunities to raise more revenue in this area. However, it is not possible to present detail without extensive engagement with industry and the other Crown Dependencies which will need to be carried out in tandem with the proposals in this Policy Letter. This will take some time as this work is economically sensitive and cannot be done in isolation or without extensive consultation and testing.

- ***Smaller revenue streams including environmental and motoring taxes***

2.34 The States have a small number of other revenue streams, including TRP, excise duties and document duties. There are also specific elements of the income tax system which can be modified to raise small amounts of revenue, including the threshold at which allowances are withdrawn for high earners, and the various tax caps. Generally, these are adjusted each year through the annual budget. Individually these have limited scope for raising revenues (discussed further in Appendix 5).

2.35 The F&IP already assumes that £1m of additional revenue will be raised each year from such measures and smaller taxes, such as real terms increase in TRP or excise duties, are the most likely route to achieve this. Such measures generally do not require major reforms and they are better suited to consideration within the annual budget process than as part of the consideration of these, more structural, proposals. This approach provides greater flexibility to adapt plans to the prevailing economic circumstances at the discussion of each budget.

2.36 The States have also identified that revenue from fuel duties is becoming increasingly unsustainable, as vehicles become more efficient and increasing numbers of households' transition to electric vehicles. A workstream to investigate the future of motor taxes, including the potential for distance charging, has been delegated to the Committee *for the* Environment & Infrastructure. It should be noted that the primary intention of this workstream is to address the current erosion of fuel duty receipts. The original proposition is phrased such that it should raise the same amount of revenue as the current fuel duty. There may be some capacity to raise revenue beyond this, and the Policy & Resources Committee have asked the Committee *for the* Environment & Infrastructure to consider this, but any such excess revenue is likely to be relatively modest.

2.37 Given the feedback from the Green Paper debate, the Policy & Resources Committee has requested the Committee *for the* Environment & Infrastructure to investigate opportunities for environmental taxes. However, such taxes, which are designed to influence behaviour, are poor candidates for revenue raising in the long term, since where they are successful in achieving their environmental aims, their revenue raising potential erodes over time. They also tend to be regressive, because they typically require a capital outlay to minimise their cost (for example buying a more fuel-efficient car or insulating a house) and those on lower incomes tend to have limited capacity to make these adaptations unless specific support is provided by the Government, which itself erodes the revenue gain.

Revenue raising target

2.38 The opportunities outlined above could meet a significant proportion of the funding gap, albeit they all come with a substantial level of uncertainty around deliverability and timeframe. Given that these opportunities exist, the Policy & Resources Committee consider it appropriate to use this as a basis on which to set the target for revenue raising from the measures presented in this Policy Letter at a level lower than the full estimate of the funding gap. However, any reduction in the immediate target needs to be offset by the known risks to the forecasts including the significant reduction in expected savings from Public Service Reform and the higher than anticipated pressure on health spending. It is also necessary to recognise the risk associated with these opportunities which may not deliver the full extent of the expected benefit.

2.39 **Combining these factors, the short-term target of the measures presented in this Policy Letter is to raise £50m to £60m by non-corporate tax measures which it proposes be put in place over the remainder of this political term.**

2.40 The balance of the shortfall will need to be met by changes in corporate and other taxes, improved economic growth and productivity and spending restraint over a longer time horizon.

3. Cost savings and service cuts

3.1 As part of the work undertaken to justify and understand the need for addressing the structural deficit, the Policy & Resources Committee has engaged with Principal Committees to examine the scope for reductions in the cost of public services, recognising that identification of opportunities to make savings within

Committee budgets is best performed by each Committee. The work undertaken was overseen by the Cost of Public Services Sub Committee, which was established following the first debate on the Tax Review in September 2021. This Sub Committee was chaired by Deputy Helyar and included a representative from each Principal Committee.

3.2 In undertaking this exercise, the Committee wishes to stress that it is **not** intending to propose such significant budget reductions. However, it is important to outline what measures would need to be taken should it be necessary to make substantial reductions in Committee budgets in order to fund the known cost increases as a result of the ageing population and policy decisions already taken. This is so that we have a clearer understanding of the consequences of a choice between reduced services and increased taxation.

3.3 All Principal Committees were requested to complete a framework document outlining what measures they felt they would need to consider *if* they were asked to reduce their Committee budget by 5%, 10% or 15% (Figure 5. Should there be a desire to close the structural deficit by cuts in expenditure/services alone, then budgets would need to be reduced by circa 13%.

3.4 **It was stressed that the aim is to establish the consequences of a significant reduction in spending on existing services for illustration purposes only and that the results of this exercise would be used to inform our continuing discussion on taxation and spending. At this stage these potential "savings" are entirely hypothetical. Significantly more work would be needed to assess both their feasibility and understand the overall consequences.**

Figure 5: 2022 Budgets of principle committees

COMMITTEE	**2022 General Revenue Budget £'000**	**5% £'000**	**10% £'000**	**15% £'000**
Economic Development	8,425	420	840	1,260
Education, Sport & Culture	84,040	4,200	8,400	12,600
Employment & Social Security	76,885	3,845	7,690	11,535
Environment & Infrastructure	12,905	645	1,290	1,935
Health & Social Care	198,100	9,900	19,800	29,700
Home Affairs	34,965	1,750	3,500	5,250
Policy & Resources – Core Services	14,280	715	1,430	2,145
Corporate Services	43,175	2,160	4,320	6,480
TOTAL	**472,775**	**23,635**	**47,270**	**70,905**
Social Security Fund expenditure	**195,175**	**9,760**	**19,520**	**29,280**

3.5 Each Committee was requested to provide a brief, high level outline of areas that would be prioritised for investigation at the various levels of cost reduction and their primary risks and benefits (including where these risks might impact other Committees). These areas were classified as:

- Sustainable efficiency savings[3]
  - These are cost savings which will not impact the level of service received by the population (although it may change the way in which it is delivered).
  - Any measure given serious consideration should be both recurring and sustainable.
  - These should be in addition to measures which are already part of Public Service Reform.
- Restrictions in access to public services
  - This is intended to cover areas where restrictions are placed on who can access services. For example, the means testing of Family Allowance or the tighter residency restrictions proposed for entitlement to Long Term Care Grants.
- Reductions in public services
  - This would reduce the level of service available to all users of a service. This might include examples where opening hours are reduced, the scope of the service provided is reduced or a service withdrawn entirely.
- Revenue generation
  - This would include areas where fees or charges were applied to services at an appropriate level.
  - Other operating revenues, such as charging for services which are currently free at the point of delivery might also be considered.

[3] If Committees identified strong opportunities in this area, they were encouraged to either progress these within their Committees if they are able, or to enter into discussions to incorporate these within the Public Service Reform Programme.

Figure 6: Approximate distributions of cost saving measures identified

COMMITTEE	**15% £'000**	Sustainable efficiency savings[4]	Restrictions in access to public services, or remodelling of services	Reductions in public services	Revenue generation
Economic Development	1,260	0%	30%	62%	8%
Education, Sport & Culture	12,600	2%	19%	79%	0%
Employment & Social Security (including funds)	40,815	0%	0%	100%	0%
Environment & Infrastructure (preferred approach)	1,935	0%	0%	0%	100%
Health & Social Care	29,700	7%	90%	2%	1%
Home Affairs	5,250	n/a	n/a	n/a	n/a
Policy & Resources – Core Services	2,145	0%	0%	100%	0%
Corporate Services	6,480	0%	0%	100%	0%
TOTAL	**100,185**	**3%**	**31%**	**64%**	**2%**

3.6 **Principal Committees identified cuts that could be made but all have stressed that these would have very significant consequences for the range and quality of public services delivered in Guernsey and have wider negative consequences for the community**. In submitting the options, Principal Committees were also all of the opinion that it would be counterproductive to publish a list of the items that would be considered given their far-reaching consequences and the hypothetical nature of the exercise.

3.7 However, the Policy & Resources Committee is of the opinion that it is important that – in helping the States to decide whether to impose new and increased taxation on the community – this Policy Letter includes illustrations of the type and extent of the cuts that would be necessary should no additional revenue be secured. The examples listed below cover some of the items identified if they were to reduce expenditure by up to 15%.

[4] If Committees identified strong opportunities in this area, they were encouraged to either progress these within their Committees if they are able, or to enter into discussions to incorporate these within the Public Service Reform Programme.

3.8 The **Committee *for* Economic Development** identified a range of measures including;

- A reduction in the Committee's core policy and operational areas which would reduce the Committee's ability to support the finance sector and to support business innovation and growth;
- A reduction in the budget for Grant & Support Schemes which would reduce the ability of third-party organisations funded by the Committee to deliver their core activities;
- A reduction in the Marketing & Tourism budget which would reduce the reach of marketing campaigns and lead to fewer visitors to the Islands.

3.9 However, the Committee advised that *"a budget reduction of 10% and 15% respectively would have a severely detrimental impact on the Committee's ability to deliver on key work streams identified within the Government Work Plan"* and that *"We urge Members to consider the core remit of the Committee for Economic Development, which is to facilitate economic development and growth within the Bailiwick, to generate incremental employment and tax take for the benefit of the local community. It is this Committee's opinion, therefore, that any further budget reductions over and above 5% would be to the detriment of GDP, employment and subsequent tax take and therefore, a false economy."*

3.10 The **Committee *for* Education, Sport & Culture** identified measures which could reduce expenditure by £12.2million predominantly through reductions in or restrictions to access of public services. Achieving this kind of reduction in expenditure would require measures such as:

- Removal/reduction of grant funding (e.g. Grant-Aided Colleges; Guernsey Sports Commission, Youth Commission)
- A change in eligibility criteria to reduce Higher Education expenditure;
- Ceasing funding for Guille Alles library;
- Removal/reduction of non-mandatory services (e.g. Museums Service, Schools Music Service); and
- The closure of a Primary School.

3.11 The Committee would wish to stress that substantially more work is required to understand the implications of cuts of this magnitude on the community, the third sector and wider committee mandates. The Committee further notes that such measures might be counterproductive given the important role of education and enrichment in supporting skills and development which are integral to supporting the earnings capacity of the future working population, particularly among those who might not be able to access these services without government support.

3.12 The **Committee *for* Employment & Social Security** identified a range of measures which it advises could deliver significant reductions in expenditure. Potential options included:

- A complete removal of family allowance;
- A reduction in all benefit rates noting that a 5% budget cut would require a 5.7% reduction in rates and a 15% cut would require a 23.5% reduction in rate;
- A restriction of access to benefits (including an affluence cap for the States' pension);
- Removal or means-testing of some benefits (including death grant, industrial injury, parental, bereavement, unemployment, winter fuel allowance for energy efficient households, Severe Disability and Carers Allowance, school uniform grants); and
- Changes in long-term care provision so people have to support more of the cost themselves, which may be supported by an equity release scheme.

3.13 In its response the Committee *for* Employment & Social Security noted that restrictions in benefit levels would be hugely unpalatable, and in particular highlighted the role of income support "*to avoid intolerable poverty*". It noted that while the indicative reductions in income support to achieve the hypothetical savings have been provided as part of this exercise, the Committee would consider this completely unacceptable in practice.

3.14 The **Committee *for the* Environment & Infrastructure** advises that its preferred option would be revenue-raising instead of expenditure reductions and has identified a range of measures for increased prices / introduction of new charges that would generate additional income which would negate the need for a wider range of spending cuts including:

- Charging for roadworks and parking suspensions;
- Introducing charges for corporate and commuter parking in some locations; and
- Charging for school bus services.

3.15 Should it be required to deliver expenditure reductions, the Committee has identified measures such as:

- Stopping beach cleaning, cutting the south coast cliffs and works in winter to maintain steps;
- Stop maintaining / dispose of Candie Gardens and coastal and town plantations; and
- A reduction in off-peak bus services.

3.16 The Committee notes that "cutting services in these areas… would negatively impact both tourism and visitor experience and also the local community."

3.17 The **Committee *for* Health & Social Care** advised that measures totalling £29.85m have been identified although £4.5m are categorised as cost avoidance (i.e. not saving money from existing budget but avoiding the need for an increased budget in the future).

3.18 The large majority of these reductions would come from service restrictions and reductions or a remodelling of existing services. In view of the large spread of services which the Committee provides, there are a number of initiatives which could reduce revenue expenditure but would result in lesser service provision and may be counter-productive in the long-term. These might include:

- Reviewing the progression of the funding of NICE TAs;
- Reviewing the model of service provision for adult community services;
- Increasing emergency department charges for adults; and
- Consideration of moving to a partial user-pays model for secondary care.

3.19 The Committee notes that these suggestions, including asking the community to contribute financially to a wider range of health care services, would represent a shift in the current model for funding for health and care and would require further detailed consideration and analysis to examine the consequences of such a change.

3.20 The **Committee *for* Home Affairs** has not provided any new initiatives to the £300,000 of potential savings opportunities it identified at the end of 2021. The Committee has advised that *"the Committee already operates exceptionally lean services, and believes strongly that further budget reductions risks damaging the infrastructure that ensures the safety and security of the Bailiwick"* and *"the Committee would describe any cost cutting exercise that would see budgets reduced by 5% as unachievable and potentially dangerous for the community."*

3.21 Opportunities previously identified included:

- *Tagging as an alternative to custodial sentences*;
- *Modernisation of fixed penalty notices*;
- *Adoption of the National 'Single Online Home' web-based platform for digital, contact and crime reporting; and*
- *Outsourcing of 'Court Group' prison officers.*

3.22 Reductions in the core budget provided to the **Policy & Resources Committee** of up to £2.75m were identified which would involve measures such as:

- Restricting the service levels on the Alderney PSO contract;

- Reducing the size of all Revenue Service teams with the consequential impact for service delivery and meeting international commitments; and
- Withdrawing from the Bureau des Iles Anglo-Normandes and the Channel Island Brussels Office.

3.23 In respect of **Corporate Services,** measures that would need to be considered include:

- Reducing the size of all enabling service teams with the consequential impact for service area support;
- Cessation of various IT contracts;
- Reducing insurance coverage in order to lower premiums (increasing the level of risk and self-insurance); and
- Restrictions/closures of public conveniences.

3.24 The Policy & Resources Committee appreciates the significant work undertaken by Principal Committees in compiling the possible cost cutting measures but also that these are theoretical only. Should the States not have an appetite to raise the revenues required to continue to fund the level of public services currently offered, further detailed work would be required by all Committees to further understand the options and implications of such drastic expenditure reductions.

3.25 The charts below show the growth of public expenditure in real terms over the past ten years. Although some of this growth has been as a result of increased demand, particularly in health and social care services and benefit expenditure (predominantly the States Pension), part of the increase is as a result of new legislation, service developments and policy changes

Figure 8: Aggregate operational expenditure including pensions and long-term care (at 2021 prices)

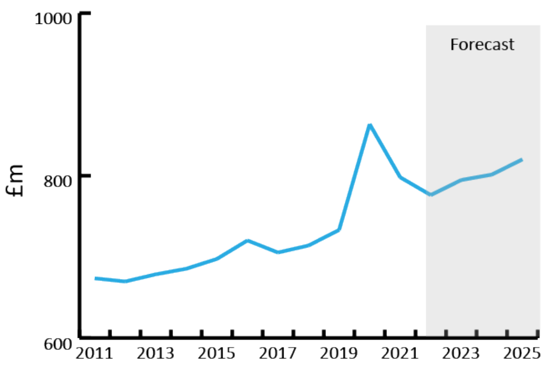
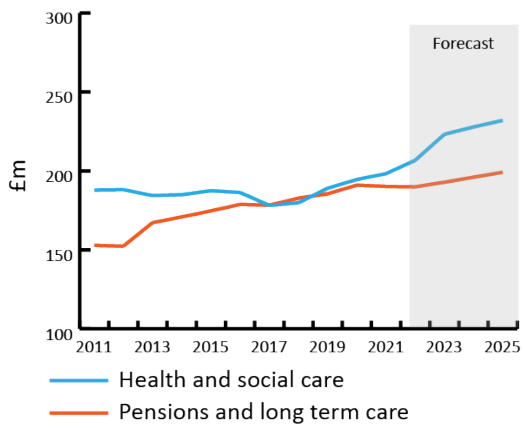


Figure 7: State expenditure on key services 2011-2025 (at 2021 prices)



3.26 Given the known impending increases in cost because of the changing demand for services and the ageing population, the Policy & Resources Committee believes that it is necessary to try and slow the real terms increases as part of the States' commitment to addressing the deficit. Therefore, the Committee is proposing three measures designed to address this:

- For the remaining budgets of this term, baseline general revenue expenditure (other than in respect of demand pressures in health and care services) should not increase in real terms.

- It should be noted that the Funding & Investment Plan already includes an allowance for savings of £10m per annum in the baseline budget. To date, progress with achieving this has been limited and so the Committee will look to allocate the remaining target across Committees in future budgets.

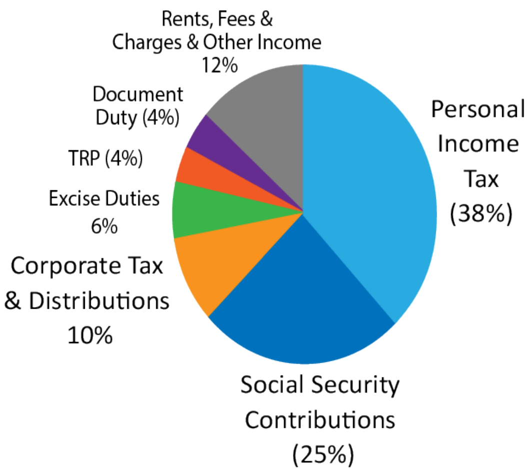
- In addition, initiatives pursued under the banner of the Government Work Plan in this term have added £26m to the baseline costs of the States to date. The Committee considers that in future a cap should be placed on the level of policy and service developments funded through the Government Work Plan with the aim of balancing policy ambition and fiscal realism.

4. Our current tax base

4.1 The makeup of our current tax base was covered in detail in the previous Policy Letter (Billet d'État XIX, September 2021) but is summarised again here. Our current tax base has some significant strengths, but it also has two integral weaknesses:

- it is exceptionally small;
- it is unusually narrow.

Figure 9: Distribution of States Revenues



4.2 Excluding investment returns, Guernsey collects about 22% of GDP from the community in taxes and other income sources each year (19% of which is taxes). By comparison, Jersey - which is our closest comparator in terms of size and economic makeup - collects approximately 26% of its GDP[5]. That gap is equivalent to more than £100m of revenue each year.

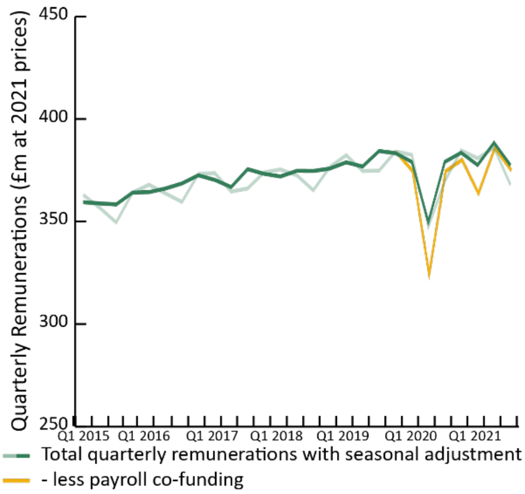
[5] Derived from 2021 accounts. For comparability this excludes trading operations, investment income and non-core entities

4.3 At the same time, there is an expectation that Guernsey will provide its residents with services broadly comparable to those offered in Jersey and in the UK (which collects around 33% of GDP[6]). That position is becoming increasingly difficult to sustain.

4.4 The lack of a consumption tax in Guernsey's current tax base means that it is unusually reliant on personal income tax and social security contributions (both of which are charged against earnings/income), which together represent 64% of total government revenues. The extent to which Guernsey relies on this single income source is highly unusual. Almost every other jurisdiction in the world balances their income across a broader range of taxes, including taxes on consumption.

4.5 The COVID-19 pandemic has highlighted that the heavy reliance on income-based taxes leaves Guernsey particularly vulnerable to shocks to the labour market. While ETI revenues held up much better than anticipated in 2020 and 2021, this is at least in part because remunerations were supported through the States' business support scheme, which at least halved the impact of lockdown measures on revenues. In Jersey this impact on tax revenues was softened by strong GST receipts.

Figure 10: Total remunerations (at 2021 prices)



4.6 While COVID-19 might be considered a once in a generation event, economic cycles mean that fluctuations in income will happen periodically. In fact, the real fall in income tax receipts from individuals in the wake of the financial crisis (a total of 10.2% between 2008 and 2010) was larger than that seen during 2020 (4.5%) and the recovery from the financial crisis much slower.

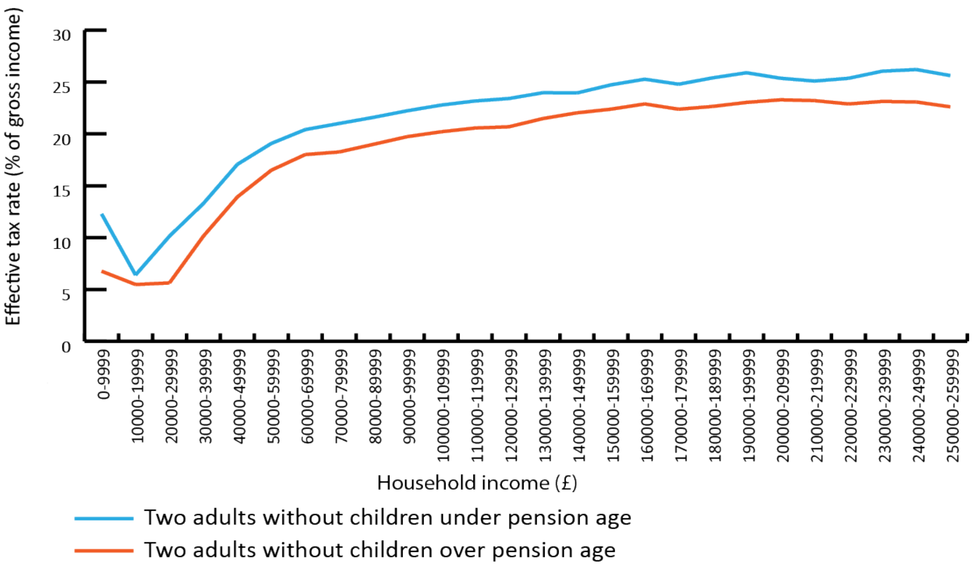
4.7 The structure of the tax system also means that the tax liability is focused quite heavily on the population below pension age. Relative to their income, working age households pay more tax than pensioner households. To a large extent this reflects the fact that pensioners face lower rates of contributions because they are no longer required to contribute to the States' pension scheme. However, they also already benefit from an allowance on their contributions and are protected by the lower income limit, which means if their income is less than £19,760 they are not liable for contributions at all. In the case of pensioner

[6] Revenue Statistics: Key findings for the United Kingdom (oecd.org)

couples, they are more likely to be utilising the ability to transfer allowances between spouses. As a result, many low-income pensioner couples can pay little or no income tax.

4.8 Many pensioners also rely more on their capital assets (including a high percentage who own their own home without a mortgage and are therefore relieved from the cost of rents or mortgages) to support their lifestyle.

Figure 11: Comparison of current effective tax rates (% of gross household income including income tax, social security contributions, TRP and excise duties)



4.9 As the balance of the population shifts towards a larger proportion of people above pension age this will tend to erode the amount of revenue generated per head of population while the cost of public services per capita will increase.

4.10 The ageing of both our own population and the population in those countries we are most likely to turn to, or compete with, for migration to our productive workforce makes Guernsey's current heavy reliance on income-based taxes a risky long-term strategy. Most of our eggs are in one basket and, notwithstanding the debate on population policy in October 2022, it is at risk of shrinking in size.

4.11 The revenue collected from different sources responds in different ways to economic stresses. Even within Guernsey's own tax base COVID-19 resulted in much higher than anticipated excise duty receipts because of the lack of availability of duty free while the borders were restricted, and the exceptionally strong housing market through 2020 and 2021 has provided a significant boost to document duty receipts. In this way the stronger performance of some taxes in response to economic conditions relative to others helps improve the resilience of the tax base to shocks.

4.12 However, in Guernsey's current tax base these taxes make up a very small proportion of revenues. Combined, commercial and domestic TRP, document duty and excise duties make up approximately 12% of Guernsey's tax base. Some increases in these may be possible but they are not realistically appropriate to form the cornerstone of any proposals to raise revenues and in most jurisdictions these taxes play a secondary role in government revenues.

4.13 Following the debate in September 2021 the Policy & Resources Committee was directed to further investigate the alternative options. Through this process it has become clear that a GST combined with other elements to make the changes progressive was the best way forward. Details of some of the other options explored but rejected are included in Appendix 5.

5. The preferred package

5.1 The preferred package as presented has a number of key elements:

- A progressive restructure of the Social Security Contribution system which reduces the liability of low- and middle-income households with a headline rate of 8.5% for employees and 8.0% for employers. This restructure raises £19m of revenues. This restructure will add an allowance for all classes of contributions which is aligned with the personal income tax allowance.

- The introduction of a new 15% rate of income tax on income up to £30,000. This means that people will pay a lower rate on all income between the value of the personal and other tax allowances (including pension contributions, mortgage interest relief or transferred allowances) they are entitled to and the £30,000 threshold, which would provide a maximum reduction of over £800 a year (over £1,600 a year for a couple). Combined with the increase in the personal income tax allowance this will reduce personal income tax receipts by £29m.

- An increase in the personal income tax allowance by £600 which reduces the income tax liability of low- and middle-income households by up to £120 per taxpayer (£240 per couple) with a further £1,150 (£2,300 for a couple) gained by applying the same higher allowance in full to social security contributions.

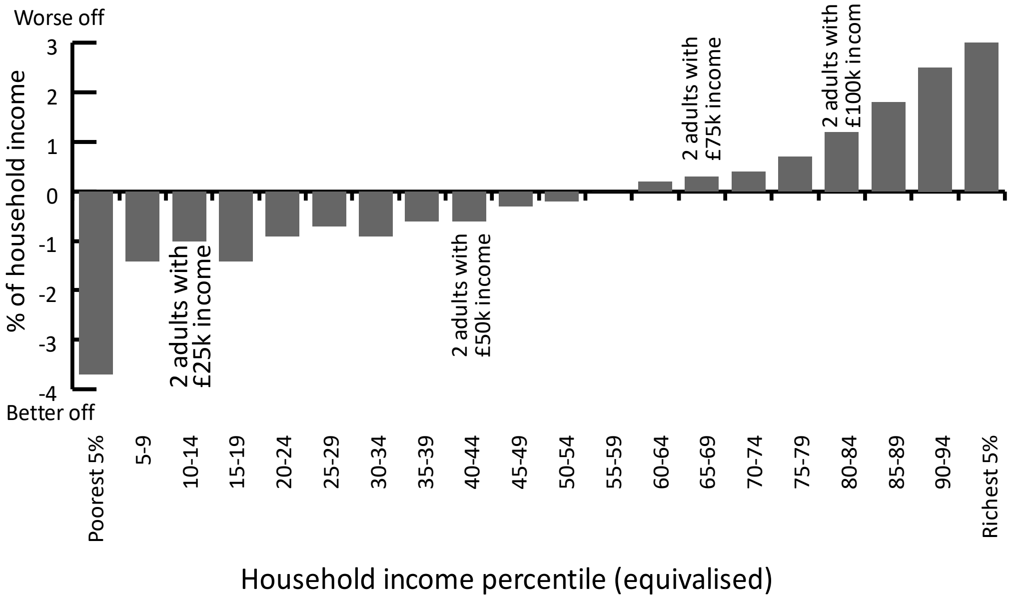
- A Goods and Services Tax (GST) at 5% which will form the primary mechanism for raising revenue estimated at £68m.

- A pre-emptive increase in the States pension by 3.4% and other benefits to reflect the increase in prices anticipated at the introduction of the GST.

- A pre-emptive increase in Income Support rates by 5% to reflect the increase in prices of items in the Income Support "basket of goods" anticipated at the introduction the GST.

- A further package aimed at providing financial support for low-income households outside of the benefits system.

Figure 12: Impact of preferred model on household finances



5.2 The net additional revenue generated by this package of measures is estimated to be £55m. Overall, the package is structured to be beneficial to households (particularly working households) with a low or middle income. Households with a higher income should expect to pay more overall. This creates a change in the tax system which is progressive overall.

5.3 The various elements of this package are discussed in more detail in the following sections, including a transition plan for implementation. A guide to interpreting the graphs and analysis presented is included in Appendix 4. More granular detail of the impact of the proposals on households by household type is included in Section 10.

5.4 Appendix 5 of this report includes analysis of tax levers which do not form part of the preferred package. Some of these, such as domestic TRP rates, may be appropriate to consider as budget measures.

5.5 Appendix 6 also includes an analysis of alternative packages which raises a similar amount of revenues without the inclusion of a GST. These include both alternatives with a GST, but using a different mechanism to reduce income tax liability; and models without a GST which utilise income based taxes.

Why is a GST preferred over income-based taxes?

5.6 Extensive analysis was conducted on numerous types of taxes. Discussion of these has formed a significant part of the regular updates provided to States Members over the course of the last year and analysis of these is included in Appendix 5. This work has led to a clear conclusion. While other forms of tax may support revenue raising there are only two options for raising revenues which have the capacity to form the corner stone of any package. This is either an increase in direct taxation (income tax and social security contributions) or a Goods and Services Tax.

5.7 Many people assume an income-based tax is "fairer", however, the Committee presents a GST based package which reduces the income tax and contributions liability of households in order to produce a model which will support low-income households (options which show an "income only" based approach are presented in Appendix 6). There are multiple reasons for this.

5.8 The use of direct taxes only increases Guernsey's already heavy reliance on taxes based on income. Because income-based taxes tend to focus more on the working age population than a consumption tax (which will also generate revenue when people spend capital or savings), further increasing Guernsey's reliance on income-based taxes exacerbates the tax system's vulnerability to labour market shocks and the ageing of the population.

5.9 The absence of a GST or similar consumption-based tax from Guernsey's tax base makes Guernsey highly unusual. Almost every other jurisdiction in the world applies one. The economic analysis (see Appendix 2) suggests that a GST based solution is likely to be less economically damaging than one based on income, particularly if it is structured to include a reduction in revenues from income-based taxes.

This is because consumption-based taxes are relatively stable in the amount of revenues they raise, create limited distortion to consumer choices (if applied evenly) and do not impact labour market decisions. In economic terms, they are considered one of the least economically damaging sources of tax and, in most jurisdictions, they are the second (sometimes third) largest source of revenue after direct taxes on income.

5.10 Jersey raises approximately 8% of its annual revenues from a GST at 5% and the package presented would raise a similar proportion of revenues from a GST in Guernsey. A comparison of Jersey's revenue streams in 2020 illustrates the differences in the way different taxes can respond to economic stresses. Personal income tax receipts fell by £12m in 2020 (2.5%) compared to 2019[7] but GST receipts increased by £3m (4%). The inclusion of a GST within the tax base, even at a low rate, therefore, improves the resilience of the tax base to economic stress.

5.11 A GST also spreads the distribution of the tax burden more evenly than income-based taxes, incorporating spend by those who support their income by capital or savings (which is most common among those above pension age), visitors to Guernsey and those who spend periods of time in Guernsey but are not tax resident here (for example, they may own a second home in the islands). It also incorporates a contribution from finance sector businesses.

5.12 By contrast, options based around income taxes place a much higher proportion of the demand on households. Where Social Security contributions are used as an alternative, the cost could be split between employees and employers, but this makes it more expensive for businesses to employ staff. In the medium-term behavioural adjustment to the increase in business costs may result in less employment, lower wages or higher prices (or a combination of all three).

5.13 High levels of direct tax on income are a potential competitive issue in attracting higher earning individuals, who may face lower headline tax rates in competitor jurisdictions. While the GST inclusive package presented also gains a higher percentage of additional revenue from higher income households than those of lower income, it is highly unlikely to be a competitive issue in the same way given that a GST or equivalent tax exists at the same rate or higher in all relevant competitor jurisdictions.

5.14 While alone a GST is regressive, combined with a restructure of the Social Security Contributions system, the introduction of a lower rate of income tax, higher personal tax allowances, a balancing of the inflationary impact through pensions and means tested benefits and additional compensations for low-income households not helped through the benefits system, the package will be more progressive than a simple increase in income tax rates and entails less economic risk.

5.15 The introduction of a GST will also place Guernsey closer to international norms in terms of its tax base and on a more equal footing with the other Crown Dependencies.

5.16 That is not to suggest that the implementation of a GST is without drawbacks. It requires the development of new administration systems for both the government and businesses (see paragraph 6.12). It will also increase the headline rate of inflation for a period of 12 months. However, the Committee

[7] Note that Jersey also operated a business support scheme

feel that a GST is the best available option to form the cornerstone of a package of measures.

Figure 13: Comparison of GST and income based taxes against review principles

The revised tax system must…	GST	Income based taxes
be capable of raising revenues of up to 24% of GDP in a way that is economically and socially sustainable;	Could raise sufficient revenue with limited economic impact, particularly if combined with a reduction in income-based taxes	Could raise sufficient revenue but at greater economic impact than a GST
be diversified between different forms of taxation;	Provides a significant diversification of the tax base	Increases existing overreliance on direct taxes against income
be transparent, simple and credible;	Widely used and understood in almost all jurisdictions and if applied broadly can be relatively simple to administer	Already accepted in the Guernsey tax system and widely understood.
be resilient to demographic change and economic shocks;	Diversification increases resilience of revenues to economic and demographic change	Concentrates existing weakness and lack of resilience to economic and demographic change
support and facilitate sustainable economic growth and employment;	Has limited impact on employment or economic growth but will increase inflation for a limited period.	Could have a negative impact on employment and a larger impact on GDP than GST.
comply with international tax standards;	Compliant with international standards	Compliant with international standards
maintain alignment on corporate tax policy with Jersey and the Isle of Man;	N/A	N/A
overall, reflect people's ability to pay and be generally progressive, while accepting that a balanced tax system will include some elements (such as excise taxes) which are considered regressive in nature;	Is not progressive in isolation, but if combined with measures to reduce direct tax liability on low-income households, can improve the overall progressive nature of Guernsey's tax system.	Directly reflects income but provides limited opportunities to reduce liability for lower income households without compromising competitiveness
not discriminate on the basis of age, gender, marital status or employment status in assessing or determining the amount an individual must pay; and,	Does not discriminate by age, gender, marital or employment status	Does not discriminate by age, gender, marital or employment status (provided acknowledged issues with social security contributions are resolved).
support the delivery of environmental and social objectives if there are opportunities to do so without breaching the previous principles.	Combined with reductions in direct tax liability for low-income households, can support objectives on in work poverty	To provide the same reduction in direct tax liability for low-income households, would require increasing rates on higher income households to a level which would be uncompetitive

6. Goods and Services Tax

6.1 The Goods and Services Tax presented is a broad-based input output tax. This means that each business in a supply chain charges the GST on the products it sells to its customers and can claim back any GST it incurred on its own supplies or imported goods. An illustration of how this works is provided in Figure 14. It is designed this way so that the tax paid does not accrue through the supply chain. This means that the maximum impact on the final consumer should never be more than the 5% headline rate of tax.

6.2 The tax would be administered by the completion of a short quarterly return by registered businesses. In Jersey, most registered businesses choose to file their returns at the same time as their quarterly income tax and social security returns, but the option to select a different return month to help manage cash flow is available.

6.3 If, as intended, the GST is kept as broad and as simple as possible, the quarterly return will be very short and, for businesses who have digital accounting packages which are well managed, relatively simple. The required information is likely to be limited to the following fields:

- Business name and registration number
- Total all sales excluding GST
- Total sales zero rated
- Total sales subject to GST
- Total purchases and expenses
- Total value of imports
- GST collected on sales (auto-calculated -> the amount owed to the States)
- GST charged on purchases (auto-calculated -> the amount the States owe to the business)
- Amount payable/refundable (auto-calculated)

6.4 Engagement with businesses and small accountants suggests a preference for the filing to be managed as an online only process and to allow, where possible, a direct interface with the most common accounting packages to limit the form filling required. This would allow businesses to load information for returns directly from their systems, rather than having to extract the information to complete a separate return.

- ***Exemptions and zero rating***

6.5 GST and similar taxes are designed so that tax liability is accrued at each stage of the supply chain, with each business remitting to the government the tax on the value that they have added. Zero-rating and exemptions are forms of relief offered within a GST regime. They are applied slightly differently and the implication on the total tax liability can be quite different.

6.6 In the provision of **exempt** goods or services, the provider does not charge GST on the sale of their products but are unable to reclaim GST paid on their own inputs. The business selling the product therefore bears the cost of the GST, but no GST is collected on the value added by this last business in the supply chain. This results in a "hidden" cost implication on the final price but at less than the full rate of the tax. Because exempting breaks the chain of credits on input purchases, it can sometimes raise prices and revenues and, hence, governments generally only exemptions when value added is hard to define, such as with financial and insurance services.

6.7 In the provision of **zero-rated** goods or services the provider does not charge GST on the sale of their product and are able to reclaim GST paid on their own inputs. The result is that the net application of the tax to the final consumer is zero. This will reduce the price of a good and governments may use zero-rating to lower the tax burden by zero-rating essential goods such as food and utilities.

6.8 A demonstration of these treatments is presented overleaf.

6.9 The inclusion of zero-rated and exempt goods and services is a standard part of consumption taxes. The primary reasons goods or services would be either zero rated or exempt could be classified as follows:

- The customer is outside the taxing jurisdiction and/or the goods or services may be liable for tax in another jurisdiction. This is the case with exported goods and services. Such products are always zero-rated in order to comply with international trade rules;

- The service is provided across jurisdictional borders and inclusion in schemes may result in double taxation or a lack of clarity about which jurisdiction the tax might be due in. This is the case with international travel. Such products are typically counted as exported and therefore zero-rated;

- The collection of tax on the service is unusually complex, as is the case of financial services where the value is generated on interest or exchange rate differentials. Such products are typically exempt, so GST remains payable on the inputs of the business;

- They are "activities in the public interest" and exemption is required under EU directives for EU member states;

- There are other social or environmental or political incentives for the application.

Figure 14: Illustration of the application of standard-rated, zero-rated and exempt tax

		If standard rate (5%)			If exempt			If zero rated		
		GST paid on inputs	GST collected from customers	GST remitted/ (reclaim)	GST paid on inputs	GST collected from customers	GST remitted/ (reclaim)	GST paid on inputs	GST collected from customers	GST remitted/ (reclaim)
Raw material Provider	Raw materials sold for £1000 (before taxes)		50	50		50	50		50	50
Raw material processor	GST incurred on raw materials	(50)			(50)			(50)		
	Processed material sold for £2000 (before tax)		100	50		100	50		100	50
Manufacturer	GST incurred on processed materials	(100)			(100)			(100)		
	Manufactured goods sold for £3000 (before tax)		150	50		150	50		150	50
Retailer	GST incurred on manufactured goods	(150)			(150)			(150)		
	Goods sold for £4000 (before tax)		200	50		0	0		0	(150)
Total tax accrued through supply chain				200			150			0

6.10 While zero ratings are a popular policy tool (as demonstrated by worldwide campaigns to zero rate female sanitary products) they are often poor at achieving the redistributive aims they are presented for.

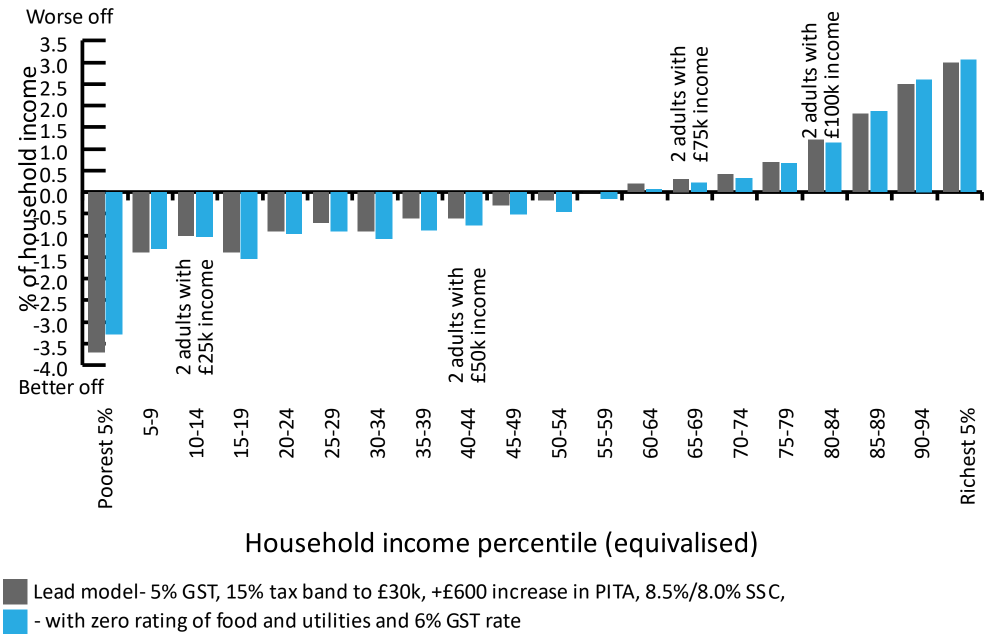
6.11 For example, many GST systems, particularly those that are older, apply zero- or lower rates some or all food items. The argument in favour of this position is that lower income households spend a larger portion of their income on food (see Figure 15). However, zero-rating food could reduce the revenue of a 5% GST by 11% (£7m-£8m). Since in absolute, rather than relative, terms higher income households spend considerably more on food than lower income households, only 20% of the lost revenue from the provision of the relief would benefit the poorest 30% of households and 40% would benefit the richest 30%.

Figure 15: Estimated spend on food by households in various income bands

Household income percentile	Average spend on food and drinks (% of income)	Average spend on food and drinks (£)	Average relief received if food and non-alcoholic drink zero rated in 5% GST
0-4	18%	£2,173	£174
5-9	18%	£3,048	£244
10-14	18%	£3,721	£298
15-19	15%	£3,784	£303
20-24	15%	£4,221	£338
25-29	14%	£4,720	£378
30-34	12%	£4,872	£390
35-39	12%	£5,346	£428
40-44	10%	£5,035	£403
45-49	9%	£5,213	£417
50-54	9%	£5,443	£435
55-59	9%	£5,794	£464
60-64	8%	£6,028	£482
65-69	7%	£5,501	£440
70-74	6%	£5,670	£454
75-79	6%	£5,573	£446
80-84	6%	£5,961	£477
85-89	5%	£6,134	£491
90-94	4%	£6,720	£538
95-99	4%	£12,606	£1,008

6.12 It then becomes necessary to replace the lost revenue by some other means. If this is achieved by increasing the rate of GST charged on all other items, the majority of the gain for low-income households is generally lost and the benefit for low- and middle-income households is very marginal (a maximum of about £10 a month for middle income households). Figure 16 compares the preferred model (a 5% broad based GST) with a model which applied 6% GST but applies a zero-rate to food, non-alcoholic drinks and basic utilities like electricity and water. The two models raise approximately the same amount of revenue, and their impact across the income profile is very similar.

Figure 16: Comparison of the preferred model without GST charged on food and utilities



6.13 The application of different rates, exemptions and zero rating significantly complicate the administration of a GST for both the government and businesses. To apply the kind of complex multiple rate structure used in the UK[8] would be unmanageable for a jurisdiction as small as Guernsey to administer. The more detailed and nuanced the application of different rates of tax, the greater the scope for challenge and queries which can rapidly increase the cost of ensuring compliance. Administrators and compliance officers need to establish not only what rate should be charged on which items but identify what proportion of the GST paid on a business' inputs can be reclaimed and at which rate.

6.14 Further complication is added at the borders where officers will need to establish, not only whether the value of a parcel is sufficient for the GST to be collected, but also whether the item is liable for tax and at what rate. The treatment may be further complicated if a parcel contains a mix of taxable and

[8] VAT rates on different goods and services - GOV.UK (www.gov.uk)

non-taxable goods, which will require officers to establish what proportion of the declared value should be subject to tax.

6.15 Neither is all food “essential” and creating a clear definition between essential food and luxury food is almost impossible. Any definition which exempts value packs of minced beef and prawns would almost certainly catch 30 day-aged steak and oysters. In systems where there are attempts to differentiate between essential and luxury food it generally results in unmanageable complications.

6.16 Disputes over the definitions of zero-rated and exempt items are the most common source of legal dispute in the UK VAT system at significant cost. The most famous is the extended legal challenge over the definition of Jaffa Cakes as a cake, not a biscuit, resolved in 1991[9]. HMRC lost the case and the legal cost appears never to have been divulged. Legal challenges of this nature tend to reduce over time, because legal precedent or adjustments to legislation tend to limit the opportunity for a successful challenge. None-the-less, although VAT in the UK has been in place since 1973, in the last decade there have been 238 judicial tribunals to determine disputes with HMRC on the application of zero-rating, exempt supplies, reduced rates and partial exemptions. These include a £3.5m settlement to Marks & Spencer over the definition of tea cakes[10].

6.17 Widespread exemptions tend to be coupled with high rates of tax applied to those goods that are taxable, creating a significant distortion in the price of goods and potentially changing the way in which people choose to spend. While on the surface zero-ratings benefit low-income households, the higher rates applied to products which remain taxable mean that much of this benefit may be lost. Compensating low-income households by other means, such as the restructure of contributions or increasing the tax allowance, are more effective at reducing the tax burden on low- and middle-income households.

6.18 As a result, more modern systems, including those implemented in Jersey, New Zealand, Saudi Arabi and UAE have tended towards broad-based relatively low-rate schemes with only limited exemptions or zero-rating.

6.19 The recommendation is that the application of zero rates and exemptions be limited to the following items:

---

[9] Why Jaffa Cakes are cakes, not biscuits? - Kerseys Solicitors. McVite won the case and Jaffa cakes are defined as cakes and therefore zero-rated

[10] M&S wins tea cake VAT battle | Accountancy Daily

Figure 17: Proposed zero-rating and exemption

Zero-Rated	Exempt
Export Services	All services provided by the States of Guernsey
Exported goods	Domestic financial services
Sale of a going concern	Primary medical care
Transport of passengers and goods to or from Guernsey or Alderney from outside the Bailiwick	Ambulance services
Transport of goods and passengers between Guernsey and Alderney/Sark/Herm	Dentists
Postal Services	Opticians
Creation, sale, or lease of a residential dwelling	Registered long-term care provision
	Childcare
	Supplies by charities (applying a source of income-based approach like that applied in New Zealand)

- ***Zero-rating***

6.20 The application of zero-rating to exported goods and services is universal in all GST and similar schemes. This is because such products are often liable for tax on entry into their destination jurisdiction and the application of a GST from the source jurisdiction is considered a barrier to trade.

6.21 A similar thought process is applied to international travel and transport where the provision of the service effectively covers multiple jurisdictions. In Guernsey consideration must also be given to the treatment of travel between the Islands of the Bailiwick. For example, applying a positive rate of GST to transport from Guernsey to Alderney would apply an additional cost to visitors to, and residents in, Alderney which would not be carried by residents in Guernsey. It is therefore recommended that the zero-rating of the transport of passengers and goods be extended to cover the transport between the Islands of the Bailiwick.

6.22 The creation, sale or lease of a dwelling is also either zero-rated or exempt in the vast majority of GST and similar regimes. Jersey opted to apply a zero rating to the "supply of dwelling", which means the creation of residential property, their sale and letting are not subject to GST and all associated GST costs can be reclaimed. Visitor accommodation and similar temporary dwellings are not included in the zero rating. Supply of property for charitable purposes is also zero-rated.

6.23 Given that housing is the most significant outlay for most islanders and the cost of housing in Guernsey is high, it is recommended that a similar approach is adopted.

6.24 All other non-domestic property transactions are standard-rated. It should be noted that given most of such property is let or purchased by businesses which would be registered for GST, it would typically be reclaimable.

6.25 Where a site is subject to mixed residential and non-residential use, the tax liability is applied in proportion. GST is applicable to carpets, furniture (not fitted kitchens) and electrical appliances sold with the house.

- ***Exemptions***

6.26 All government provided services are exempt from GST (it makes little sense for the government to remit GST to itself). This exemption is extended to private provision of goods and services which are widely subsidised by the government. In the list provided this includes various health and care services and childcare.

6.27 Domestic financial services are typically exempt within most financial systems because the calculation of GST due on things like interest or exchange rate differentials is technically challenging.

6.28 Jersey provides a blanket exempt status for charitable activities, but the current drafting of their legislation means that there are areas within their legislation which Guernsey may not wish to replicate in their entirety. For example, the exemption allows registered charities to carry on commercial activities (for example operating a gift shop or restaurant) under an exemption that would not be available to an equivalent business not operating as a charity but providing the same goods and services. Also note that while technically listed as exempt within the legislation, Jersey allows charities to reclaim GST on their purchases.

6.29 The New Zealand GST operates a more nuanced approach which applies the exemption only to particular revenue streams. For example, any charitable income from bequests, donations, subsidies or the sale of donated goods and services is exempt; the sale of purchased goods and other trading activities is liable for GST.

6.30 The recommendation from the Policy & Resources Committee is that Guernsey legislation be structured to follow the New Zealand model, so that charitable activity should be exempt except where the charity is deemed to be carrying out a commercial operation.

- ***Registration thresholds***

6.31 The registration threshold is the value of taxable supplies at which a business is required to register with the Revenue Service. In a broad-based system with minimal exemptions, this is effectively a turnover threshold for the majority of businesses.

6.32 ***Registered businesses*** will remit the difference between GST paid on their inputs and the GST collected on their sales to the Revenue Service. If a registered business imports goods it is assumed that goods will be released directly to the business without the application of GST. This will be collected as part of the routine submission to the Revenue Service.

6.33 ***Unregistered businesses*** will pay GST on their inputs where appropriate (including imported goods) but will not collect GST and will not remit money to the Revenue Service. In effect the goods and services they sell to their customers are treated as exempt. If they are importing goods, they may need to register with the Guernsey Border Agency as an ***approved importer*** to best manage the payment of GST on their imported goods.

6.34 Setting this threshold high:

- reduces the number of businesses requiring registration by the Revenue Service;
- results in a small loss of revenue from the "value add" generated by unregistered businesses;
- increases the number of unregistered businesses who routinely import goods, which may need to register with the Guernsey Border Agency as an approved importer.

6.35 Setting this low:

- increases the number of businesses requiring registration by the Revenue Service; potentially bringing less sophisticated businesses into regular administration;
- Decreases the number of unregistered businesses who routinely import goods, which may need to register with the Guernsey Border Agency as an approved importer

6.36 Note that businesses can choose to register if they are below the threshold.

6.37 On balance, the administrative burden for a small business is likely to be less as an approved importer than a GST registered business. Many small businesses do not import goods and rely on locally purchased supplies, and such businesses would not need to register at all (incidental imports could be handled in the same way as personal imports). This means that a higher registration threshold is likely to be better for the small business community and could reduce the overall administrative cost.

6.38 Jersey operates a high registration threshold set at £300,000 per annum. At this level it is estimated that more than 50% of incorporated businesses outside the finance sector would *not be required* to register with the Revenue Service (they may *choose* to do so), but that the tax would still cover more than 95% of company turnover.

6.39 If businesses below the threshold did not register, a further increase in the threshold could reduce the administrative cost by about £40,000 a year. However, in Jersey, registrations by businesses under the threshold are common, particularly where a business is importing goods since it smooths the import process and allows them to reclaim GST costs on their inputs. Increasing the threshold beyond £300,000 is unlikely to make a material difference to either administrative costs, the number of businesses which register or revenues.

6.40 In discussion, both the Guernsey Society for Chartered and Certified accountants (GSCCA) and the Guernsey Retailers Group (GRG) favoured a high registration threshold over a lower one. It was also requested that the threshold be adjusted for inflation on a routine basis rather than be allowed to erode in real terms over time and that it be applied on a multi-year average basis to prevent companies being caught by a single year's turnover. Thresholds of this nature (such as the tax cap) are not usually reviewed every year, because it is generally preferable to keep them at round numbers for simplicity of communication and annual inflation adjustments do not lend themselves to this. However, a scheduled programme of review every four/five years is considered appropriate.

- ***Direct imports and the de minimis***

6.41 The treatment of the de minimis is a significant challenge in the design of a GST. Within the legislation all imports will be subject to GST at an appropriate rate. However, the collection of the tax on imported goods is also the most labour-intensive element of the administration. As a result, most schemes apply a threshold (a de minimis) below which tax is not collected on personal goods, imported via the post or couriers, for administrative purposes. It should be noted that the de minimis is justified in international rules as an administrative provision to prevent excessive administration to collect small amounts of revenue. It should not be viewed as an allowance.

6.42 Low levels of de minimis:

- are favoured by retailers as preventing GST creating more competition from the internet;
- raise more revenues from personal imports (but the net value after cost is likely to be low);
- significantly increase the burden of administration at the borders;
- may create delays in the postal system.

6.43 High levels of de minimis:

- make the implementation of measures at the border significantly easier (and cheaper);
- are likely to be viewed as favouring online purchasing.

6.44 The setting of this administrative threshold has a substantial bearing on the cost of administering the GST. The lower it is set, the greater the intervention required by the Guernsey Border Agency to collect it.

6.45 Jersey's approach was to introduce GST with a high de minimis (£400) and reduce this in stages when either the rate was increased, or other changes reduced the administration involved in collection.

6.46 The de minimis in Jersey is currently set at £135 (the same level as the UK). It has been agreed to reduce this to £60 (originally by January 2023 but this has been delayed by a year). To achieve this, Jersey has amended its legislation to require external retailers selling goods to customers in Jersey of a total value in excess of £300,000 to register for GST. This will mean GST on these goods should be collected on payment without the application of a de minimis (as they would for a local retailer).

6.47 The Policy & Resources Committee proposes that Guernsey adopt a similar approach, and that external retailers selling to customers in Guernsey with a net total value in excess of the registration threshold be required to register. Further it is intended that the de minimis be initially set at the lowest level compatible with administration at reasonable cost, with the intention that this be reduced over time to match the £60 de minimis proposed in Jersey if this level is not achievable at the outset.

- ***International Services Entity Scheme***

6.48 Jersey operates an International Services Entity Scheme. This is a voluntary scheme by which primarily international finance sector entities who provide the majority of their services to customers outside of the Bailiwick pay a fixed fee in order to remove the requirement to file annual returns. The justification of this is that because the majority of their services will be zero rated, their net GST payment will be minimal. However, they would, under normal circumstances, have to file a return to reclaim tax paid on their inputs at administrative cost both to the business and the government.

6.49 The voluntary ISE fee (determined by the entity type) grants the participant:

- an exception to the requirement to register for GST and to file returns
- an end user certificate, which entitles them to request suppliers not charge GST on goods and services provided to them
- a light touch online reclaim form enabling them to reclaim incidental GST incurred from other businesses who may not be able to deduct GST (for example on supplies purchased from a shop, or restaurant food)

6.50 The scheme has administrative benefit on both sides and has been well received in Jersey. It is an attractive way to both gain additional revenue from the finance sector and minimise administrative costs. In Guernsey such a scheme would extend to other service export businesses such as international insurers and e-gaming. The Jersey scheme has a discretionary category under which other non-financial businesses might fall. In Guernsey, this discretion could be extended to manufacturers exporting goods.

6.51 Annual fees in Jersey in 2022 range from £78,300 for a registered bank down to £300 for collective investment schemes and other vehicles[11]. Fees in Guernsey would be set at a comparable level.

6.52 The scheme has some significant revenue raising potential. Estimates suggest the scheme will add £8m a year to the aggregate revenue of a GST scheme in Guernsey.

[11] Register or renew an ISE (gov.je)

- ***Cost of Administration for Business***

6.53 Estimating the cost of administration for business is challenging. The available research typically relates to schemes significantly more complicated than that proposed and many studies pre-date the current accounting and point of sale software which has become more sophisticated in handling GST type systems and are now widely used. The cost of compliance also varies hugely between countries.

6.54 However, there are some general conclusions which can be drawn:

- Broad-based schemes such as that applied in New Zealand are less expensive for businesses to administer than the more complex model applied in India, Australia and the UK[12],[13].

- Implementation and administration costs vary widely from business to business, but they are generally highest in small businesses and those which do not use modern point of sale and accounting packages.

- The costs are highest in the first year of registration because of the need to implement processes in the business and learn the process of application and filing. The time and cost to file typically reduces as processes become embedded.

- Costs are lower where the tax is administered by the same authority as that which collects corporate and personal income tax type schemes.

- Globally, the time required for businesses to comply is falling as the software and electronic filing opportunities have improved.

- Compliance is faster and less expensive where filing and payment can be made online.

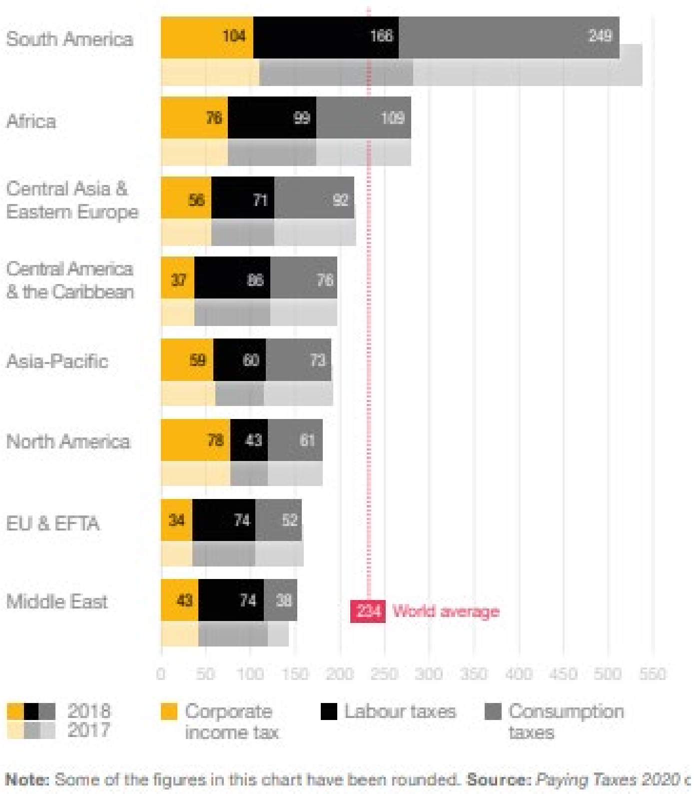
6.55 Price Waterhouse Cooper periodically assess the average time for their case study company[14] to comply with various tax compliance requirements. They estimate the average consumption tax requirement (including preparing, filing, and paying) for EU and free trade area countries at 52 hours, compared with 74 hours for labour taxes and 34 hours for corporate income taxes in 2018. Where countries have significantly reduced the time to comply this is typically attributed to:

---

[12] *The impact of the introduction of the GST on small businesses in Australia, Breen, J. P et al*
[13] Paying Taxes 2020 (pwc.com)
[14] Case study company employs 60 people

- Increased stability of electronic bookkeeping and the greater use of accounting software (Brazil; Vietnam)
- Simplifications to the information required in filling (Vietnam)
- The application of a single rate and broad-based GST or VAT (Bahamas)
- Online filing and payment (Jordan, Senegal, India)

Figure 18: Comparison of time to comply with filing requirements for various taxes (source: PWC, paying taxes 2020)



6.56 During engagement with stakeholders to date it was discussed whether some form of support for businesses during the introductory period is needed. Internal engagement has also helped shape thinking in this area.

6.57 Initial thinking is as follows:

- Support needs to be focused on those businesses which might need to register but lack sophisticated systems;
- Support should be combined or aligned with the digital agenda, to encourage greater digitisation and modernisation of businesses. The objective here is that GST itself is easier to administer if businesses have modern point of sale, accounting and website structures. Combining this with the objective to enhance the digital services sector could improve the general resilience of medium-sized businesses;

- Support should be made conditional on attending training, which should help reduce the volume of queries and issues upon implementation; and

- Support could include the creation of a network of supporting professionals, primarily small business accountants and digital service providers, willing to offer reasonably priced support for the implementation of the GST.

6.58 Feedback from accountants dealing primarily with smaller businesses is that most now use some form of accounting software which should be able to incorporate a GST. For those that do, and that use it constructively, the transition to filing GST returns should be relatively straightforward but will require an additional degree of cash flow management for the activation of the relevant functions of the software and some accounting assistance which may have an upfront cost.

6.59 However, there are still a number of businesses (mostly, but not always, small) that rely on spreadsheets or paper records or whose record keeping is poor. Such businesses are likely to need a greater level of support in implementation. The need to administer a GST could push such businesses into more modern accounting practices and act as a trigger for digitisation and an opportunity to promote better financial management, but there is a particular risk to such businesses.

6.60 It is proposed that implementation costs include up to £1m to help support businesses with the introduction of GST, including appropriate training in the administration of the GST and a system of business grants to support its introduction.

- ***Cost of administration for government***

6.61 In-line with the findings of the literature, it is proposed that the core administration of the GST be performed by the Revenue Service, due to the opportunities to maximise common skills and processes with the collection of corporate and personal taxes. The Revenue Service would accept responsibility for the necessary legislation, day to day administration of the filing, processing and assessment of quarterly returns, the receipt of payment, the management of repayments and compliance and audit activities. It is anticipated that the majority of collections will be made via the Revenue Service.

6.62 Additional responsibilities will also fall on the Guernsey Border Agency, in respect of the movement of goods across the border. This includes the management of goods imported by both GST registered and unregistered business and goods imported by households directly. Revenues collected this way are expected to comprise a minority of the total revenue collected but their administration represents more than half of the anticipated annual cost.

6.63 The cost of administering a GST has been formally assessed by an independent business analyst and is estimated as follows:

Figure 19: Estimated administrative cost of GST

Total cost of administration	**£930,000-£1,060,000**
Revenue Service	**£430,000**
- processing tasks	£180,000
- compliance (at 40% of businesses reviewed per year)	£120,000
- ongoing IT costs	£130,000
Guernsey Border Agency	**£500,000 - £630,000**
- resource costs	£410,000 - £540,000
- ongoing IT costs	£70,000
- office space	£20,000

6.64 These costs are established based on a range of key assumptions the most significant of which are:

- The registration threshold for businesses is set at £300,000 a year.
- The filing is exclusively conducted online.
- Compliance reviews are conducted on 40% of businesses each year.
- A personal import de minimis is applied at a rate of £135 a year (as currently applied in Jersey).

6.65 The latter assumption has a significant impact on the cost of administration. The de minimis is an administrative tool applied because there is a point at which the cost of collecting taxes on personal goods imported through the postal or courier systems exceeds the revenue collected from it. Reducing the de minimis significantly increases the volume of parcels which must be processed and can significantly increase the cost. Reducing the de minimis from £135 to £60, for example, is expected to add more than £100,000 to the annual cost of administration.

6.66 There may be additional operating costs in the first year in order to support businesses though the returns process for the first time.

6.67 In addition to the administration costs there is a significant capital cost associated with setting up a new tax system. Current estimates suggest this will require:

Figure 20: Capital and implementation cost of a GST

Total capital cost of introduction	**£2,435,000**
Revenue Service	£835,000
Guernsey Border Agency	£600,000
Business engagement, training, support and digital development grants	£1,000,000

7. Personal income tax rates and allowances

7.1 In order to balance the more regressive elements of the GST, the Policy & Resources Committee proposes to reduce the amount people pay in direct taxes (i.e. income tax and social security contributions).

7.2 The tax rate and the personal tax allowances impact taxpayers in quite different ways.

- ***Personal Tax Allowances***

7.3 The personal income tax allowance is a portion of your income which is not subject to income tax. From January 2023, this will be set at £13,025 per annum.

7.4 Because this allowance represents a larger share of a person's income if their income is low, this means it is most beneficial for those whose income is equal to or just above the value of the allowance. It is also withdrawn at a rate of £1 for every £5 of income above £90,000 (reduced from £100,000 from 1 January 2023). This means that the impact of the tax allowance is generally progressive.

7.5 The value of the tax allowance is often underestimated. A £1,000 increase in the personal tax allowance is generally more beneficial to an individual earning up to £50,000 than a 0.5% reduction in the headline tax rate, but the two measures would reduce tax revenues by the same amount. This effect is more pronounced if, as proposed, allowances are also applied to social security contributions.

7.6 The Policy & Resources Committee is therefore proposing an increase in the personal income tax allowance of £600, which (against the 2023 rate) would increase the tax allowance to £13,625. Because allowances are typically increased by inflation each year, the actual rate applied in 2025 when implementation is to be completed will likely be higher.

- ***Personal tax rate***

7.7 The 20% headline rate has been a long-standing feature in the Guernsey's tax system. Reducing the tax rate is most beneficial for higher-income households, although lower- and middle-income households do gain some benefit if their income is above the personal tax allowance and it has the advantage of reducing the marginal amount of tax paid. This means that for each *extra* hour of paid work undertaken, an employee takes home more money.

7.8 A lower headline tax rate may also make Guernsey more attractive to high-net-worth individuals and aid recruiting to very senior roles, making it a potential competitive advantage. However, in monetary terms this directs the most benefit to those with the largest income, so the Committee is recommending a nuanced approach, introducing a lower rate tax band of 15% on income between the personal and other tax allowances (including mortgage interest relief and deductions for pension contributions) and a threshold of £30,000. This provides maximum benefit to individuals with income at approximately median earnings, and, of the models considered, is the most beneficial step for middle-income households.

	2023 Tax Structure
Taxable at 0% (the tax allowance)	Income up to £13,025 (plus inflation uplifts and any other reliefs the taxpayer is entitled to[15]), with access to allowances withdraw at a rate of £1 for every £5 on income above £90,000
Taxable at 20%	Income over £13,025
Liability cap	£150,000 of tax payable on non-Guernsey source income £300,000 of tax payable on worldwide income (excluding income from Guernsey land and property)
	Proposed structure from 2025
Taxable at 0% (the tax allowance)	Income up to £13,625 (plus inflation uplifts and any other reliefs the taxpayer is entitled to), with access to allowances withdraw at a rate of £1 for every £5 on income above £90,000
Taxable at 15%	Income between £13,626 (+other reliefs) and £30,000
Taxable at 20%	Income above £30,000
Liability cap	£150,000 of tax payable on non-Guernsey source income £300,000 of tax payable on worldwide income (excluding income from Guernsey land and property)

7.9 By combining both a 15% tax band with an increase in the personal tax allowance all taxpayers will receive a reduction in their income tax liability as part of this

[15] This may include transferred allowances, mortgage interest relief or relief on pension contributions

package of measures. However, this structure will ensure that the benefit of this is focused towards lower- and middle-income earners.

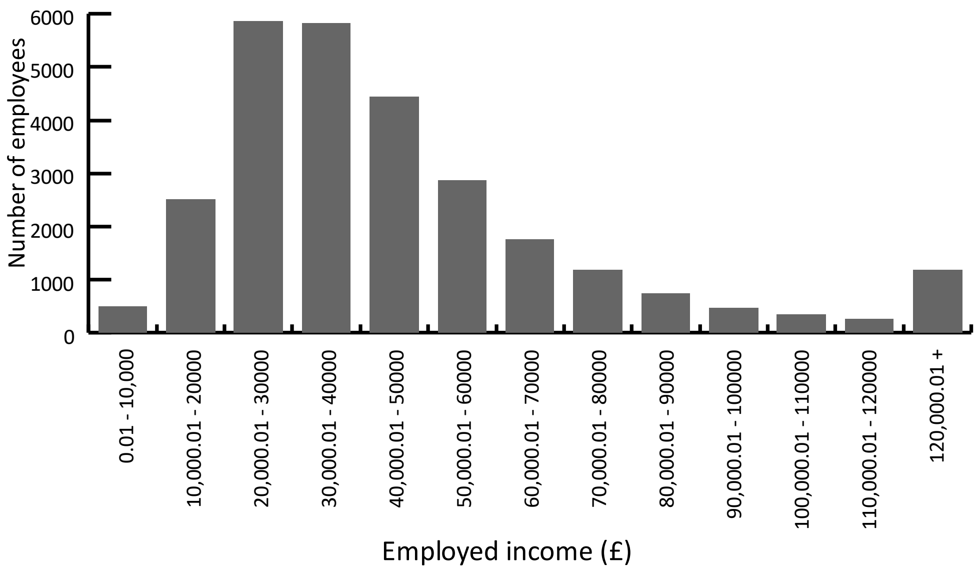
7.10 The systems changes required to implement a 15% tax band are estimated to cost £0.5m.

- ***Higher rate tax bands***

7.11 The Tax Review Steering Group and the Committee did consider options which included higher rate tax bands, applying a rate above the headline rate to income above a set threshold (potentially as low as £60,000).

7.12 Higher rate tax bands have the effect of making the tax system significantly more progressive. However, relatively few people have a significant amount of income which would fall above the threshold, even if set as low as £60,000. At this level only 21% of employed people would face any additional tax from a higher rate and only 4% would face the higher rate on more than half their earned income.

Figure 21: Employment income distribution (June 2022)



7.13 This means that higher rates on high incomes push the majority of revenue raising into a very small group of households. Models incorporating a higher tax rate for higher earners can push more than 75% of the revenue raising from households into the richest 5% of households, with an average increase in the tax liability for this group more than double that applied in the model proposed. It also places the tax liability for higher income households at a clear competitive disadvantage when compared to our closest competitors.

7.14 Because the Guernsey upper earnings/income limit on Social Security contributions is much higher than in comparable jurisdictions, this results in very high marginal tax rates for higher earners when contributions are included (the rate on each additional £ of income, not all your income).

7.15 As an illustration a 32.5% tax rate on income above £60,000 would need to be applied to raise £50m in full. If this is applied and the contributions system were to remain unchanged this would mean a high earner would face a total marginal rate on their earned income of 32.5% + 6.8% = 39.3% (32.5% + 11.3% = 43.8% if self-employed). This compares to:

- 20% marginal rate in Jersey (their standard social security limit being set at approximately £55,000 so high earners would not be liable for contributions on any additional income); and

- 40% + 3.25% = 43.25% marginal rate in the UK (a 3.25% NI rate applying on income above c£50k) rising to 48.25% on income above £150,000.

7.16 If combined with the proposed restructure of social security (even one that raises no additional revenue) the marginal rates would be even higher.

7.17 This means that in terms of direct taxes Guernsey would be at a significant competitive disadvantage relative to Jersey, and for a particular cohort with earnings between c£60k and £157k marginal rates would be close to (or if self-employed potentially slightly more than) those applied in the UK. Proposals of this nature would therefore not comply with the principles governing the tax review that its proposals should not create competitive imbalance with competing jurisdictions.

7.18 **Given Guernsey's economic make-up, and the restructure of contributions proposed, which itself has the effect of redistributing liability towards higher income households, it was felt by the Committee and the steering group that the application of higher rate tax bands for higher earners is a poor choice for Guernsey economically and would not comply with the principles underlying the tax review (see paragraph 1.2).**

8. Reformed Social Security Contributions

8.1 Social security contributions were originally very close in structure to the UK national insurance system. It was an ad velorum tax on earned income paid by employers, employees and self-employed up to an earnings limit intended to represent the value of contributory benefits a contributor would be entitled to claim. Over time, successive decisions have extended both the benefits supported by the contributions system and the scope of contributions charged.

8.2 Unlike the equivalent schemes in the UK and Jersey[16], Guernsey's system now collects contributions from those over pension age and from those not employed but with private income[17]. Full rate contributions are also payable to a much higher limit following the introduction of zero-10, which broke the insurance principle. Those not employed or who are over the States' pension age have access to an allowance and a higher lower income threshold (£19,760 in 2022) before they are required to start contributing. These features are not available to employed or self-employed people who are required to pay contribution on all their earned income as soon as they pass the lower earnings threshold (£7,904 in 2022). The scheme is summarised in Figure 22 overleaf.

8.3 As a result, people who gain their income in different ways can be subject to different rates of contributions, charged on different definitions of their income, with liability commencing at different income thresholds. The scheme can result in very different liabilities for individuals whose income is the same and examples are also included in Figure 22 overleaf.

8.4 Employed and self-employed people also face a "cliff-edge" with a sudden increase in their liability from £0 to £537 a year as their income passes £7,904.

8.5 For pensioners, the lower level of liability reflects a lower contribution rate, because they are no longer required to contribute to the States' Pension and are not entitled to other benefits like unemployment or invalidity benefit. They do contribute toward the long-term care scheme and various health benefits.

8.6 Non-employed individuals do accrue entitlement to a pension, but they are not entitled to smaller income replacement benefits like unemployment or invalidity benefit. They do contribute toward the long-term care scheme and various health benefits.

[16] When Jersey introduced their long-term care scheme in 2014 the payments for the scheme were established as a separate charge more closely aligned to their income tax system allowing contributions to be collected in the same way for all.

[17] This allows non-employed people to gain entitlement to a pension and also make a contribution to the cost of the long-term care insurance scheme and various health benefits.

Figure 22: Outline of current Social Security Contribution System (based on 2022 rates)[18]

	Employee/ Employer (2022)	**Self - employed (2022)**	**Non-employed under pension age (2022)**	**Pensioner (2022)**
Threshold for liability (The lower annual earning/income limit)	£7,904 (for both employer and employee)	£7,904	£19,760	£19,760
Contribution free allowance	£0	£0	£8,904	£8,904
Upper earning/income limit for contribution (annual)	£157,404	£157,404	£157,404	£157,404
Rate on earned income (2023)	6.8% employee 6.7% employer (total rate 13.8%)	11.3%	NA	3.5% employee 6.7% employer (total rate 10.2%)
Rate on unearned income	0%	0%	10.7%	3.5%
Estimated liability for £50,000 of income (Earned income if employed or self-employed, unearned income for non-employed or pensioners)	£3,400 employee £3,350 employer (total £6,750)	£5,650	£4,397	£1,438
Estimated liability for £50,000 of income (mixed 50% earned 50% unearned)	£1,700 employee £1,675 employer (total £3,375)	£2,825	N/A	£1,438 individual £1,675 employer (total £3,113)
Estimated liability for £25,000 of income (Earned income if employed or self-employed, unearned income for non-employed or pensioners)	£1,700 employee £1,675 employer (total £3,375)	£2,825	£1,722	£563
Estimated liability for £15,000 of income (Earned income if employed or self-employed, unearned income for non-employed or pensioners)	£1,020 employee £1,005 employer (total £2,025)	£1,695	£0	£0
Estimated liability for £157,404+ of income (not mixed)	£10,703 employee £10,546 employer (total £21,250)	£17,787	£15,890	£5,198

[18] Note that in November 2022 the States approved an increase in contribution rates for 2023.

8.7 The Social Security system is also a significant source of long-term expenditure pressure because the largest benefits supported through contributions (the States Pension and Long-term Care benefit) are directly related to the age profile of the population. It is estimated that these schemes combined will need in the region of £34m a year in order to achieve a sustainable position. In fact, in October 2021 the States agreed to a 10-year programme of increases in contribution rates (see Figure 23), which forms a de facto alternative for revenue raising for these schemes should the proposals in this Policy Letter not provide a better alternative. The first year of this transition was applied from January 2022, raising an estimated £4.6m, with a further £4.6m to be raised in 2023, but it was acknowledged that proceeding with these contribution increases applied to the current system did not address the identified problems with the way it is structured.

Figure 23: Contribution rate increase agreed in October 2021 (%)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Class 1	**13.2**	**13.5**	**13.8**	**14.1**	**14.4**	**14.6**	**14.8**	**15.0**	**15.2**	**15.4**	**15.6**
Employer	6.6	6.7	6.8	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6
Employee	6.6	6.8	7.0	7.2	7.4	7.5	7.6	7.7	7.8	7.9	8.0
Class 2											
Self-employed	11.0	11.3	11.6	11.9	12.2	12.4	12.6	12.8	13.0	13.2	13.4
Class 3											
Non-employed under pension age	10.4	10.7	11.0	11.3	11.6	11.8	12.0	12.2	12.4	12.6	12.8
Over pension age	3.4	3.5	3.6	3.7	3.8	3.8	3.8	3.8	3.8	3.8	3.8

8.8 There is an opportunity to reshape the contributions system to resolve some of the issues with social security contributions, if it forms part of a wider package of measures.

- ***Applying an allowance***

8.9 Most contributors in Guernsey do not benefit from an allowance. This means for low-income working age households the contributions system is less progressive than income tax since as soon as their earnings pass the lower earnings limit, they are liable to pay contributions on all their earnings, not just those above the threshold.

8.10 Applying an allowance to the contributions system would be of significant benefit to low- and middle-income working households. However, doing so is expensive. If the allowance for contributions is matched to the personal income tax allowance it would result in a loss of around £19m of revenue, which will need to be balanced by changes elsewhere. If managed internally to the contribution system, it will require an increase in the combined employer employee rate to approximately 15.5% (from 13.5% in 2022) simply to replace the revenue lost through the provision of the allowance. This makes a restructure of contributions very difficult to achieve without wider reform of the tax base, particularly if the funding shortfall within the contributions system is also to be addressed. To address both the application of the allowance and to raise the full £34m the combined employer employee rate would need to increase to 17.5% or more.

8.11 However, the progressive nature of the change also makes it an ideal choice to balance a GST, since it is able to offset much of the regressive impact on low- and middle-income households by increasing their disposable income to counter the increase in their costs.

8.12 Because the number of contributions made by a contributor currently determines their entitlement to income replacement benefits (including a pension), steps will need to be taken to ensure that adding an allowance at a level higher than the current Lower Earnings Limit does not remove people from entitlement.

8.13 The recommendation is that an allowance, aligned with the personal income tax allowance, be applied to all contribution classes except employers.

8.14 To balance the revenue lost from the application of an allowance it is necessary to increase the contributions rate applied. The proposed rate of employee contributions of 8.5% would cover around 85% of the revenue lost from the application of an allowance.

8.15 Because the proposed allowance is higher than the existing threshold there will be a number of contributors (generally low-income part-time employees) who will no longer be required to make contribution. However, the Committee *for* Employment & Social Security has expressed a wish to protect the entitlement of this group so they do not become disadvantaged in the long term. **It is therefore proposed that a contribution credit should be awarded to any employed individual with an assessable income of more than £152 a week (or the equivalent of the lower earnings limit at the point of introduction and subject to annual review)**

- ***Aligning the basis of assessment***

8.16 Different classes of contributors are also assessed on different definitions of income. Imagine two people who each benefit from a private income of £25,000 from investment and rental incomes but that one is also employed, and one is not. Provided the employed individual is earning at least enough to pass the lower earnings threshold (the equivalent of £7,904 a year) they will be classed as employed and not liable for contributions on their private income. The other individual will be classed as non-employed and is under pension age, meaning that they will be liable for contributions at a rate of 10.7% on their private income less an allowance of £8,904. The non-employed individual will be liable for contributions of £1,722 a year on this income.

8.17 This position is clearly inequitable and creates some behaviour distortions. It is relatively common for early retirees with significant private pension or other income to engage in a minimum amount of paid work to protect their unearned income from becoming liable for contributions. Their employed income will be liable for contributions for both employer and employee contributions (totalling £1,067 a year at the minimum level) but at the potential loss of significantly more revenue on their unearned income.

8.18 Aligning the definition of income for all contributors would remove this inequity. Some additional revenue will be generated by this step.

8.19 It is recommended that the definition of income on which people are assessed is aligned to capture all income for all classes except employers.

- ***Employer contributions***

8.20 A small number of modifications are proposed for employer contributions. It is proposed that employer contributions be increased slightly beyond the 7.6% target at the end of the ten-year programme agreed in October 2021, to 8.0%. This will allow a proportion (around £19m) of the overall revenue raising to be raised from the Social Security contributions system. The allowance will not be applied to employer contributions.

8.21 Beyond that, **it is proposed that the application of the Lower Earnings Limit to employers be removed**. This limit currently prevents very low-income individuals from being required to make a contribution, but it is also applied to employers. In a very small number of cases this acts as an incentive for employers to limit the weekly or monthly income of their part time employees in order to avoid becoming liable for contributions.

8.22 Given that employers are required to file a return even if their employees do not reach the lower income limit, removing its application to employers would require no additional administration and remove the incentive to limit employees' hours to avoid contributions. Given the very small number of employees with earnings at this level the income generated will be negligible.

8.23 In both the UK and in Jersey the equivalent of Guernsey's upper earnings limit is set much lower. However, in both jurisdictions its application to employer contributions is different to that applied in Guernsey. In the UK, no upper limit is applied to employer contributions (only employees and self-employed); in Jersey a 2% contribution rate is applied to employers between their Standard Earnings

Limit (£4,764 a month or £57,168 a year) and a second limit (£21,724 a month or £260,688 a year).

8.24 Only about 2% of employees have income above the current upper earnings limit (£157,404 in 2022) and only a small number of larger employers benefit from the limit. **It is proposed that an employer's contribution of 2% be levied on earnings above the upper earnings limit up to a second limit of £250,000. This would contribute approximately £2m in additional revenues.**

- ***Treatment of Self-Employed***

8.25 The application of contributions to the self-employed is more complicated. The 11.3% rate currently charged represents a discount on the combined employer/employee rate (13.5%). Consideration was given to whether the treatment of self-employed should be aligned in full with the proposed structure for employee/employer contributions, but this would mean a very significant increase in the liability for higher income self-employed individuals, which was considered uncompetitive.

8.26 Therefore, the proposal is to split the liability for the self-employed, so it more closely mirrors that charged for employer/employees, but to retain a reduced overall rate. Under this scheme a self-employed individual would be liable for:

- an individual rate charged against all income at the same rate (8.5%) as that applied for employees and with access to the same allowance;
- a reduced "employer" rate charged only against self-employed income of 6.0% but maintaining access to an allowance;
- an employer's contribution of 2% levied on earnings above the upper earnings limit up to a second limit of £250,000.

- ***Treatment of Non-employed and Individuals over State Pension Age***

8.27 The proposal is that a non-employed individual below States Pension age would be liable for the individual rate charged against all income at the same rate (8.5%) as that applied for employees and with access to the same allowance. This would mean that an individual is treated in the same way regardless of their employment status. Note that this will reduce the rate applied to non-employed individuals below pension age.

8.28 Within the current social security system, those above pension age are liable for contributions to the Long-Term Care and Guernsey Health Service schemes. They do not make contributions to the benefits funded from the Guernsey Insurance Fund since they are in receipt of a pension and no longer entitled to claim other income replacement benefits like unemployment or sickness benefit. As a result, they pay a lower total rate of contributions than those employed or self-employed.

8.29 In discussion, it was agreed that the principle of a lower contribution rate should be retained. It is therefore proposed that a reduced rate of 4.0% is applied to individuals above States Pension age.

8.30 Non-employed individuals and those above States Pension age also have access to a higher lower income limit than employed individuals and this protects any non-employed individual or pensioner with an income below £19,760 a year from having to make contributions. Given the intention to align the treatment of individuals across different classes as far as possible, this lower income limit should be removed. However, doing so draws a number of lower-income pensioner households into the payment of contributions who do not currently contribute at all. It is considered that removing this element of the contributions system may need a greater degree of phasing, and it is therefore proposed that the lower income limit applied to non-employed contributors over pension age **should be frozen until such a time as the Personal Income Tax allowance reaches that same value.**

8.31 In summary, the restructured contributions system would apply as follows:

- All contributors under the States' pension age should be subject to an individual contribution rate of 8.5% on their total income (less an allowance), up to the upper earnings limit (subject to annual review).

- All contributors over the States' pension age should be subject to an individual contribution rate of 4.0% on their total income (less an allowance), up to the upper earnings limit (subject to annual review) reflecting that they will no longer accrue entitlement to a pension or income replacement benefits.

- A contribution-free allowance should be made available to all contributing individuals (not employers) equal to the Personal Income Tax Allowance and the lower earnings limit should no longer apply.

- The lower income limit for non-employed contributors (including those over States' pension age) should be frozen until such a time as the allowance becomes equal to or exceeds its value, from which point it should no longer apply.

- A contribution credit should be awarded to any employed individual with an assessable income of more than £152 a week (or the equivalent of the lower earnings limit at the point of introduction and subject to annual review)

- The application of a lower earnings threshold for employer contributions should be removed.

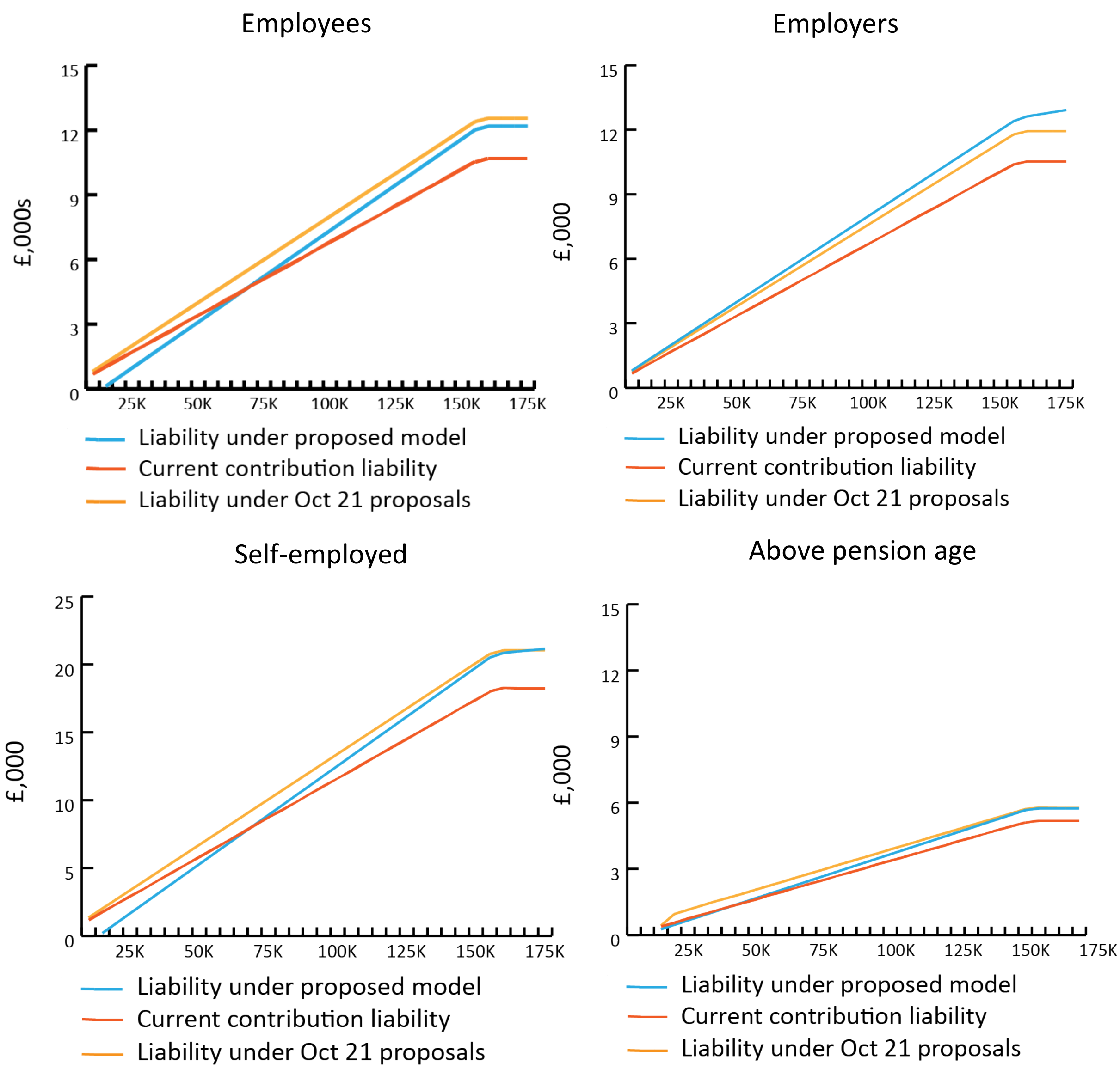
- Employers should be subject to a contribution rate of 8.0% on the earnings of their employees up to the upper earnings limit, and that they should be subject to contributions at a rate of 2% on the earnings of their employees above the upper earnings limit up to £250,000.

- In addition to their contribution as an individual, self-employed individuals should be subject to a reduced employer contribution rate of 6.0% on their self-employed income (less the allowance) up to the upper earnings limit, and that they should be subject to contributions at a rate of 2% on their self-employed earnings above the upper earnings limit up to £250,000.

8.32 This restructure would raise approximately £19m when compared to the current structure (prior to the increases applied in 2022 and 2023) but would be of substantial benefit for low-income working households. For someone working 35 hours a week on minimum wage (about £17,400 a year) the proposed restructure would reduce their contributions liability by about £860 a year against what they would be expected to pay in 2022 and by £1,070 a year against what they would be paying if the agreed increase in contribution rates under the current structure proceeds unchanged (a net benefit of 5.0% or 6.2% of their income respectively). For low earners the change in the contributions system alone may be enough to compensate them for the implementation of a GST.

8.33 Any employed person with an earned income of £65,000 or less (and no significant unearned income) should pay less in contributions than they do currently (although they may pay more overall with the package proposed). Allowing for the continuing protection of anyone currently benefiting from the £19,760 threshold for liability, anyone over 65 with an income of £45,000 or less will pay less in contributions than they did in 2022.

Figure 24: Comparisons of Social Security contribution liability by individual income for employees, employers, self-employed, and those over States' pension age (£ per year)



Costs associated with restructure

8.34 The proposed restructure is a significant change and there will be both upfront and ongoing cost implications. The cost implications for the Revenue Service are estimated as follows:

Capital costs estimate for implementation	£1.6m
Operating cost implications	£150,000 per annum

9. Further mitigation and protection for low-income households

9.1 For households the most visible impact of GST will be an increase in prices. It is estimated that a 5% GST will create an upward pressure on RPIX of about 3.4% and it is via these higher prices that households will be impacted.

9.2 Not all prices will increase. Rents and mortgages for example are both zero rated, so should not be directly impacted by the GST. Some larger stores operating national chains also operate a "sterling price" policy, which means that they charge the same price for goods regardless of the tax payable in the specific jurisdiction in which they are sold. Differences in taxes in different places are instead absorbed into the margins. Such prices as these may also remain unchanged.

9.3 The majority of households will be fully or partially compensated for the increase in prices via the increase in the tax allowance and the social security contributions restructure.

9.4 It is the States normal policy to increase both the States' pension and income support benefits by RPIX or more each year. In this way households in receipt of these will be compensated for the increase in their costs. However, the increase is typically applied retrospectively – with the adjustment in January reflecting the increase in prices over the year ending the preceding June.

9.5 Clearly, it is not desirable for those households in our community who are the most financially vulnerable to wait up to 12 months for compensation. It is therefore proposed that:

- The States pension and other income replacement benefits[19] be increased by 3.4% (the forecast upward pressure on RPIX) prior to the

[19] This will include the majority of benefits paid weekly where the intention is to support an individual or households income. From the Guernsey Insurance Fund this includes unemployment benefit, incapacity benefit, parental benefit, and sickness benefit as well as some of those supported by general revenue such as severe disability Benefit and Carers allowance.

introduction of GST; and that any difference between the actual rate of RPIX resulting from the GST and the forecast impact be addressed at the subsequent uprating. This results in an out of policy cost of £5m-6m for a period of 12 months if increases are applied in the January preceding the introduction. If the increases are applied mid-year, the period over which pensions are being paid above the level set out in standard policy will be shorter and the cost proportionally less.

- The Income Support Requirement rates be increased by 5% (the full rate of GST) prior to the introduction of GST, noting that the GST is expected to apply to the majority of items in the "basket of goods" used to determine appropriate income support levels and that support for rents is applied through the rent allowance. Income support payments are calculated on a household's income after payment of tax and contributions, so any reduction in a claimant's tax and contribution liability will be offset in their benefit claim. Once both the increase in the rates and the impact of the reduced contribution and tax liability are factored in this is estimated to result in an out of policy cost of £2m for a period of 12 months. On an ongoing basis the reduction in support required due to lower tax and contribution payment should approximately balance the above inflation increase in benefit rates.

9.6 There is a small group of households who are not eligible for income support, who may receive limited benefit from the increase in the personal tax allowance or the restructure in Social Security Contributions. For example, a pensioner couple whose income is below the proposed personal income tax allowance and includes a partial Guernsey States pension may not be entitled to income support if their savings exceed the allowable limits. Because they are in receipt of only a partial pension, the compensation through that mechanism may be incomplete. It is, therefore, proposed that a cost support payment be introduced (as is applied in Jersey), calculated based on the number of individuals in a household with a baseline rate of £450 a year for a single adult (£675 for a couple), to households with a gross income of £28,000 or less that are not in receipt of income support. This implies an ongoing cost of £1m-£1.5m. It is suggested that this might be made payable in monthly instalments.

10. The overall package and its impact on households

10.1 The package presented will provide an estimated £55m a year in additional net revenues to the States. The package is designed to distribute the revenue raising and the net impact is split between:

- Households £23m (42%) comprising

    a) No net change in revenues from the Social Security contribution system (although lower income households will pay less and higher income households will pay more)
    b) A net decrease of £29m in income taxes
    c) A net increase of £53m from GST
    d) A net gain of £1m-£1.5m in above inflation increases in benefits and the cost support scheme

- Businesses £27m (49%) comprising

    a) A net increase of £19m from Social Security contributions (compared to £16m from the increases agreed in October 2021)
    b) A net increase of £8m from the ISE fees for international financial services within the GST

- Visitors and other non-residents £6m (11%) from the application of GST to visitors spend.

Figure 25: Overview of the financial implication of the proposed package

Social Security Contributions	Rates and allowances	Change in revenue/ costs
Employee contributions	8.5%	(£3.1m)
Employer	8.0%	£18.9m[20]
Self-employed (combined employee employer rate)	14.5%	£3.0m
Non-employed/>State pension age	8.5%/4.0%	(£0.1m)
Total contributions		**£18.8m**
Personal income tax		
Personal income tax headline rate	20.0%	**(£29.3m)**
Lower rate tax band (on income up to £30,000)	15%	
Personal income Tax Allowance	+£600	
GST	5.0%	
Households		£53.4m
Visitor and other non-residents		£6.3m
International Services Entity Fee		£8.0m
Total GST		**£67.7m**
Total revenue changes		**£57.2m**
Ongoing costs (including administration and real increases in benefits)		(£2.6m)
Net change		**£54.6m**
Borne by households		**£22.7m**
Borne by businesses		**£26.9m**
Borne by non-residents		**£6.3m**

[20] It should be noted that £20m of this additional revenue would be raised by increases in Social Security contributions for employers, which compares to approximately £16m of revenues raised from employer contributions approved in October 2021.

10.2 Figure 26, Figure 27 and Figure 28 below show the average impact of the package for households in different income bands. This is broken down even further in Figure 29, Figure 30 and Figure 31, which show the breakdown of the average impact by both income and households. Guidance on how to interpret this data and approximations of the actual gross income levels for different household types in each 5% band is provided in Appendix 4.

Figure 26: Impact of package on household income percentiles (% of gross income and £ per annum)

Equivalised Household income percentile	Average of impact on Household circumstances (% of gross household income)	Average of change in circumstances (£ per annum)	
0-4 (5% with lowest income)	-3.7%	-£ 242	better off
5-9	-1.4%	-£ 196	
10-14	-1.0%	-£ 164	
15-19	-1.4%	-£ 348	
20-24	-0.9%	-£ 235	
25-29	-0.8%	-£ 221	
30-34	-1.0%	-£ 322	
35-39	-0.7%	-£ 279	
40-44	-0.6%	-£ 306	
45-49	-0.4%	-£ 198	
50-54	-0.3%	-£ 195	
55-59	0.0%	-£ 8	
60-64	0.2%	£ 105	worse off
65-69	0.3%	£ 200	
70-74	0.4%	£ 337	
75-79	0.7%	£ 697	
80-84	1.1%	£ 1,363	
85-89	1.8%	£ 2,512	
90-94	2.5%	£ 4,156	
95-99 (5% with highest income)	2.9%	£ 9,156	

10.3 These tables illustrate how different households might be impacted by the changes. Very low-income households (those in the poorest 10%) receive the most benefit from changes via the pensions and benefits systems. They may get limited benefit from the application of the increase in the personal tax allowance or the application of that allowance to contributions because they may not have enough taxable income to be liable for either income tax or contributions.

Figure 27: Impact of package on household income percentiles (£ per year)

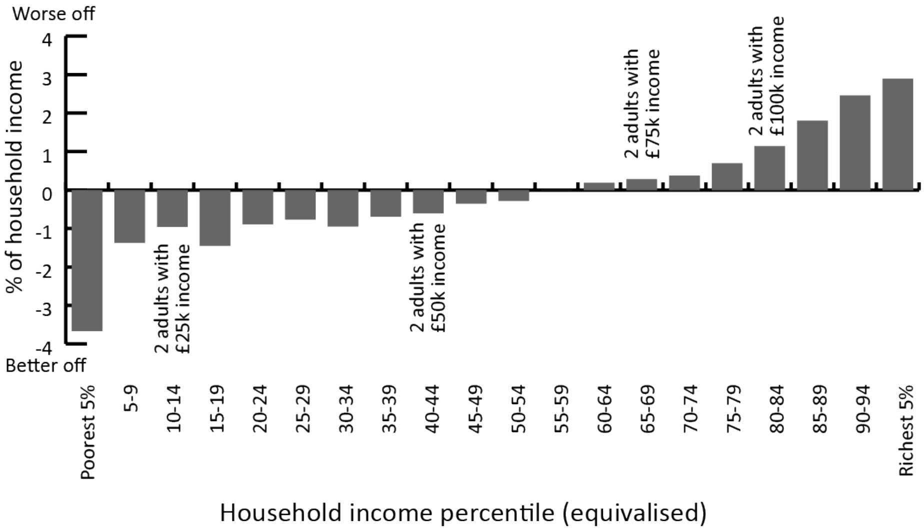
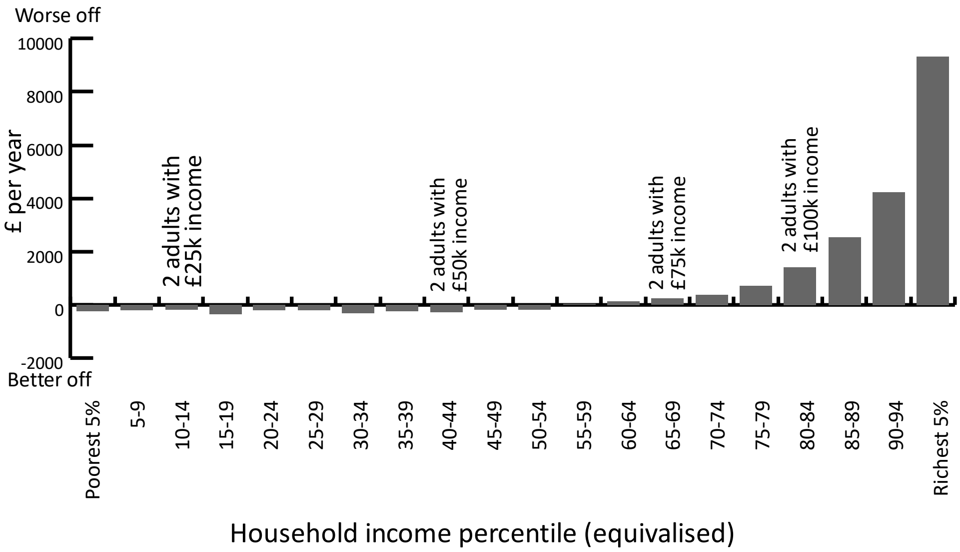


Figure 28: Impact of package on household income percentiles (£ per annum)



10.4 For the lower- and middle-income groups the impact of the increase in the personal tax allowance and the application of that allowance to contributions becomes much more significant, and for most low to middle income working households this is more than sufficient to compensate them for the increase in prices associated with the GST.

10.5 However, non-employed and pensioner households already benefit from an allowance on Social Security Contributions and are therefore more favourably treated in the current system than employed or self-employed contributors of working age. While the tax allowance is higher than the allowance currently available to this group the benefit they will receive from its application to social security contributions is significantly less than for households of working age. They are also less likely to be spending their money on goods that are exempt or zero rated in the GST like rents and mortgages (70% of pensioner households own their own property without a mortgage). This means, in the process of equalising the treatment of people within the system, low to middle income pensioner couples may see a larger negative impact than working age households of similar income.

Figure 29: Impact on Household finances as % of gross household income[21]

Equivalised Household income percentile	One adult (16-64)	One adult (16-64) with child(ren)	One adult (65 and over)	Two adults (16-64) with child(ren)	Two adults (16-64)	Two adults (65 and over)
0-4	-7.0%	-3.7%	-3.9%	-1.4%	-3.9%	-0.9%
5-9	-1.7%	-0.6%	-2.7%	-1.0%	0.6%	0.3%
10-14	-2.3%	-1.2%	-2.3%	-1.0%	-0.3%	0.9%
15-19	-1.8%	-1.7%	-1.9%	-0.7%	-1.9%	-1.2%
20-24	-1.3%	-1.3%	-2.2%	-1.1%	-0.6%	0.5%
25-29	-1.7%	-1.3%	-1.8%	-0.3%	-0.3%	0.3%
30-34	-3.1%	0.0%	-2.8%	-0.6%	-0.3%	0.5%
35-39	-2.3%	0.4%	-2.0%	-0.6%	-0.4%	0.8%
40-44	-1.7%	0.7%	-1.3%	-0.3%	-0.8%	0.7%
45-49	-1.0%	1.5%	-0.8%	-0.1%	-0.9%	0.9%
50-54	-0.5%	1.0%	-0.4%	0.2%	-0.9%	0.9%
55-59	-0.1%	1.5%	-0.1%	0.5%	-0.6%	1.3%
60-64	0.3%	1.7%	0.2%	0.9%	-0.2%	1.5%
65-69	0.6%	2.1%	0.3%	1.2%	-0.3%	1.1%
70-74	1.0%	*	0.7%	1.4%	-0.3%	0.6%
75-79	1.2%	*	1.0%	1.6%	0.2%	0.8%
80-84	1.6%	*	1.6%	2.1%	0.6%	0.9%
85-89	1.3%	3.4%	1.9%	2.7%	1.9%	1.3%
90-94	1.9%	*	2.5%	3.0%	2.8%	1.7%
95-99	2.9%	*	2.1%	3.2%	3.8%	1.9%

[21] Cells marks * represent groups with less than 10 households in the data set

Figure 30: Impact on household finances (£ per year)

Equivalised Household income percentile	One adult (16-64)	One adult (16-64) with child(ren)	One adult (65 and over)	Two adults (16-64) with child(ren)	Two adults (16-64)	Two adults (65 and over)
0-4	£(244)	£(181)	£(314)	£(253)	£(164)	£(98)
5-9	£(231)	£(137)	£(353)	£(347)	£109	£53
10-14	£(341)	£(304)	£(357)	£(363)	£(83)	£212
15-19	£(332)	£(476)	£(346)	£(309)	£(516)	£(323)
20-24	£(271)	£(360)	£(454)	£(529)	£(181)	£156
25-29	£(399)	£(405)	£(430)	£(151)	£(116)	£122
30-34	£(817)	£21	£(719)	£(300)	£(99)	£208
35-39	£(689)	£217	£(582)	£(315)	£(175)	£347
40-44	£(571)	£366	£(408)	£(185)	£(416)	£330
45-49	£(363)	£813	£(280)	£(68)	£(506)	£503
50-54	£(188)	£620	£(137)	£190	£(508)	£541
55-59	£(54)	£969	£(21)	£465	£(369)	£823
60-64	£166	£1,147	£84	£900	£(131)	£1,006
65-69	£304	£1,437	£149	£1,329	£(260)	£838
70-74	£537	*	£382	£1,652	£(230)	£496
75-79	£736	*	£566	£2,096	£205	£696
80-84	£1,109	*	£1,063	£3,146	£602	£882
85-89	£1,015	£4,001	£1,467	£4,505	£2,206	£1,497
90-94	£1,865	*	£2,451	£6,049	£4,092	£2,534
95-99	£5,769	*	£5,830	£11,619	£10,806	£6,107

10.6 Upper middle-income households are generally benefited by both the introduction of the new 15% rate of income tax and the application of allowances, but in general they would expect to pay a little more overall. Generally, increases in pensions and benefits has little impact on this group.

10.7 For those in the highest income groups, the allowances on both Income Tax and Social Security are assumed to be withdrawn at a rate of £1 for every £5 of income beyond £90,000. This means they get little benefit from the increase in allowances and the higher rates applied to social security would tend to result in a higher net contributions liability for this group. Once the impact of GST is added, the top third of households might be expected to pay between an additional 1% and 3% of their gross income overall.

10.8 Figure 31 below provides an estimate of the expected average overall effective tax rate for different household types. This is the total amount of Income Tax, Social Security Contributions, GST, TRP and excise duties a household would be expected to pay as a percentage of household income. This shows that typically the effective tax rate born by a household will increase as income increases.

However, it should be noted that because this includes TRP the effective rates of tax on some low-income pensioner groups are higher than may be expected because of the number of low-income pensioners who own properties disproportionally large relative to their income (see Appendix 5 for more detail).

Figure 31: Estimated total effective tax rate (including income tax, social security contributions, GST, TRP and excise duties) as % of gross income

Equivalised Household income percentile	One adult (16-64)	One adult (16-64) with child(ren)	One adult (65 and over)	Two adults (16-64) with child(ren)	Two adults (16-64)	Two adults (65 and over)
0-4	12.9%	9.5%	9.2%	10.2%	12.4%	13.1%
5-9	9.3%	9.2%	8.7%	9.8%	11.7%	12.4%
10-14	11.3%	10.3%	10.4%	11.5%	13.0%	12.1%
15-19	13.0%	11.2%	11.9%	14.1%	10.2%	9.0%
20-24	12.2%	12.0%	13.5%	14.8%	11.8%	10.7%
25-29	14.5%	13.6%	15.4%	16.7%	13.7%	12.7%
30-34	15.0%	16.9%	15.1%	17.9%	15.6%	14.1%
35-39	16.8%	18.4%	16.1%	18.3%	16.4%	15.6%
40-44	19.0%	19.6%	17.3%	19.5%	17.3%	16.7%
45-49	20.3%	20.2%	18.3%	20.5%	17.8%	18.3%
50-54	20.9%	21.8%	19.0%	21.0%	19.0%	18.8%
55-59	21.9%	22.3%	19.7%	22.0%	19.8%	20.0%
60-64	22.4%	21.3%	20.7%	22.8%	20.7%	20.4%
65-69	22.9%	23.7%	21.3%	23.5%	20.6%	20.1%
70-74	23.7%	*	21.7%	24.2%	21.2%	19.8%
75-79	24.5%	*	22.6%	25.0%	22.1%	20.6%
80-84	25.4%	*	23.3%	26.2%	23.1%	21.3%
85-89	25.5%	28.7%	24.2%	27.5%	25.1%	22.4%
90-94	26.9%	*	25.1%	28.3%	27.0%	23.8%
95-99	28.7%	*	25.5%	28.2%	29.1%	24.6%

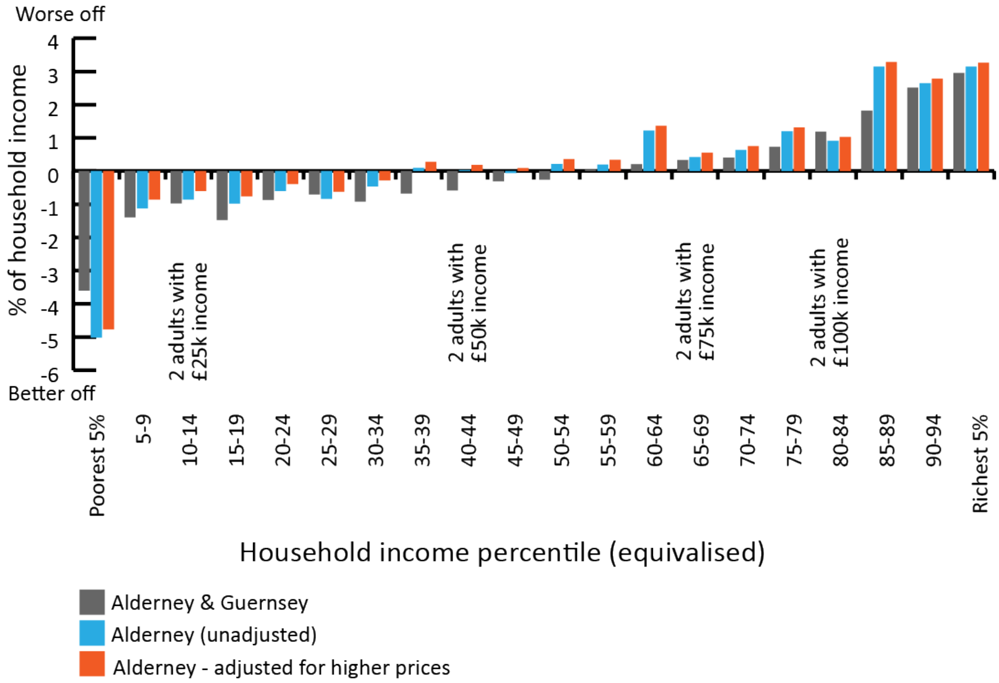
- ***The impact on Alderney***

10.9 Figure 32 presents a comparative analysis of the expected impact of the package of measures in Guernsey and Alderney. It should be noted that because of the smaller population in Alderney, the analysis is more subject to being skewed by individual cases with unusual circumstances.

10.10 There are two primary differences which affect the impact that these proposals have on the Alderney population. The population in Alderney is older, which means that the overall level of benefit gained from the restructure of the contributions and the application of an allowance is lower because more people benefit from the allowance applied to pensioners in the current system. This accounts for most of the difference between the Islands.

10.11 Alderney also faces higher prices for some items (although housing is significantly cheaper). An exercise was undertaken to establish the extent of the price differential between the two islands which found that the weighted price differential on taxable items is around 5%. Figure 32 includes an adjustment for this price differential.

Figure 32: Comparison of impact in Alderney



11. Cost implications

11.1 Figure 33 below presents the total estimated cost of implementing these proposals including the cost of applying an anticipatory increase in pensions and benefits.

Figure 33: Overall implementation and ongoing costs

Implementation and capital cost	£12.5m
GST Implementation and support for businesses	£2.4m
Introduction of 15% tax band	£0.5m
SSC restructure implementation	£1.6m
Pre-emptive, out of policy increases in pension and benefits (if applied from Jan 2025[22])	£8m
Ongoing annual costs	£2.5m
GST administration	£1.0m
Revised SSC system administration	£150,000
Cost support scheme	£1.4m

12. Implementation and Transition

12.1 The timing of the implementation of these proposals is critical. The logistical realities of restructuring the contributions system and introducing a GST will require a significant amount of legislative and operational change (although enabling legislation for the GST was approved in 2009 which should simplify the legislative process). It also requires sufficient notice for businesses to implement the systems required to manage a GST. This will take up to two years.

12.2 However, to delay the formal launch until after the next election presents significant political risk. It is therefore proposed that the GST element of the proposal be implemented no later than 1 April 2025.

12.3 In order to ensure that the mitigations are in place for the community at the launch of the GST, it is proposed that most other elements of the package be put in place before the implementation of the GST. This should include the proposed pre-emptive increase in pensions and income support as well as the application of higher tax allowances to both income tax and social security and the introduction of the 15% tax band. This will ensure that low-income households are compensated for the inflationary impact of the GST no less than three months prior to its introduction.

---

[22] Out of policy may be lower if the increase is applied later in the year

12.4 The States have agreed in principle to increase the Social Security contribution rates gradually over a period of 10 years (the first two of which will have been implemented by the time this Policy Letter is debated). Given that the recommended package also incorporates an increase in the rates charged on contributions it is proposed that this continue as planned into 2024. This will help smooth the transition to a system which applies higher contribution rates to both employers and individuals.

13. Allocation of Revenues

13.1 The package of measures proposed raises approximately £19m via the Social Security Contributions system, and approximately £36m through General Revenue. If implemented in full this will replace the proposals laid by the Committee *for* Employment & Social Security and agreed in October 2021 which would have raised £34m over a ten-year period.

13.2 This Policy Letter does not seek to determine how the resources raised should be allocated but some further development of this will be required, particularly given that the funding gap is larger than the revenues raised within this package of measures.

13.3 As part of the implementation, it will be necessary to:

- review the relevant funding requirements for both General Revenue and Social Security in light of evolving cost pressures, prevailing assumptions on net migration and participation, and any potential cost saving implications.

- establish the appropriate distribution of Social Security Contribution between the Guernsey Insurance Fund, the Long-Term Care Fund and the Guernsey Health Service Allocation.

- establish, as necessary, an appropriate allocation of additional revenues between the Social Security Funds and General Revenue.

14. Engagement

14.1 A substantial public engagement campaign began in February 2022. This commenced with a live media briefing which was broadcast on 10 February to outline the issues the Tax Review was seeking to address, explain the main options that were being considered at that stage and why, promoting the public events that would follow and take media questions.

14.2 Several public events were then held affording the community an opportunity to come and speak to members of the Policy & Resources Committee and the Tax Review Steering Group at various locations in the Bailiwick. This included four drop-in events and a public meeting in Alderney. The events were held on the following dates and locations:

- St Peter's Community Hall – 12th February 2022
- Vale Douzaine Room – 12th March 2022
- The Alderney public meeting – 16th March 2022
- Beau Sejour – 26th March 2022
- Cobo Community Centre – 25th April 2022

14.3 Further to this, an online public Q&A was also held on 26 April. This format allowed members of the public to send questions in via social media during a live broadcast where a panel of members of the Policy & Resources Committee and the Tax Review Steering Group could answer them live.

14.4 The events themselves were well received, although attendance varied with the first of the drop-ins being very busy and the last drop-in at Cobo seeing a very low attendance.

14.5 These events were supported by a range of materials produced and publicised to raise awareness of the Tax Review, engage the community and direct them to where they could find more information. A new website was created, ourfuture.gg, with a dedicated Tax Review section where people could find detailed information on the States' revenue and expenditure, the population forecasts and how they were expected to impact the funding of public services, various revenue-raising options and their pros and cons, case studies explaining how some of the initial tax options would impact different households, video links to the earlier online broadcasts that had been held, and more. It also invited members of the public to leave comments.

14.6 Leaflets were sent to all households to promote the public events, and a social media campaign highlighted the key issues that the Tax Review sought to address and promoted the website. A series of columns were published in the traditional media, each focusing on a different aspect of the Tax Review.

14.7 Having carried out this intensive period of public engagement, which aimed to raise awareness of the Tax Review, encourage discussion and invite suggestions from the community, the Policy & Resources Committee believes understanding of the demographic challenges facing the Bailiwick has improved. There is no doubt that many (though not all) of those who attended the events were opposed to a GST. One of the greatest challenges of the campaign was persuading the community that a GST can form part of a package that would see those on the lowest incomes pay less tax overall compared to what they contribute now. While this was a central message in all the events and materials produced, there is a deeply embedded aversion to GST in the community where many are suspicious and do not believe this will be the case.

14.8 Amongst the feedback from Islanders during the public engagement campaign was a sense that not enough had been done to explore all of the possible options, and this prompted the Committee to do further work exploring corporate tax alternatives, which was done by way of the independent review by EY. This review is addressed elsewhere in this Policy Letter, but it is important to reflect that the Committee entered the corporate tax review in recognition that it may reveal new options, and that at the very least it was important to demonstrate to the community that 'no stone had been left unturned'.

14.9 Following the publication of this Policy Letter, it is the Committee's intention to hold further public engagement events to raise awareness and explain the Committee's final proposals ahead of the debate by the States of Deliberation.

14.10 The Committee has also engaged extensively with States Members over the period since the last debate. A total of seven briefings have been held providing updates on the work undertaken (including sharing of papers and analysis) and giving an opportunity for Members to ask questions, make suggestions and seek clarifications. Alderney States Members have also been invited to attend these sessions.

15. Compliance with Rule 4

15.1 Rule 4 of the Rules of Procedure of the States of Deliberation and their Committees sets out the information which must be included in, or appended to, motions laid before the States.

15.2 In accordance with Rule 4(1)(a), the Propositions which this Policy Letter accompanies respond to Resolutions of the States made in relation to the Fiscal Policy Framework, as noted and explained throughout this Policy Letter. The review of taxation is a critical component of the action in the States' Government Work Plan (Billet d'État XV of 2021) to 'Agree a sustainable taxation policy'. This action forms part of the Priority area: 'Reshaping Government', which the States have resolved is one of the four main priorities for government at this time (Billet d'État VI of 2021).

15.3 In accordance with Rule 4(1)(b), the Propositions have been developed with consultation and engagement as explained in section 14 of this Policy Letter.

15.4 In accordance with Rule 4(1)(c), the Propositions have been submitted to His Majesty's Procureur for advice on any legal or constitutional implications. She has advised that there is no reason in law why the Propositions should not be put into effect.

15.5 Rule 4(1)(d) concerns the financial implications to the States of carrying into effect the proposals. As set out in paragraph 11.1 of this Policy Letter, it is estimated that £12.5m will be needed to implement these proposals with a further £2.5m a year of ongoing costs, covering administration cost for both a GST and the restructured Social Security Contributions and the payment of the additional cost support benefit. The proposals will generate a net financial gain of an estimated £55m to the States.

15.6 In accordance with Rule 4(2)(a), the Propositions relate to the duties of the Committee to co-ordinate policy including leading the policy planning process, the allocation and management of resources, including the States' budget and facilitating cross-committee policy development.

15.7 In accordance with Rule 4(2)(b) of the Rules of Procedure of the States of Deliberation and their Committees, it is confirmed that the Propositions above have the unanimous support of the Members of the Committee.

P T R Ferbrache
President

M A J Helyar
J P Le Tocq
D J Mahoney
R C Murray

Appendix 1. Committee *for* Employment & Social Security: Letter of Comment

Committee *for*
Employment & Social Security

Edward T. Wheadon House
Le Truchot, St. Peter Port
Guernsey, GY1 3WH
+44 (0) 1481 222500
employmentandsocialsecurity@gov.gg
www.gov.gg

Deputy P T R Ferbrache
President
Policy & Resources Committee
Sir Charles Frossard House
St Peter Port
Guernsey

Our Ref:
Your Ref:
Date: 25 November 2021

By email

Dear Deputy Ferbrache

Tax Review: Phase 2

Thank you for inviting the Committee *for* Employment & Social Security ('the Committee') to provide a letter of comment in respect of the Tax Review Policy Letter, to be appended to that Policy Letter.

A near final draft of the Policy Letter was considered by the Committee at its meeting on 21 November 2022. There was consensus among members that there is a pressing need to raise more revenue in order to adequately fund essential public services, pensions and benefits in the future. That said, members have differing views regarding the amount of additional revenue required and how it should be raised, which they will articulate during debate. For that reason, I will confine the Committee's comments to the proposed restructure of the social security contributions system.

The Committee remains supportive of restructuring the social security contributions system to make it more equitable and, along with proposed changes to the income tax system, to offset the regressive nature of GST.

The Committee is supportive of the recommendation to align the basis of assessment for employees, self-employed persons and non-employed persons in order to make the system more equitable across classes of contributors, thereby removing the incentive for early retirees to engage in a minimal amount of paid work to reduce their contributions liability. This behaviour is not in the best interests of the wider insured population.

In particular, the Committee welcomes the proposal to introduce an allowance, aligned with the personal income tax allowance, for all classes of contributors, excluding employers. This will have the benefit of removing the 'cliff-edge' created by the lower earnings/income limit at which liability on all earnings/income (as applicable), up to the upper earnings/income limit, currently kicks in. However, the Committee notes that the consequential substantial loss in revenue will need to be replaced through other measures in order not to worsen the already unsustainable financial position of the Guernsey

Insurance Fund and the Long-term Care Insurance Fund. Therefore, the allowance must only be implemented as part of the wider package of reforms, as recommended by the Policy & Resources Committee, and not in isolation.

The Committee is pleased to note that the Policy & Resources Committee is proposing to introduce a Class 1 contribution credit for people with earnings above the lower earnings limit but below the proposed allowance, who are currently liable to pay a weekly contribution but will not be liable under the proposed new structure. Without such a measure, the contribution records and future benefit entitlement of those low-earners would suffer.

While the Committee is very supportive of the broad proposals for reforming Guernsey's social security system, it has identified some detailed, consequential policy issues that are not explored in the draft Policy Letter. For example, the removal of the lower income limit means that it will be necessary to determine a new method for setting the non-employed voluntary contribution and special rate contribution which are currently based on the minimum weekly rate payable as a non-employed person under pensionable age (i.e. contribution rate for non-employed persons under pensionable age x (lower income limit - non-employed allowance)). It is expected that other points of technical detail will be identified during the course of the implementation phase which are likely to necessitate further Committee and States decisions prior to the implementation of the reformed system.

As noted in the Policy Letter, an additional £34m is required to put the Guernsey Insurance Fund and the Long-term Care Insurance Fund on a sustainable financial footing. The draft Tax Review Policy Letter indicates that the package of measures proposed raises approximately £20m via the social security contributions system and approximately £36m through General Revenue. The Committee notes that the Policy Letter does not seek to determine how the resources raised should be allocated. This is a matter that will need to be addressed as a priority should the proposals set out in the Policy Letter be approved.

While the Committee proposed in its Policy Letter entitled 'Contributory Benefits and Contribution Rates for 2022' (Billet d'État XX of 2021, Article 11) ten- and four-year plans to gradually increase the percentage contribution rates of relevant classes of contributors to the Guernsey Insurance Fund and the Long-term Care Insurance Fund ('the Funds') respectively, in order to ensure their financial sustainability, it made clear at that time that its preferred approach to addressing this issue was through the Tax Review, taking a more holistic view of fiscal issues. Importantly, the Policy & Resources Committee's proposals are more progressive than, and therefore preferable, from the Committee's perspective, to the ten- and four-year plans approved by the States in October 2021. However, if Proposition 2 is not approved by the States, the Committee will seek to implement the ten- and four-year plans in accordance with these resolutions.

Thank you for inviting non-voting member, Mark Thompson, and myself to input in the development of the Policy & Resources Committee's proposals through our membership of the Tax Review Steering Group. We have very much welcomed this opportunity to work collaboratively with your Committee.

Yours sincerely

Deputy Peter Roffey
President

Appendix 2. Economic Impact Study of the States of Guernsey Tax Review

A2.1 The following analytical report was commissioned and published for the first phase of the Tax Review. The analysis presented is in relation to packages which raise more revenue than the lead model presented in this Policy Letter and apply a different combination of measures. However, the general principles, including the relative economic impact of a GST combined with a reduction in direct taxes, versus an increase in direct taxes remains relevant.

Deloitte.

Economic Impact Study of the States of Guernsey Tax Review

Final Report

4 August 2021

Important Notice from Deloitte

This Final Report has been prepared by Deloitte LLP ("Deloitte") for the States of Guernsey (the "States") in accordance with the contract with them dated 10 March 2021 (the "Contract") and on the basis of the scope and limitations set out below.

The Final Report has been prepared solely for the purposes of providing economic analysis of a set of tax policy options as set out by the States of Guernsey, as set out in the Contract. It should not be used for any other purpose or in any other context, and Deloitte accepts no responsibility for its use in either regard including its use by the States for decision making or reporting to third parties.

The Final Report is provided exclusively for the States' use under the terms of the Contract. No party other than the States is entitled to rely on the Final Report for any purpose whatsoever and Deloitte accepts no responsibility or liability or duty of care to any party other than the States in respect of the Final Report or any of its contents.

As set out in the Contract, the scope of our work has been limited by the time, information and explanations made available to us. The information contained in the Final Report has been obtained from the States and third-party sources that are clearly referenced in the appropriate sections of the Final Report. Deloitte has sought neither to corroborate this information nor to review its overall reasonableness. Further, any results from the analysis contained in the Final Report are reliant on the information available at the time of writing the Final Report and should not be relied upon in subsequent periods.

This document also includes certain statements, estimates and projections provided by the States with respect to anticipated future performance. Such statements, estimates and projections reflect various assumptions concerning anticipated results and are subject to significant business, economic and competitive uncertainties and contingencies, many of which are or may be beyond the control of the States. Accordingly, there can be no assurance that such statements, estimates and projections will be realised. The actual results may vary from those projected, and those variations may be material. Whilst we have commented on such statements, estimates and projections and their implications, we accept no responsibility for their accuracy or completeness, and they are the sole responsibility of the States.

We have conducted options analysis based on projections provided by the States (these comprise the options outlined and analysed in the report). The results produced by the options under different assumptions are dependent upon the information with which we have been provided. Actual results are likely to be different from those projected by the options due to unforeseen events and accordingly we can give no assurance as to whether or how closely the actual results ultimately achieved will correspond to the outcomes projected in the options. The scenarios are intended only to provide an illustrative analysis of the implications of the States' projections.

Any decision to invest, conduct business, enter or exit the markets considered in the Final Report should be made solely on independent advice and no information in the Final Report should be relied upon in any way by any third party. This Final Report and its contents do not constitute financial or other professional advice, and specific advice should be sought about your specific circumstances. In particular, the Final Report does not constitute a recommendation or endorsement by Deloitte to invest or participate in, exit, or otherwise use any of the markets or companies referred to in it. To the fullest extent possible, both Deloitte and the States disclaim any liability arising out of the use (or non-use) of the Final Report and its contents, including any action or decision taken as a result of such use (or non-use).

Contents

1 Executive Summary

Guernsey is facing increasing fiscal pressures. These pressures are driven by Guernsey's ageing population and the requirement for financial resources to fund the increasing costs associated with meeting its existing service commitments and infrastructure requirements. As part of the measures under consideration to combat these pressures, the States are reviewing the possibility of several tax policy options. This Report compares Guernsey's tax structure to those of a set of benchmark jurisdictions and outlines the economic impacts of a set of tax policy options proposed by the States.

As with several other advanced economies, the population in Guernsey is ageing and this means that a greater level of expenditure is required to maintain current service levels. This pressure is accompanied by the fiscal demand for infrastructure investment to keep pace with the expanding scope of medical care services and to meet international commitments on areas such as climate change. Furthermore, the economic impacts of COVID-19 have resulted in the States operating at a deficit of £64 million, equivalent to 2.1% of the 2020 GDP estimate.[1]

To fund upcoming expenditure, the States must either raise additional revenues, increase their deficit or reduce spending elsewhere. The States view increasing their deficit to fund future costs as an unsustainable long-term option. The States are separately considering efforts to control expenditure. Approximately 63% of the States' expenditure is on health and community services, old age pensions and social welfare benefits. Each of these elements of expenditure is expected to increase and the States do not consider expenditure restraint alone to be a viable solution. Therefore, the States have stated that they will need a system capable of raising revenue within the 24% of GDP limit on government revenues set out in the States' Fiscal Policy Framework published in 2019. To this end, the States have identified three tax policy options that are under consideration.

Each of these policy options involves the restructure of social security contributions (SSCs). The exact rates of SSCs vary across the policy options. As well as changes in the rates, the policy options involve the introduction of an SSC allowance that is aligned with the personal income tax (PIT) allowance. Finally, across all policy options the nature of income treatment for SSC purposes is changed for all employed and self-employed persons, with contributions being made based on income from all sources as opposed to gross income from employment, which is currently the case. The key elements are provided below in Table 1 with the full details provided in Table 2. It can be seen that Option 1 is based predominantly on the introduction of a Health Tax of 3%, administered in a similar way to PIT. Options 2 and 3 are predominantly based on the introduction of a GST at rates of 8% and 5% respectively.

[1] The States of Guernsey Accounts 2020.

Table 1: Policy options overview

	Current	Option 1	Option 2	Option 3
GST	-	-	8%[2]	5%[3]
Health Tax	-	3% levied in a similar manner to PIT	-	-
PIT allowance	£11,875	£11,875	£14,000	£12,700
SSC allowance	-	£11,875	£14,000	£12,700
SSC employee rate	6.6%	9%	8%	9%
SSC employer rate	6.6%	7.5%[4]	7.5%[5]	7.5%[6]
Income treatment	Employee SSC contributions charged on earnings from employment[7]	Employee SSC contributions charged on all income	Employee SSC contributions charged on all income	Employee SSC contributions charged on all income

This Report includes analysis of the impacts associated with each of these options, which were selected by the States.[8] More broadly, other tax reforms, such as changes in corporate taxation, are being considered separately but are out of scope for the purposes of this Report. An assumption has been provided by the States as to the revenue that any change in CIT may generate.

Benchmarking analysis

This Report considers the impacts of the tax changes described above in relation to the tax systems of some of Guernsey's benchmark jurisdictions. The benchmarking study considers differences in the economic and financial context of four jurisdictions. These benchmark jurisdictions, as agreed with the States, are Jersey, the Isle of Man, Luxembourg, and Singapore. These jurisdictions have been chosen because they are broadly as economically developed as Guernsey and have dominant financial service sectors. These jurisdictions may also be considered as alternatives to Guernsey if businesses or high net worth individuals choose to relocate as a result of changes in local tax policy. The benchmarking analysis considers total tax revenue as a share of GDP, Income Taxation (Personal Income Taxation (PIT), the Health Tax and Social Security Contributions (SSCs)) and Goods and Services Taxation (GST). The analysis concludes by discussing the relative reliance of Guernsey on direct and indirect taxation and how this may change under each of the options.

Total tax revenue as a share of GDP

Figure 1 shows how in comparison to some benchmark jurisdictions, the States currently raise less tax as a share of GDP, at 19%.[9] This is the ratio of tax revenue to GDP rather than the ratio of total government revenues to GDP. The latter is higher and includes other sources of revenue such as charges for services and rental incomes. Under each policy option the ratio of tax revenue to GDP would increase. Even under Option 2, which is associated with the largest increase in the ratio of tax revenue to GDP, Guernsey's ranking relative to the benchmark jurisdictions is unchanged.

---

[2] Applied on a broad basis with limited exceptions in line with application in Jersey (https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/PayingGSTJersey.aspx). Primary exemptions include financial services and some health-related expenditure. All exports including financial services are assumed to be zero-rated.

[3] Applied on a broad basis with limited exceptions in line with application in Jersey (https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/PayingGSTJersey.aspx). Primary exemptions include financial services and some health-related expenditure. All exports including financial services are assumed to be zero-rated.

[4] The headline self-employed rate would fall from 11% to 9.0% but be charged on all income (less allowance up to the upper earnings limit) rather than solely on income earned from self-employment (up to the upper earnings limit). A rate of 5.0% would then be applied to all self-employed earnings in excess of the upper earnings limit after accounting for the allowance. The non-employed rate for those under State Pension Age (SPA) would fall from 10.4% to 9.0% and the non-employed rate for those of SPA and older would increase from 3.4% to 4.5%.

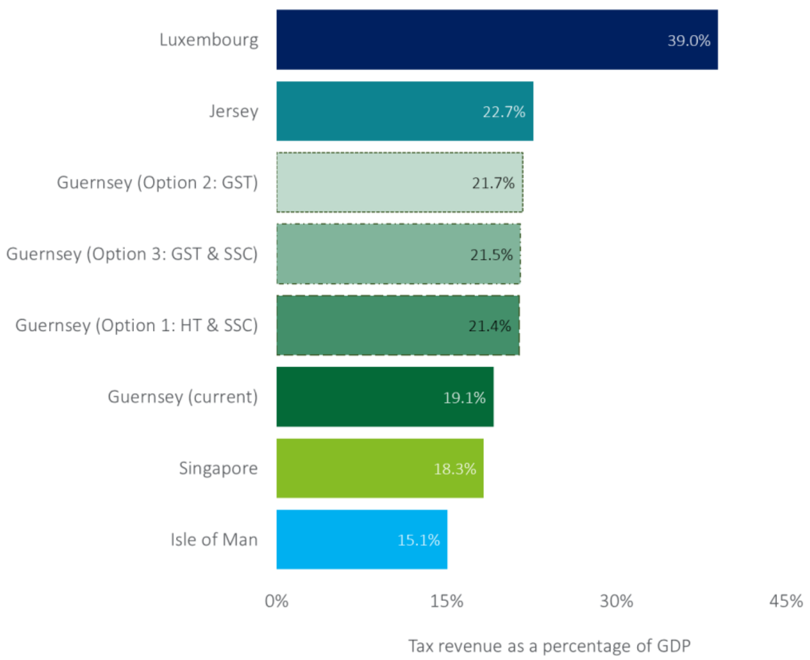
[5] The headline self-employed rate would fall from 11% to 7.5% but be charged on all income (less allowance up to the upper earnings limit) rather than solely on income earned from self-employment (up to the upper earnings limit). A rate of 5.0% would then be applied to all self-employed earnings in excess of the upper earnings limit after accounting for the allowance. The non-employed rate for those under SPA would fall from 10.4% to 7.5% and the non-employed rate for those of SPA and older would increase from 3.4% to 3.5%.

[6] The headline self-employed rate would fall from 11.0% to 9.0% but be charged on all income (less allowance up to the upper earnings limit) rather than solely on income earned from self-employment (up to the upper earnings limit). A rate of 5.0% would then be applied to all self-employed earnings in excess of the upper earnings limit after accounting for the allowance. The non-employed rate for those under SPA would fall from 10.4% to 9.0% and the non-employed rate for those of SPA and older would increase from 3.4% to 4.5%.

[7] Note that those over State Pension Age (SPA) already get charged SSC on all income

[8] The precise scope of this report is set out in Section 2.4.

Figure 1: Tax revenue as a percentage of GDP, 2019



Source: See Appendix A2, Options revenue data as provided by the States

Income Taxation (PIT, Health Tax and SSCs)

In general, comparisons across both personal income tax rates and social security contribution rates show that Guernsey's rates are broadly comparable to those of its benchmark jurisdictions. For example, Guernsey's current headline PIT rate (20%) is much less than Luxembourg's highest marginal tax rate (42%), slightly less than Singapore's (22%) and identical to those of Jersey and the Isle of Man.

While no policy option under consideration in this report proposes a higher headline rate of PIT, Option 1 involves an increase in the rate of income taxation through the introduction of a Health Tax of 3%. The impact of the Health Tax is very similar to the impact of increasing PIT by 3 percentage points. Jersey is the only benchmark jurisdiction that currently has a Health Tax. The Jersey Health Tax, known as the long-term care charge, has a headline rate of 1.5% and a marginal rate of 1.95%[10], which is lower than the Health tax under consideration for Guernsey in Option 1.

As well as differences in the rate of PIT, the allowance for which no tax is charged also differs. Guernsey's current allowance is only higher than those of Singapore and Luxembourg but lower than the allowances in the Isle of Man and Jersey. Under Option 1 there would be no change in this allowance and thus no change in Guernsey's position. Under Options 2 and 3, Guernsey's personal allowance would increase to £14,000 and £12,700 respectively. The increase in the allowance under Options 2 and 3 would not be sufficient to change Guernsey's position relative to the benchmark jurisdictions. As well as the tax-free allowance, another key dimension of income taxation amongst some benchmark jurisdictions is the tax cap. The policy options under consideration by the States do not include any change in the levels of these tax caps.

In this report, the term SSC is used to cover all national insurance schemes. In Guernsey, SSCs are currently payable at a rate of 6.6% for employees and employers. This rate is lower than in the Isle of Man and Singapore, where rates of 11%

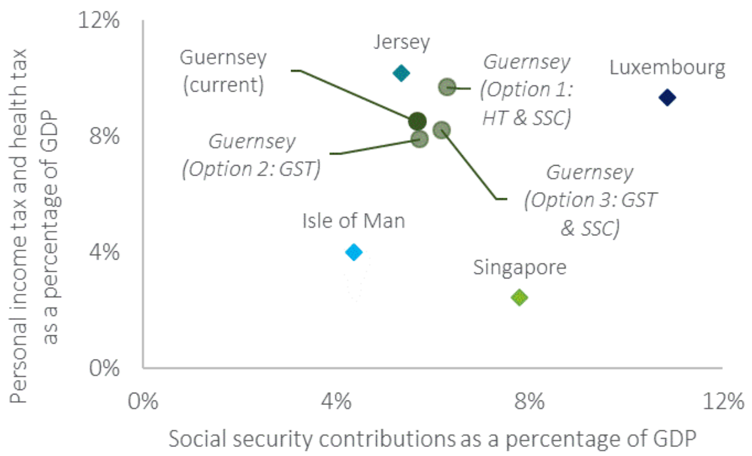
[10] Marginal rates are applied in line with Jersey's PIT

and 20% respectively are charged above lower thresholds.[11] Jersey's social security contribution rate is more comparable to Guernsey's, at 6% for employees and 6.5% for employers.[12] Employers in Jersey are charged at a rate of 2.5% for income between £55,320 and £252,360. By comparison, Guernsey currently charges a rate of 6.6% capped at the same level for both employees and employers. All policy options under consideration involve an increase in the headline rate of SSCs for employees and employers. Under Options 1 and 3 the employee rate is increased to 9% and the employer rate is increased to 7.5%. Under Option 2 the employee rate is increased to 8% and the employer rate to 7.5%. The increases under these options do mean a greater divergence from Jersey but the rates remain lower than in the Isle of Man and Singapore.

All policy options under consideration for Guernsey involve the adoption of the PIT allowance as an SSC allowance, meaning that individuals with income below the allowance threshold will not pay SSCs. The introduction of the allowance, which decreases SSC revenues, and the increased rates, which increase SSC revenues, mean that the change in the level of revenue raised through SSCs under each option is unclear in advance. When the revenue lost from the increased allowance is compared to the revenue gained from the increase in rates, Option 1 sees an increase in SSC revenue, Option 2 sees an increase but to a lesser extent than under Option 1 due to the higher personal allowance, and Option 3 sees an increase greater than under Option 2 but less than Option 1.

Figure 2 compares how the different options under consideration would affect Guernsey's position relative to its peers in terms of the ratio of PIT and Health Tax to GDP and the ratio of SSCs to GDP. Guernsey currently sits below Jersey and Luxembourg in terms of PIT and Health Tax and below Luxembourg and Singapore in terms of SSCs. Options 2 and 3, which are GST based, do not produce a material change in Guernsey's relative position. By contrast, Option 1 significantly increases the ratio of PIT and Health Tax to GDP to a level above that observed in Luxembourg and approaching the higher level found in Jersey.

Figure 2: Personal income tax (PIT) and social security contributions as a percentage of GDP



Source: As in Appendix A2 Figure 7

GST

Guernsey is the only jurisdiction in the benchmarking analysis that does not currently have a GST; in this report the term GST is used to include all forms of consumption tax. The Isle of Man follows the UK's GST regime and thus has a 20% standard rate, Luxembourg's GST is set at 17% and Singapore applies a broad-based, low rate GST at 7%. Jersey introduced

[11] Singapore has an allowance of £4,891 (SGD 9,000) and the Isle of Man has a primary threshold of £7,176. In Luxembourg, however, the minimum annual earnings used to calculate contributions are the legal monthly social minimum wage – at £22,977 (€26,423).
[12] However, Jersey has a much lower upper earnings limit of £55,320 at the 6% rate, compared to Guernsey's limit of £153,660.

a GST at 3% in 2009 and has now increased this to 5%.[13] The current lack of a GST in Guernsey is atypical in the sense that such taxes are common internationally. Across the 37 OECD countries, 36 have some form of GST.[14]

Under Options 2 and 3, a GST would be introduced in Guernsey at rates of 8% and 5% respectively. This level of GST remains at the lower end of the distribution of GSTs, but importantly the 8% GST would be higher than the 5% level currently charged in Jersey. Options 2 and 3 include exemptions for financial services, although many financial services organisations would be liable to pay international services exemption fees. These exemptions closely align to those found in Jersey, which are detailed in Table 10 in Appendix A3, alongside other benchmark jurisdictions' exemptions, all of which include financial services.

Reliance on direct tax revenue

Tax revenue can be delineated by that which is directly paid to the government, such as PIT, SSCs, Corporate Income Tax and the Health Tax, and that which is indirectly paid to the government such as GST. Of the benchmark jurisdictions, Guernsey is currently most reliant on direct taxation, with only 10% of its tax revenue coming from indirect taxation. Option 1 would further increase this reliance, as the level of revenue raised through indirect taxation would fall to 9%. By contrast, under Options 2 and 3, which would see the introduction of a GST at 8% or 5% respectively, the share of tax revenue raised through indirect taxation would increase to 21%, which is greater than the rates for Jersey and Singapore under Option 2, and 17% under Option 3, which is greater than that of Jersey.

Economic impacts

This Report considers the potential economic impacts of the tax policy options proposed by the States. To assess these impacts, we examine the expected changes in the size of the economy and the potential distributional consequences of the policies under consideration.

To maintain current service levels in the face of fiscal pressures arising from an ageing population requires a non-trivial expansion in the size of the state; this issue has been compounded by the impacts of COVID-19. Assuming the States' current working target is achieved, this would see total government revenue as a share of GDP increase from 21.9%, the estimate before 2020 and the resulting COVID-19 impact, to the target of 24%. The States estimate that under Policy Option 1 this increase would be to 23.8% by 2026, under Option 2 the increase would be to 24.1%, and under Option 3 it would be to 24.0%.

Under the options considered in this report, the overall impacts on GDP are unlikely to be large and likely to be short-term in nature; the structure of Guernsey's economy will change as a result of the increase in spending on health and aged care necessary to maintain current service levels. However, it is important to note that the macroeconomic impacts may be exacerbated if there is a disconnect between when the tax revenue is raised and when the revenue is spent. The structural changes may include a reduction in the size of sectors such as wholesale, retail, and repairs. These industries currently make up only about 8% of total GVA, implying that their impacts on the overall economy are unlikely to be very large. The changes proposed will likely include an expansion of the healthcare and government sectors, at 12% of GVA, in order to maintain current service levels in the face of increasing pressure.[15]

As the States have posited that this increase in tax revenue will ultimately be matched by an increase in spending as fiscal pressures manifest, this change will have a relatively small impact on the size of the economy in the long run. There may be a disconnect between when the tax revenue is raised and when it is ultimately spent as the spending is smoothed to keep pace with changes in the demographic profile of Guernsey. This difference in timing will have an impact on GDP up until the point that the accrued revenue is spent. Whilst the overall lasting impact on the economy may be small, the changes will have important distributional consequences and heterogeneous impacts across sectors. Empirical studies

[13] Note that both GST and VAT are taxes on goods and services and thus input/output taxes on consumption. The Isle of Man (alongside the UK) and the EU refer to Value Added Tax (VAT). Others refer to Goods and Services Tax (GST). For simplicity, we will refer to either as a GST throughout this report.
[14] OECD report, "Consumption Tax Trends 2020" available at: https://www.oecd-ilibrary.org/sites/152def2d-en/index.html?itemId=/content/publication/152def2d-en
[15] Guernsey Facts and Figures, 2020, States, available at: https://www.gov.gg/CHttpHandler.ashx?id=131184&p=0

have shown that increases in taxes accompanied by largely unchanged fiscal positions may have temporary impacts on the economy.[16]

Empirical evidence finds that income tax changes have a larger impact than GST on output, private consumption and investment in the short run. The GST is a more efficient tax than income taxation because of its base, which does not include mobile capital income. Further, it can be argued that the ageing population in Guernsey means that PIT revenues are on a downward trajectory, all else being equal, whereas GST revenues are likely to be less affected by this. The GST would help to reduce the States' reliance on direct tax revenue, diversifying their revenue base. GST also causes fewer market distortions as it does not impact the cost of labour or capital directly. Furthermore, the GST decreases in efficiency as rates and the number of exemptions increase. Finally, through increasing the cost of consumption, the GST has a general equilibrium impact via an increase in the savings ratio, which may lead to higher levels of investment that could be beneficial for the economy in the long run. The main drawback of the GST is that it can be regressive, but this may be mitigated through interventions for lower income households, as is proposed in the options outlined by the States. It is also worth noting that the administration and adjustment costs associated with the GST are somewhat independent of the rate selected.

Policy Option 1 is predominantly based on an increase in income taxation and thus there are likely to be transitory impacts on household consumption, GDP growth and employment. Policy Option 2 is based on a GST and is thus most likely to have an impact on inflation in the short term with impacts dissipating after one year. Under Policy Option 3 a lower rate GST is introduced, which will have a more moderate impact on price levels. Option 3 also includes the raising of more revenue through income taxation via SSCs, but this is likely to have a smaller impact on consumption, GDP growth and employment than Option 1.

An increase in the tax to GDP ratio, compliance and administrative costs and changes in incentives will lead to significant short-term transitory impacts as businesses, individuals and the government learn to navigate the new systems and the new structure of the economy. In this context, the short term could refer to a period of around 1 to 3 years. The adjustment costs will be more pronounced where new systems are being introduced, such as in the case of the introduction of a GST. Based on the effect of the GST introduction and subsequent increase in Jersey, a 1 percentage point increase in the GST rate was associated with an increase in price levels of approximately 0.65 percentage points. Given the similar level of proposed exemptions, it is reasonable to assume a similar level of impact for Guernsey; the introduction of a 5% GST will therefore lead to an increase in price levels by approximately 3 percentage points. The impact would likely be greater under Option 2, which includes a GST of 8%. However, after a year this would be expected to have no ongoing impact on inflation as prices settle to a new level.

Given the expenditure drivers and Guernsey's ageing population, the health and aged care sector will benefit most from the increase in government expenditure. The States will need to ensure that the labour market is able to keep up with the changing structure of the economy and the demand for new jobs in sectors such as healthcare. As the economy transitions to a new state, this may require investment in upskilling the labour force or the need to bring in skilled labour from abroad. The described increase in government expenditure may be complicated by the States' ability to expand the healthcare sector and increase health expenditure given the availability of skilled labour.

The economic impacts will not be felt equally across the income distribution. The progressivity of each of the taxes considered is different. The introduction of a broad-based, low-rate GST is a relatively efficient means of raising tax revenues in comparison to an income tax, as it has less impact on people's incentives to work. However, it can be regressive and impact lower income households more as these households tend to spend a larger proportion of their income on essentials. The States have outlined a suite of offsetting measures, such as increasing the tax-free allowance, restructuring social security contributions to make them more progressive, and allocating funding for a compensating increase in income support and an allowance for additional mitigation. This approach is in line with those of other

[16] Guajardo, Leigh & Pescatori (2014) "Expansion Austerity? International Evidence", available at: https://onlinelibrary.wiley.com/doi/abs/10.1111/jeea.12083, Romer & Romer (2007) "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks", available at: https://www.nber.org/system/files/working_papers/w13264/w13264.pdf

countries or jurisdictions increasing government expenditure alongside such tax changes. The resulting impact is that all policy options are progressive when tax impacts are expressed as a share of household income, after taking the States' proposed mitigations into account. In absolute terms, under each policy option the majority of additional tax revenues are raised from those in the highest income quintile. Under Option 1, 73% of revenue is raised from the top 20% of earners; under Options 2 and 3 the figures are 62% and 63% respectively.

The higher earners, defined as individuals with a high income in the top 5% of households,[17] are likely to be impacted most by the changes in personal income tax relative to the impact from the other considered tax changes. They differ from high net worth individuals (HNWIs), who are much smaller in number, are more mobile and would be most influenced by the tax cap and any taxes on capital. The analysis suggests that the proposed changes may not have a material impact on the attractiveness of Guernsey for the higher earners. These individuals are unlikely to see an impact on their employment status as they are employed in high-skilled industries, such as the financial services industry, where changes in marginal income tax rates are one element of a broader list of factors that influence where a business chooses to locate. Aside from these tax changes being comparable to the taxes levied in other benchmark jurisdictions, Guernsey also has an attractive capital taxes policy (with no tax on capital gains and no inheritance tax), along with a corporate tax structure that moves in broad alignment with the other Crown Dependencies'.

A summary of the impacts associated with the policy options is provided below. Short-term impacts are likely to be felt for approximately 1 to 3 years following the introduction of the policies. Macroeconomic impacts are likely to be felt for at least the duration of the disconnect between when revenue is raised and when spending increases. One exception to this is the impact of the GST on inflation, which can be expected to dissipate after one year as suggested by empirical studies.

[17] Appendix A1 sets out the criteria for identifying these higher earners from the data on the top 5% in Guernsey.

	Policy Option 1 (income tax based)	Policy Option 2 (GST based)	Policy Option 3 (GST & income)
Tax revenue as a share of GDP	↗ 21.4%	↗ 21.7%	↗ 21.5%
	Tax revenue currently 19.1% of GDP Guernsey's ranking relative to benchmark jurisdictions would not change		
PIT + Health Tax revenue as a share of GDP	↑ 9.7%	↓ 7.9%	↘ 8.2%
	PIT + Health Tax revenue currently 8.5% of GDP Guernsey's ranking relative to benchmark jurisdictions would increase by 1 under Option 1		
SSC revenue as a share of GDP	↑ 6.3%	↔ 5.7%	↑ 6.2%
	SSC revenue currently 5.7% of GDP Guernsey's ranking relative to benchmark jurisdictions would not change		
GST revenue as a share of GDP	↔ 0.0%	↑ 2.7%	↗ 1.7%
	GST revenue as a share of GDP currently 0% in Guernsey as there is no GST Guernsey would have the 3rd highest GST revenue relative to GDP amongst benchmark jurisdictions under Option 2 but would remain lowest under Option 3		
Short-term impact on household consumption	↓	↗ due to decreased income taxation	↘
Short-term impact on GDP growth	↓	↗ due to decreased income taxation	↘
Short-term impact on employment	↓	↗ due to decreased income taxation	↘
Short-term impact on Inflation	↔	↑	↗
Progressivity	✓	✓	✓
Most impacted household type	2 working age adults and children by 2.7%	2 working age adults with children by 2.2%	2 working age adults with children by 2.2%
Impact on higher earners income	↓ 3 to 4%	↘ 2 to 3%	↘ 2 to 3%

Key Findings

- In comparison to those of other OECD countries, and the benchmark jurisdictions considered in this report, the States' tax revenues as a percentage of GDP are on the lower end. If Guernsey were to raise its PIT or SSC rates, or introduce a Health Tax, the illustrative tax rates considered in this report and the reliance on direct taxes would **still be broadly comparable to those of the benchmark jurisdictions**. Though it is worth noting that Guernsey is currently reliant on direct taxation for the majority of its tax revenue and Option 1 (the introduction of a Health Tax along with a restructuring of SSCs) would compound this reliance.
- In the context of other OECD countries and the benchmark jurisdictions considered here, Guernsey is **atypical in that it does not currently have a GST in place**. While the GST rates under consideration of 8% in Option 2 and 5% in Option 3 are within the range of benchmark jurisdictions, a rate of 8% would be higher than the level currently in place in Jersey.
- **Overall impacts on GDP are likely to be limited over time,** given that tax increases will be approximately matched by an increase in spending to maintain current service levels given an ageing population. However, there will be **transitory impacts on the economy** as the structure of the economy changes. **Short-term impacts will also be felt to the extent that there is a disconnect in the timing of when the tax revenues are raised and when they are spent.**
- An introduction of a GST at a rate of 5%, as in Option 3, could be expected to lead to a **short-term increase in price levels** of approximately 3 percentage points and this impact would likely be greater if a GST was introduced at 8%, as would be the case under Option 2. There will also be upfront compliance and administrative costs as businesses learn to navigate the new legislation as well as ongoing compliance costs.
- As the structure of the economy changes, the impacts on sectors will differ. An increase in taxes on income will adversely impact household consumption and therefore **impact sectors such as wholesale, retail, and transport**. On the other hand, the increase in expenditure on healthcare driven by **increasing demand for healthcare will expand these sectors**.
- The **introduction of a GST is less progressive than other core tax levers**. When a broad-based GST has been introduced in other jurisdictions, it has often been accompanied by other changes to support lower income households in an effort to redress some of the regressivity; this approach has also been suggested within the options proposed by the States. **These mitigating interventions help to offset the regressive impacts of the GST under Options 2 and 3 such that each option under consideration is progressive in terms both of absolute revenues raised and of revenues raised as a share of income or expenditure.**
- Of the tax changes proposed, higher earners (part of the top 5% of households) are most likely to be adversely impacted by increases in income taxation. Given the nature of the industries they work in (high-skilled), it is **unlikely that their employment status will be adversely impacted given that changes in the marginal personal income tax rate may not be a significant factor when companies choose where to locate**. Furthermore, given that there are currently no capital gains taxes in Guernsey, and that a majority of the higher earners have lived in Guernsey for over 10 years, it is **unlikely that the tax changes illustrated here will lead to a material change in factors that make Guernsey an attractive location for some of these higher earners**.

2 Introduction

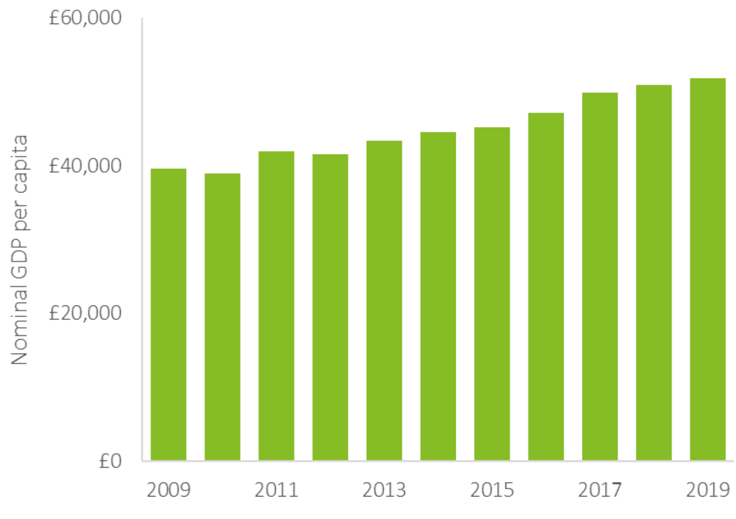
Guernsey’s economy has grown considerably over the last decade, but an ageing population and the fiscal impacts of the Covid-19 pandemic have led to a need to increase spending to maintain current service levels

2.1. Background and context

This Report discusses the impact of certain tax policy changes in Guernsey, which includes Herm, and Alderney, where residents and businesses are subject to Guernsey’s tax regime. For the purposes of this Report all references to Guernsey apply to both Guernsey and Alderney. The impact of any selected tax reform is contingent on the economic conditions which prevail in Guernsey at the time, and to that end it is important to understand the current economic context in Guernsey.

Guernsey’s economy has flourished over the last 10 years. We measure the size of the economy using Gross Domestic Product (GDP) and Gross Value Added (GVA). GDP is a monetary measure of the value of goods and services in the economy, measured in Guernsey using the income approach. The components include employees’ compensation, gross operating surplus of companies and government, mixed income from sole traders, household income, and taxes less subsidies. GVA is GDP before including taxes less subsidies. Guernsey’s nominal GDP per capita has increased from £39,555 in 2009 to £51,868 in 2019.[18] Figure 3 shows the increase in Guernsey’s nominal GDP per capita from 2009 to 2019.

Figure 3: Guernsey’s nominal GDP per capita (2009 – 2019)



Source: The States government website, ’Supplementary GVA and GDP Data 2019’ for 2009- 2019 data, available at https://www.gov.gg/gdp.

The finance sector has long been important to Guernsey’s economy and has been one of the prime drivers of growth. Indeed, the finance sector has remained the largest single sector by Gross Value Added (GVA) in the last 20 years. In 2019, this sector comprised 40% of Guernsey’s GVA. In the last 20 years, the finance sector has grown by approximately 225%, with its GVA increasing from £0.4 billion to £1.3 billion. In comparison, overall GVA has grown by 164%. The finance sector

[18] The methodology used to estimate GDP was updated in 2017 and series were backdated to 2009. Guernsey Facts and Figures Supplementary Data, 2020, States, available at: https://www.gov.gg/CHttpHandler.ashx?id=131185&p=0

also continues to be the largest sector by employment. Figure 4 shows the five largest sectors by GVA contribution and employment in Guernsey.

Figure 4: Largest sectors by GVA contribution (2019) and employment (March 2020)

Source: The States government website, 'Supplementary *GVA and GDP Data 2019', available at https://www.gov.gg/gdp & 'Facts and Figures 2020 Supplementary Data: T 2.16, F 2.16 – Employment by economic sector', available at https://www.gov.gg/ff*

2.2. Fiscal context

The States published a Fiscal Policy Framework in 2019 that sets out the key principles on which their fiscal policy should be based.[19] One of the key elements of the States' fiscal policy is that it should operate on a principle of long-term permanent balance – any increases in government spending should be offset with an increase in government revenues. This framework clearly sets the limits on the annual net deficit such that, in any given year, Guernsey's net deficit should not exceed 15% of its operating revenues. As of 2020, Guernsey's expected deficit is £64 million, 2.1% of the 2020 GDP estimate, which has been achieved by limiting capital spending.[20]

Guernsey's current tax base and levels are relatively low compared to those of other countries or jurisdictions. For example, the States currently collect 19% of annual GDP in tax revenues (with a further 2-3% from other revenue sources) compared to 23% in Jersey and 33% in the United Kingdom.[21] As of 2018, 29% of public expenditure was spent on health and community services, 20% on old age pensions, and 14% on social welfare benefits.[22] Given the fiscal pressures of an ageing population identified in their Fiscal Policy Framework Report, the States believe these costs will increase in the future, and, as a result of the growing demand for services, will present critical challenges to the sustainability of existing services.[23]

This increased demand on public finances was estimated to require between £79 million and £132 million per annum in additional revenue in the Fiscal Policy Framework published in 2019.[24] While government priorities are currently under review, the impacts of COVID-19 have intensified Guernsey's pre-existing financial pressures. In order to meet this demand, the overall revenue working target, to be considered as a working assumption for the purposes of this Report, as provided to us by the States, is 24% of GDP per annum over five years. To meet the needs of their ageing population,

[19] The Review of the Fiscal Policy Framework and Fiscal Pressures, available at: https://www.gov.gg/CHttpHandler.ashx?id=122178&p=0
[20] The States of Guernsey Accounts 2020 as provided by the States
[21] Revenue Statistics 2020 – the United Kingdom, available at https://www.oecd.org/tax/revenue-statistics-united-kingdom.pdf
[22] Guernsey Facts and Figures, 2020, States, available at: https://www.gov.gg/CHttpHandler.ashx?id=131184&p=0
[23] The Review of the Fiscal Policy Framework and Fiscal Pressures, available at: https://www.gov.gg/CHttpHandler.ashx?id=122178&p=0
[24] The Review of the Fiscal Policy Framework and Fiscal Pressures, available at: https://www.gov.gg/CHttpHandler.ashx?id=122178&p=0

the States can either reduce costs from other parts of their expenditure, increase their overall deficit and debt, or raise additional revenues. Given the predicted increase in expenditure as mentioned above, the States do not consider that greater expenditure control alone can provide a solution. Furthermore, the States also have to fund their capital programme, which ensures that investment in key infrastructure is undertaken in the Bailiwick.

Funding costs through a higher deficit is not viewed by the States as a sustainable long-term solution, especially since the States' costs are likely to continue to increase with an ageing population. Furthermore, tax revenues, which are currently highly dependent on personal income tax (PIT), social security contributions and corporate income tax, are also determined by the proportion of the population that is of working age, which is likely to reduce with time.

It is in this context that the States are reviewing potential changes to Guernsey's tax structures so that they are capable of raising revenues up to the 24% of GDP limit.

2.3. Tax Options

To raise the finances needed to meet the future demand of public provision, the States have provided us with three tax policy options for analysis and further consideration. Option 1 would raise revenue through a Health Tax of 3% levied on income and increased social security contributions. Option 2 would raise revenue through a GST of 8% and increased social security contributions, while offsetting this would be a reduction in tax revenues due to an increase in the PIT allowance from £11,875 to £14,000. Option 3 would raise revenue through a GST of 5% and increased social security contributions, while offsetting a reduction in tax revenues due to the PIT allowance increasing from £11,875 to £12,700.

While an assumption is made about changes in corporate taxation, as outlined below, a specific discussion of this policy and its broader impacts is beyond the scope of this report. Other tax changes such as tax on real property, road pricing and excise taxes are under consideration by the States of Guernsey, but these are unlikely to make a significant contribution and, as such, will only be briefly described in comparison to the other benchmark jurisdictions in Section 3.

Corporate Income Tax (CIT)

According to the OECD*, on 1 July 2021 "130 countries and jurisdictions joined a two-pillar plan to reform international taxation rules to ensure that multinational enterprises pay a fair share of tax wherever they operate." "Pillar One will ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs (multinational enterprises with a global turnover above 20 billion euros and profitability above 10%), including digital companies. It would re-allocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there." "Pillar Two seeks to put a floor on competition over corporate income tax, through the introduction of a global minimum corporate tax rate (for MNEs with global revenues of more than 750 million euros) that countries can use to protect their tax bases." The minimum rate under Pillar Two will be at least equal to the 15% assumption used in this report. The 130 countries and jurisdictions referenced in the OECD publication include Guernsey and all benchmark jurisdictions analysed in this report: Jersey, the Isle of Man, Singapore and Luxembourg.

For the purposes of this report, The States of Guernsey have used a working assumption that the impact of the Pillar One and Pillar Two proposals would raise an additional £10m in revenue. The States of Guernsey have stated that this change is independent of the policy options under consideration.

*https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm

The tax policy options under consideration each make use of different core levers. Option 1 raises revenue through a tax on income whereas Option 2 raises revenue through a tax on consumption. Option 3 also raises revenue through a tax on consumption; however, through the restructuring of social security contributions, it will also raise revenue through income taxation to a greater extent than Option 2.

The following section sets out what each of the main tax levers is and their theoretical impacts.

2.3.1. Personal Income Tax (PIT) and the Health Tax

PIT is a direct tax charged on individuals' earnings that is usually applied on income earned above a tax-free allowance. The States' current headline tax rate of 20% is charged on earnings above the 2021 allowance of £11,875, with no other rates applied, but there are a number of other allowances and benefits granted.[25] Currently, the personal allowance in Guernsey is withdrawn at a rate of £1 for every £5 of income earned in excess of £100,000.[26] Consequently, very high earners do not benefit from the personal allowance and other allowances and deductions available in Guernsey.

The current cap on personal income tax for worldwide income is £260,000 or £130,000 for non-Guernsey sources of income.[27] There are other tax caps charged in Guernsey, including a £50,000 cap for Alderney residents.[28] In addition, an open market cap of £50,000 is applicable to newly resident individuals for the first four years of their residence subject to certain requirements.[29] Certain Guernsey residents can also elect to pay a standard charge, which is set at the higher of £40,000 or the tax on the individual's Guernsey source income.[30]

The States have proposed some changes to PIT and Health Tax under the three tax policy options. Option 1 involves the introduction of a 3% Health Tax which would be administered in the same way as PIT, Option 2 involves an increase in the PIT allowance to £14,000, and Option 3 involves an increase in the PIT allowance to £12,700. No option under consideration includes a change in the level of the tax caps.

Income taxation rates vary significantly across countries, often accompanied by intra-country variation in the marginal tax rate as income increases. In OECD countries, the revenue from PIT makes up a significant proportion of collected tax revenue, at an average level of 24% in 2018.[31] Furthermore, over 60% of OECD countries report a PIT share of more than 20% of overall tax income.[32]

Theoretically, PIT is considered the main method of redistributing income from higher income to lower income households. However, this depends on the structure and progressivity of the tax.[33] PIT reduces the value of labour, as an individual earns less take-home income for the same amount of work. Therefore, any decision to change the rate of PIT, or the rate of income taxation more broadly, has the potential to theoretically affect labour supply decisions. Furthermore, the decrease in disposable income that results from a higher level of taxation may also reduce household expenditure, which in turn has an impact on the economy.

The overall impact of a PIT increase or the introduction of a Health Tax will depend on whether the government uses this revenue to reduce the deficit or whether it redistributes this revenue. If the revenue collected from this increase in tax is spent by the government, this could counteract the adverse effect that lower household spending has on economic growth. The nature of this government spending could also improve redistribution if focused on welfare provisions.

2.3.2. Social Security Contributions (SSC)

The social security contributions (SSC), as discussed in this report, covers all national insurance schemes. Guernsey's employed persons' social security contributions are currently based on the earnings of employees and is usually split into

[25] A single parent's annual "Charge of Children" allowance is £8,075 and the mortgage interest cap on tax relief is £5,000. A detailed list is available at: https://www.gov.gg/CHttpHandler.ashx?id=135587&p=0. A carer gets an annual allowance of £4,671 as in: https://www.gov.gg/CHttpHandler.ashx?id=102818&p=0
[26] See details on the limit for withdrawal, allowances and deductions withdrawn as well as the way withdrawal is phased in: https://www.gov.gg/wopa
[27] See "Tax cap for individuals" in: https://www.gov.gg/CHttpHandler.ashx?id=135587&p
[28] All States tax caps summarised here: https://gov.gg/taxcap
[29] "This cap can only be claimed if the individual that has paid £50,000 or more in document duty on the purchase of a property, that is on Part A of the Open Market Register, and that property is purchased within 12 months (either before or after) they take up permanent residence in Guernsey." See: https://gov.gg/taxcap
[30] Residency and tax liability information is summarised in: https://gov.gg/residency
[31] OECD e-book, "Revenue Statistics 2020", available at: https://www.oecd-ilibrary.org/sites/8625f8e5-en/index.html?itemId=/content/publication/8625f8e5-en
[32] OECD data on tax and personal income, available at: https://data.oecd.org/tax/tax-on-personal-income.htm
[33] Analysis of UK data shows that a reduction in average direct tax rate – which includes income tax – and an increase in progressivity have had a positive impact on redistribution. See ONS website, "The effects of taxes and benefits on income inequality", available at: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/theeffectsoftaxesandbenefitsonincomeinequality/1977tofinancialyearending2015#what-impact-do-taxes-and-benefits-have-on-income-inequality

two parts, with the employer and the employee both making contributions. Contributions are also made by self-employed persons and by non-employed persons.

The current rate for both employees and employers in Guernsey is 6.6%, the self-employed rate is 11% and the non-employed rate is 10.4% (the non-employed rate applies to all types of income, not just income from labour). A lower non-employed rate of 3.4% is applied to those over state pension age. The social security contributions are charged up to an upper earnings limit of £153,660.

Currently, Guernsey has a lower threshold for SSCs above which contributions are paid on all employed or self-employed income. As proposed by the States, an allowance for social security contributions would be introduced and aligned with the allowance for income tax for all options. Under the allowance SSCs are payable on the first pound above the threshold, with the lower earnings limit SSCs become payable on income below the threshold and for the first pound above the threshold, creating a spike in the effective marginal tax rate. Further, under all tax policy options considered in this report, employee SSCs would be charged on all income less the allowance and up to the upper earnings limit rather than on gross earnings as is currently the case. The employer rate would be charged on all earnings but would no longer be subject to an upper earnings limit.

For Option 1, the current SSC lower earnings limit of £7,696 would be superseded by the allowance of £11,875.[34] The employee rate would increase from 6.6% to 9.0% and the employer rate would increase from 6.6% to 7.5%. For Option 2, the SSC allowance (given its alignment with the PIT allowance) is increased from £11,875 to £14,000. The employee rate would increase from 6.6% to 8% and the employer rate would increase from 6.6% to 7.5. For Option 3, there would be an increase in the SSC allowance from £11,875 to £12,700. The employee rate of SSCs would increase from 6.6% to 9.0% and the employer rate would increase from 6.6% to 7.5%. The self-employed rates and non-employed rates would also change, as is shown by option in Table 2.

The report focuses on the impact of the change in the level of total SSCs. In the case of Policy **Option 1, the net effect of the changes outlined above is an increase in the level of SSCs by £21m. For Policy Option 2, the net effect of the changes outlined above is an increase in SSCs by £2m. For Policy Option 3, the net effect of the changes outlined above is an increase in SSCs by £17m.**

OECD countries have an average social security to total tax revenue ratio of 26%, higher than the average for PIT.[35] It is also the most important source of tax revenue for countries like France, Germany and the Netherlands.[36]

The impact of a social security tax on individuals is similar to that of a PIT. It reduces the value of labour, as an individual earns less after-tax income for the same amount of work. When employer contribution rates increase, research suggests that employees shoulder approximately two thirds of the burden of an increase in social security contributions through a wage reduction.[37] There is some evidence which shows that individuals perceive social security and PIT differently if their social security contributions are directly linked to some future benefits they will receive (for example, pensions). In this case, individuals perceive it as a price rather than a tax.[38] This helps to mitigate the adverse impacts on labour supply as this perception leads to individuals not associating a rise in social security rate with a devaluation of labour. Such reasoning may also exist for the Health Tax relative to an equivalent change in the headline rate of PIT.

[34] In addition, class 2 contributions, which are currently not subject to any lower earnings limit or allowance, would also benefit from this allowance.
[35] OECD data on tax and social security, available at: https://data.oecd.org/tax/social-security-contributions.htm#indicator-chart & https://data.oecd.org/tax/tax-on-personal-income.htm#indicator-chart
[36] OECD data on tax and social security, available at: https://data.oecd.org/tax/social-security-contributions.htm#indicator-chart
[37] "Who really pays social security contributions and labour taxes?" available at: https://voxeu.org/article/who-really-pays-social-security-contributions-and-labour-taxes
[38] Goudswaard & Caminada (2016) "Social security contributions: Economic and public finance considerations" available at https://www.researchgate.net/publication/297713926_Social_security_contributions_Economic_and_public_finance_considerations

Social security contributions levied on employers will have a greater impact on sectors that depend more on labour compared to capital. Therefore, sectors such as hospitality, that are labour intensive but have lower profit margins, could be relatively more impacted by social security increases.

2.3.3. Goods and Services Tax (GST)

As discussed in this report, the GST covers all types of consumption tax and there is currently no GST in place in Guernsey. Under Policy Option 2 and Option 3 a broad-based low rate GST would be introduced at the point of sale on goods and services at a rate of 8% in the case of Policy Option 2 and 5% under Policy Option 3. The scheme considered in this report is broadly equivalent to that applied in Jersey[39], which has a low rate and broad-based GST. Exemptions are limited and apply primarily to financial services and some health-related services. Zero-rating is applied to the buying, selling and renting of accommodation and exported goods and services (including exported financial services). As in Jersey, while domestic financial services would be exempt, an International Services Entities (ISE) scheme would be available for international financial services organisations to opt into. At a fee, this would entitle the beneficiaries to GST exempt supplies and involve a simplified GST charge reclamation process.

The term Goods and Services Tax is analogous to Value Added Tax (VAT). While such taxes are referred to as VAT in the EU, UK, and the Isle of Man, for consistency, all taxes of this variety will be referred to as GST in this Report. Guernsey is fairly atypical in the sense that it does not currently have a GST; 36 of the 37 countries in the OECD charge GST. On average, their GST rates are 19.3%.[40] This tax raises 20% or more of total tax revenue in most of the countries, ranging from 15.4% of total taxes in the United States to 49.5% in Chile.

An increase in the GST rate essentially increases the price of the relevant goods or services by that rate, resulting in lower real income for consumers. A GST without any adjustments can be regressive, since lower income households typically spend a larger percentage of their income on essential items such as food, where the demand elasticity is low.[41] This is often the reason for lower rates or zero-rating of essential items. Recently, an alternative approach has been adopted in some countries where a broad-based GST is introduced at a lower rate, and compensation is provided by other means to minimise the regressive impacts.[42] There is evidence to suggest that, in OECD countries, fewer exemptions and zero ratings are better for long-term growth than an increase in the standard rate of the GST.[43] This is because the former broadens the GST base and in turn improves the efficiency of the tax. The added intricacy of GST administration due to the inclusion of multiple exemptions and zero ratings is another reason why countries may adopt a simple GST structure.

A GST also has an effect on businesses via the costs of compliance. Based on a study evaluating the impact of a GST on Australian small businesses during the introductory period of the tax, these compliance costs can be as high as approximately 3% of annual turnover.[44] The burden of ongoing compliance is lower, the highest estimate being 1% of annual turnover.[45] The complexity of the tax reclamation process could also require time commitments and specific know-how in addition to the financial costs of compliance. This has been highlighted as a point of improvement in a European Commission study.[46]

Empirical evidence finds that income tax changes have a larger impact than the GST on output, private consumption and investment in the short run. The GST is a more efficient tax relative to income taxation because its base does not include mobile capital income. Further, it can be argued that the ageing population in Guernsey means that PIT revenues are on

[39] Jersey's GST is fully outlined Table 10.
[40] OECD report, "Consumption Tax 2020" available at: https://www.oecd-ilibrary.org/sites/152def2d-en/index.html?itemId=/content/publication/152def2d-en
[41] IMF eLibrary, "Value-Added Tax: Administrative and Policy Issues", available at: https://asean.elibrary.imf.org/view/IMF084/07774-9781557751843/07774-9781557751843/ch01.xml
[42] For example, the UK zero-rates most food items and levies a lower rate of 5% on domestic fuel, while its standard rate is 20%. Most EU countries charge a reduced rate on food items, except Malta and Ireland where zero ratings apply to some foodstuff: https://www.avalara.com/vatlive/en/vat-rates/european-vat-rates.html
[43] IMF working paper, "The Value Added Tax and Growth: Design Matters", available at: https://www.imf.org/~/media/Files/Publications/WP/2019/WPIEA2019096.ashx
[44] "The Impact of the Introduction of the GST on Small Business in Australia", available at: https://www.emerald.com/insight/content/doi/10.1108/eb060751/full/html
[45] Ibid
[46] European Commission report, "VAT refunds and reimbursements: A quantitative and qualitative study ", available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/20190620_final_report_vat_reimbursements.pdf

a downward trajectory, all else being equal, whereas GST revenues are likely to be less affected by this. GST also causes fewer market distortions as it does not impact the cost of labour or capital directly. Furthermore, the GST decreases in efficiency as rates and the number of exemptions increase. Finally, through increasing the cost of consumption, the GST has a general equilibrium impact through an increase in the savings ratio, which may lead to higher levels of investment which could be beneficial for the economy in the long run. The main drawback of the GST is that it can be regressive, but this can be mitigated through interventions for lower income households as is proposed in the options outlined by the States.

In general, countries and jurisdictions zero-rate exports for the purposes of the GST. This is because a GST will generally be applied to exports at their point of sale in the country where they are consumed (at the rates of the destination country). This is to ensure that world prices are not distorted as a result of a GST. As outlined previously, the tax is usually levied on imports at the point of sale.

Table 2, which summarises the changes relative to the current tax regime in Guernsey under the three policy options, is provided below for reference. The table also shows the allowances for additional mitigations under each scenario and the accompanying changes in income support.

Income support payments would fall under all options as a result of the introduction of the SSC allowance, and the increased PIT allowance for Options 2 and 3. As well as these automatic fiscal stabilisers, the States have allocated funds to offset the regressive impacts of the GST in Options 2 and 3. £6m to £9m has been allocated to combat the regressivity of the 8% GST in Option 2, while £4m to £5m has been allocated for this in Option 3 where a 5% GST would be introduced. Some of this will be temporary, such as pre-empting the inflationary uprating of pensions and benefits which would otherwise not occur for up to 12 months. Others, such as the above inflation increase in income support or the provision of additional cost support grants will be on-going costs. As well as these increases in income supports, the States have also allocated £0.5m and £0.3m as allowances for further mitigation in options 2 and 3 respectively.

The final row in Table 2 includes the States' estimates of the administration costs associated with managing the GST, which would be set at £0.8m regardless of the rate.

Table 2: Current Guernsey Tax Regime and Tax Options

Lever	Approach	Current	Option 1: 3% Health Tax + SSC	Option 2: 8% GST, higher PIT allowance & small SSC increase	Option 3: 5% GST, higher PIT allowance + SSC
GST	Rate	0%	No change	8%[47]	5%[48]
PIT/Health Tax	Rate	20% PIT	3% Health Tax	No change	No change
	Allowance	£11,875[49]	No change	£14,000	£12,700
Social Security Contributions	Class 1 – employed persons				
	C1 allowance	£7,696[50]	£11,875	£14,000	£12,700
	C1 Employee <65	6.6%	9%	8%	9%
	C1 Employee <65 income treatment	Gross earnings <UEL once LEL exceeded	All income less allowance <UEL	All income less allowance <UEL	All income less allowance <UEL
	C1 Employer rate	6.6%	7.5%	7.5%	7.5%
	C1 Employer income treatment	Gross earnings <UEL	All earnings	All earnings	All earnings

[47] Applied on a broad basis with limited exceptions in line with application in Jersey (https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/PayingGSTJersey.aspx). Primary exemptions include financial services and some health-related expenditure. All exports including financial services are assumed to be zero-rated.
[48] Applied on a broad basis with limited exceptions in line with application in Jersey (https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/PayingGSTJersey.aspx). Primary exemptions include financial services and some health-related expenditure. All exports including financial services are assumed to be zero-rated.
[49] Withdrawn at £1 for every £5 of income above £100k.
[50] This SSC lower earnings limit (LEL) differs from the SSC allowances. When income crosses the lower earnings limit, tax becomes payable on all income up to this point. By contrast with an allowance set at the same rate the tax would only be payable on income in excess of the allowance.

	Class 2 – self-employed persons				
	C2 allowance	-	£11,875	£14,000	£12,700
	C2 <UEL rate	11%	9%	8%	9%
	C2 <UEL income treatment	Gross earnings <UEL once LEL exceeded	All income less allowance <UEL	All income less allowance <UEL	All income less allowance <UEL
	C2 SE employer / above UEL rate	11%	5%	5%	5%
	C2 employer / above UEL income treatment	No charge	All earnings	All earnings	All earnings
	Class 3 – non-employed				
	C3 non-employed <65 allowance	£8,695	£11,875	£14,000	£12,700
	C3 non-employed <65 rate	10.4%	9%	8%	9%
	C3 non-employed <65 income treatment	All income	No change	No change	No change
	C3 non-employed >64 allowance	£8,695	£11,875	£14,000	£12,700
	C3 non-employed >64 rate	3.4%	4.5%	4%	4.5%
	C3 non-employed >64 income treatment	All income	No change	No change	No change
Income support	Reduction due to higher income	-	-£0.4m	-£1.8m to -£2.3m	£1m to -£1.5m
	Pre-emptive inflation increase	-	-	£6m to £9m	£4m to £5m
	Above inflation increase			£1.4m to £2.4m	£0.8m to £1.2m
	Additional mitigation allowance	-	-	£0.5m to £2.5m	£0.3m to £0.7m
Admin costs	Ongoing GST admin cost	-	-	£0.8m	£0.8m

Source: The States of Guernsey

The GST introduction means that a tax is levied on goods and services at the point of sale. Understanding the consequences for the total level of income taxation is more complicated given the number of affected elements of income taxation that are included in the options. For example, this includes the Health Tax, the PIT allowance, the SSC allowance and the rate of SSCs.

Figure 5 compares how the marginal tax rate varies across the income distribution currently in Guernsey and subsequently under each policy option under consideration. The marginal tax rate shows the percentage rate of tax paid on income for the next pound earned. The final chart in Figure 5 shows the difference in rate for each income level relative to the current level for each policy option.

Guernsey's current income tax schedule has 6 points of inflection for those with incomes from £0 to £200,000.[51] The first is the SSC lower earnings limit, which means that income between £0 and £7,696 is subject to no tax. However, the first pound of income in excess of £7,696 results in all income up to this level becoming eligible for SSCs, resulting in exceptionally high marginal rates as the threshold is passed. After this initial spike in SSCs, income between £7,696 and the PIT allowance of £11,875 is subject to Class 1 SSCs at a rate of 6.6%. Income between £11,875 and £100,000 is subject to both PIT and SSCs, meaning that the effective marginal tax rate for income in this range is 26.6%. At an income level of £100,000 the tax-free PIT allowance is reduced at a rate of £1 for every £5 the income is above the £100,000 threshold. The withdrawal of the allowance increases the effective marginal tax rate to 30.6%. This marginal rate of taxation falls to 24.0% for income in excess of £153,660 as the SSC upper earnings limit is reached. This rate is charged only up to an income level of £159,375, when the withdrawal of the tax-free allowance is complete[52]; for income in excess of this level only PIT is charged at a rate of 20% and this rate holds for income levels up to the level of the tax cap.

Under tax Policy Option 1 the PIT allowance and SSC allowance are aligned, meaning that in Guernsey no-one would pay any tax or SSC on their income below £11,875. The other changes to the rate of tax on income for Option 1 are the 3% Health Tax and the increase in SSCs, such that the effective marginal rate is 5.4 percentage points higher when compared to the current system.

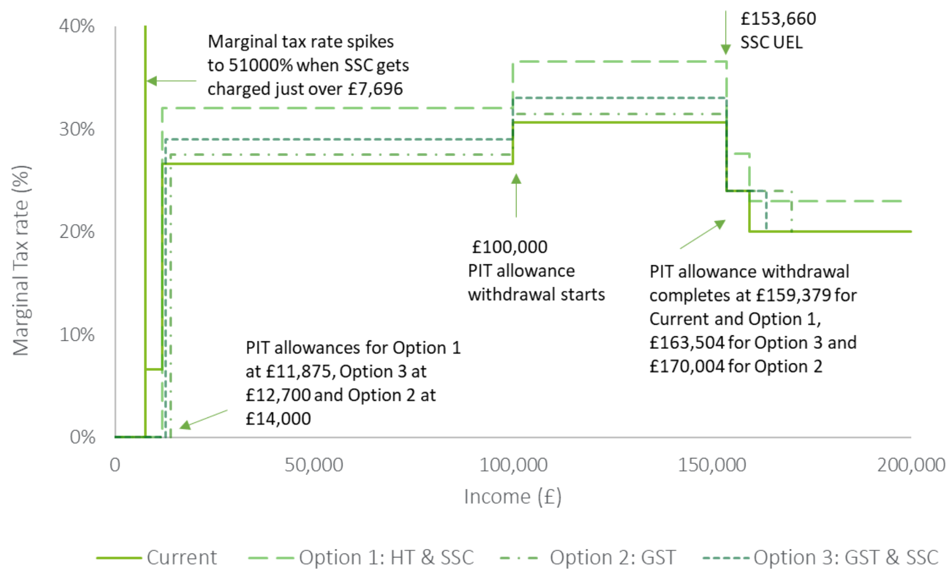
Under Policy Options 2 and 3, the PIT and SSC allowance are aligned and increased to £14,000 or £12,700 respectively. This means that in Guernsey no one would pay any form of tax on their income below £14,000 under Option 2 or £12,700 under Option 3. There is no Health Tax in Policy Options 2 or 3 but there is some increase in marginal rates from SSCs, as seen in Figure 5 below. The final change is that given the higher tax-free allowance value, the income level at which this withdrawal is complete is higher (currently the withdrawal is complete by £159,375; under Option 2 this would not be complete until an income level of £170,000 and under Option 3 £163,500[53]). A visual summary of these changes relative to the current situation is provided in the final chart.

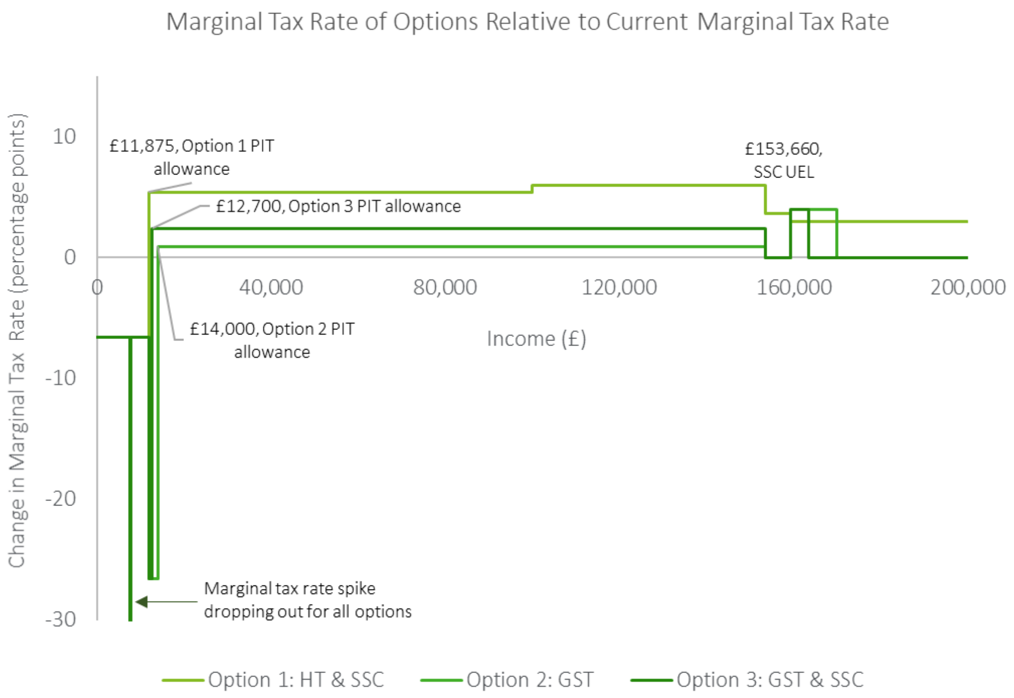
[51] The tax caps are discussed elsewhere in this report.

[52] Other allowances and deductions such as pension contributions and mortgage interest relief are also withdrawn. Therefore, this is indicative of a situation where an individual only receives a PIT allowance. There is a myriad of thresholds at which the marginal rate falls when other withdrawals are considered.

[53] Other allowances and deductions such as pension contributions and mortgage interest relief are also withdrawn. Therefore, this is indicative of a situation where an individual only receives a PIT allowance. There is a myriad of thresholds at which the marginal rate falls when other withdrawals are considered.

Figure 5: Marginal Tax Rates for Current Regime and Options (PIT, Class 1 employee SSCs and Health Tax)





Source: See Table 2 above for current rates; options data as provided by the States

Key Insights

Guernsey's economy has flourished over the past 10 years with significant growth in per capita GDP between 2009 and 2019. The finance sector is Guernsey's largest contributor to GVA and employment.

The States collect 19% of GDP as tax revenue, and 2-3% of GDP as revenue from other sources. Due to growing demographic pressures and the impact of COVID-19, there is an increasing demand on public finances. To meet these needs, the States can either reduce expenditure, increase overall deficit and debt, or raise revenues. Expenditure restraint alone, which is being examined separately by the States, is not deemed a solution. Similarly, deficit funding is not sustainable, as the ageing population is increasing. Thus, the States are reviewing potential changes to Guernsey's tax structures so that they are capable of raising revenues up to the 24% of GDP limit.

This report considers three tax reforms that may help to achieve this. The tax policies considered are: Option 1 (3% Health Tax + significantly increased SSCs), Option 2 (8% GST + PIT decrease due to higher allowance + modestly increased SSCs) and Option 3 (5% GST + modest PIT decrease due to higher allowance + moderately increased SSCs).

Changes in personal income taxation through the introduction of a Health Tax may distort the labour market, as it changes the value of labour. The wider economic impacts of changes in income taxation are contingent on whether and when the revenues are spent. If revenues are spent instantaneously, the adverse economic impacts of the tax increase are approximately offset by the benefits of increased government spending. The impacts of social security contributions and a Health Tax are similar to that of PIT. However, social security contributions and the Health Tax may be less distortionary than PIT since they are perceived as a price for the consumption of public goods.

GST is a more efficient tax relative to PIT, especially at low rates. However, GST has a direct price impact and can be less progressive than the income taxation described above if it is not complemented with offsetting policies for lower income households. Evidence from the OECD suggests that fewer exemptions and zero ratings are better for economic growth in the long run. The introduction of a GST is likely to be accompanied by significant friction costs associated with implementation.

2.4. Scope of this Report

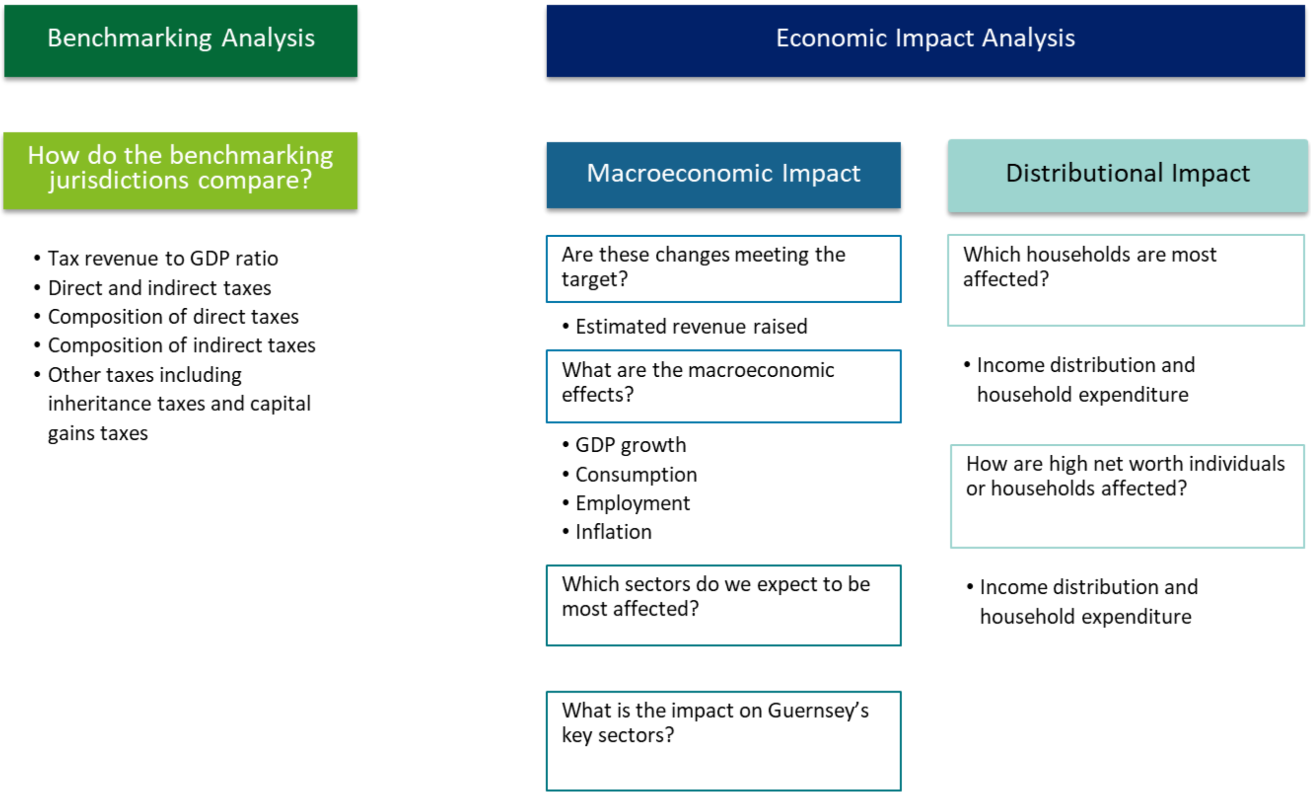
Given the wider context and the levers under consideration, the States have contracted Deloitte LLP to provide economic analysis to support the delivery of the Tax Review. As outlined in the Request for Proposal, the States' Tax Review is to ensure that Guernsey's tax base can raise necessary revenues. To guide this, the States are seeking to understand the economic implications of potential tax policy options.

The States initially provided us with a set of broad potential tax levers which included: PIT, SSCs, Health Tax and GST. In a predecessor report to this we considered Guernsey's position relative to benchmark jurisdictions and the potential economic impacts of illustrative changes in the broad tax levers listed above. The States subsequently selected the three policy options that are analysed in this report. The analysis carried out in the Interim Report forms the basis of this Final Report. The Final Report adds to the Interim Report by considering in detail how the three options under consideration change Guernsey's position relative to its benchmark jurisdictions and by specifically analysing the economic impacts of the three policy options under consideration.

This Final Report reviews the tax structures and policies in comparable benchmark jurisdictions and the expected economic impacts of a set of tax policy options provided by the States. This Report does not conclude or opine on the suitability of the tax policies being considered, nor does it provide advice or recommendation on the policy design, implementation of the chosen option(s) or legislation required.

Figure 6 provides an overview of the framework adopted in this Report. Overall, each tax revenue-raising option is considered in the context of the revenue it raises with respect to the overall revenue-raising goal as set out by the States.

Figure 6: Benchmark and economic impact analysis overview



This Report is appended with a Policy Letter and presented to the States of Deliberation.

The rest of this Report is structured as follows:

- Section 3 sets out the results of the benchmarking analysis;
- Section 4 sets out the economic impacts; and
- Section 5 concludes.

3 Benchmarking analysis

Guernsey is currently reliant on direct taxation and is unique amongst its benchmark jurisdictions in that it currently has no GST in place. Option 1, which relies on income taxation, increases Guernsey's reliance on direct taxation and makes its income tax schedule less competitive. Options 2 and 3 involve the introduction of a GST, which reduces the reliance on direct taxation. The GST is typically a more efficient means of taxation but can be regressive.

Before undertaking the economic impact study, this section of the Report compares Guernsey's current tax structure to those of other chosen jurisdictions. This forms a picture of how Guernsey measures up to other jurisdictions in terms of the amounts of tax revenues raised as a percentage of GDP, and the types of tax revenues that are relied on in these jurisdictions. The Report goes on to consider how Guernsey's tax structure would compare to the other jurisdictions' following the implementation of each of the policy options under consideration.

The jurisdictions that Guernsey's tax regime is benchmarked against have been chosen and agreed by the States considering their comparability to Guernsey along four dimensions: the structure of their economies, specific tax structures, overall tax as a share of GDP, and size of the economy. In particular, the chosen jurisdictions are those whose economies tend to rely on the financial services industry and that would be potential alternatives for individuals and businesses to relocate to in the case of material domestic tax policy changes.

Each of these jurisdictions is compared to Guernsey across a range of dimensions:

- **Tax revenue as a percentage of GDP:** the economy's overall reliance on tax revenue is compared across each of the jurisdictions.
- **Core tax levers:** the core tax levers (PIT, social security, Health Tax, and GST) are compared across the benchmark jurisdictions to determine whether the proposed illustrative changes are in line with the current tax structures in these comparable jurisdictions.
- **Direct and indirect tax revenue:** the relative reliance on direct and indirect taxes is considered.
- **Other taxes:** a high-level review of the structure of taxes such as inheritance taxes or capital gains taxes is also undertaken.

This analysis highlights where Guernsey is placed in comparison to each of these jurisdictions to ensure that an overall picture can be built that outlines whether there is scope for the States to raise revenues through different types of taxes whilst remaining comparable to the benchmark jurisdictions.

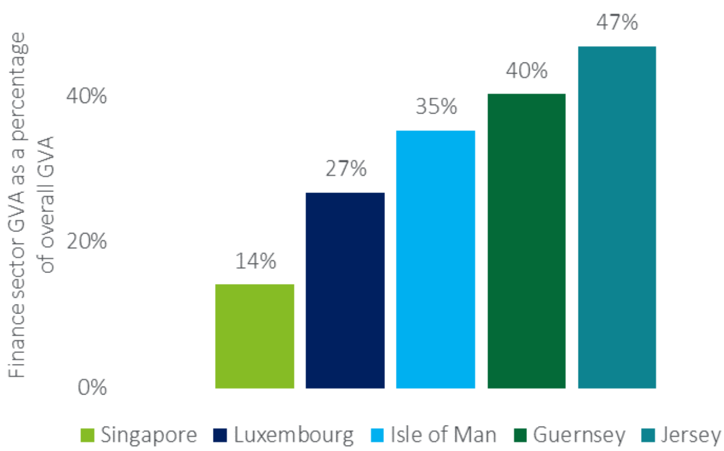
3.1. Economic rationale for chosen jurisdictions

The four comparable jurisdictions chosen for this benchmarking analysis, as agreed upon with the States are: Jersey, the Isle of Man, Luxembourg and Singapore. In addition, New Zealand is considered with respect to its GST. These jurisdictions have been chosen as they either have similar tax regimes and are directly comparable or are similarly developed, with an emphasis on the financial services sector. It is worth noting that given that Jersey and the Isle of Man are English speaking jurisdictions that use British pound sterling, they are particularly important comparators for higher earners, HNWIs and businesses that prioritise these features in comparison to the other benchmark jurisdictions that have been chosen.

The size of the economy amongst benchmark jurisdictions varies, ranging from £4.89 billion in Jersey and £3.25 billion in Guernsey to £276 billion in Singapore. Each of these jurisdictions is highly developed, with Luxembourg leading at GDP per capita of about £87,892, followed by the Isle of Man with GDP per capita of £64,173. Guernsey, Singapore and Jersey follow with GDP per capita of £51,868, £48,355 and £46,120, respectively.

As in Guernsey, the finance sectors in Jersey and the Isle of Man contribute the most of all sectors to GVA. Guernsey's finance sector contributes 40% to its GVA, Jersey's contributes 47% and the Isle of Man's 35%.[54] The other two benchmark jurisdictions, Singapore and Luxembourg, are chosen with a view to comparing the competitiveness of Guernsey to Europe and beyond, given the importance that these countries or jurisdictions place on their financial services sectors. Luxembourg's financial sector contributes 26% to its overall GVA and the country has a reputation as an international financial hub, with 94% of its banks being foreign.[55] Singapore is also a leading world financial centre, but with a highly developed economy overall such that its financial sector only contributes 14% to GVA.[56] Figure 7 shows the financial services sector's GVA as a share of total GVA in 2019 for each of the benchmark jurisdictions.

Figure 7: Finance Sector GVA as a percentage of overall GVA, 2019



Source: See Appendix A2

3.2. Comparison of tax components across jurisdictions

3.2.1. Tax revenue as a percentage of GDP

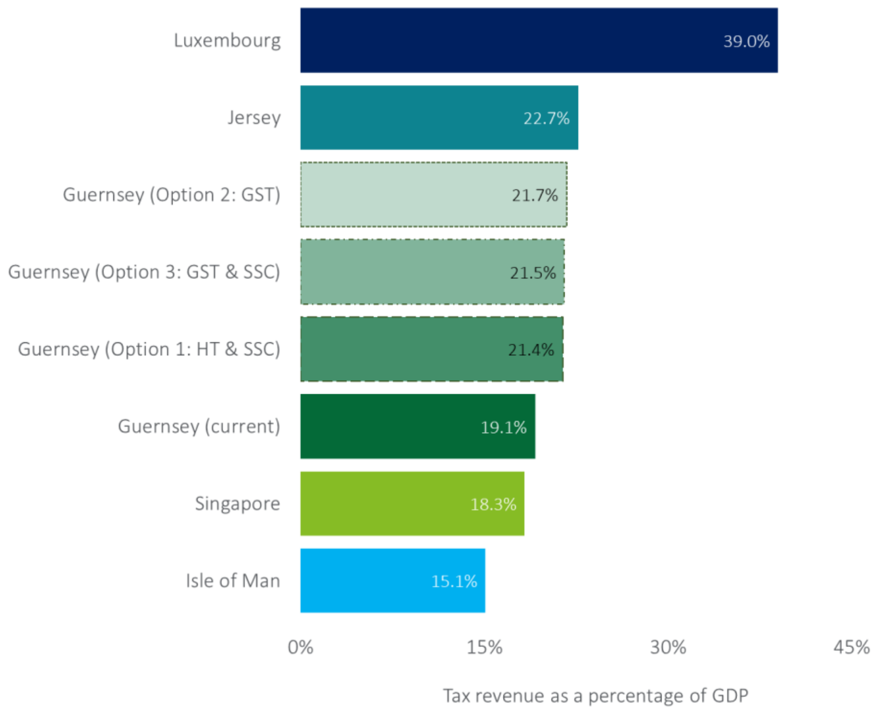
Guernsey sits in the middle of its benchmark jurisdictions in terms of its tax revenue to GDP ratio and would continue to do so under the different options. Luxembourg is most reliant on revenues from tax, as its tax to GDP ratio is 39%, whereas the Isle of Man is at the other end of the spectrum with a ratio of 15%. The other jurisdictions fall in between these two extremes, as seen below. Singapore's highly stable economy and consistent surplus explain the relatively low tax to GDP ratio of 18%. Figure 8 shows the tax revenue as a percentage of GDP ratio for these jurisdictions, with Guernsey's 19% solely reflecting income from taxation for comparability purposes. This suggests that if Guernsey were to increase its tax revenue as a share of GDP it could do so and remain broadly in line with its benchmark jurisdictions; by way of example, in Jersey tax revenue as a percentage of GDP is 4 percentage points higher at 23%. Figure 8 also shows that under each policy option under consideration, Guernsey would retain its position in terms of having the third highest level of tax revenue as a percentage of GDP.

[54] Guernsey - https://www.gov.gg/CHttpHandler.ashx?id=133038&p=0 ; Jersey - https://opendata.gov.je/dataset/national-accounts
Isle of Man - Banking, Insurance and Other Finance and Business Services computed to make up the Finance Sector https://www.gov.im/about-the-government/departments/cabinet-office/economic-affairs-division/national-income/

[55] Luxembourg – National accounts, Annual aggregates https://statistiques.public.lu/en/economy-finances/index.html

[56] Singapore - https://www.tablebuilder.singstat.gov.sg/

Figure 8: Tax revenue as a percentage of GDP, 2019



Source: See Appendix A2, options revenue data as provided by the States

3.2.2. Core tax levers

To provide context when comparing the level of tax revenue raised as a share of GDP, Table 3 shows a summary of tax rates across the jurisdictions.

Personal Income Taxation (PIT) & Health Tax

Guernsey's current headline rate of PIT is identical to those in Jersey and the Isle of Man but higher than the levels in Singapore and Luxembourg. Jersey is the only jurisdiction with a Health Tax; under Option 1 where a Health Tax of 3% would be introduced, Guernsey and Jersey would be aligned in terms of the headline PIT rate but income taxation would be higher in Guernsey due to the higher Health Tax. Guernsey and Jersey have a headline PIT rate of 20% for income in excess of their respective personal allowances. However, in Jersey, low-income individuals liable to pay income tax are charged at whichever of the following two rates gives the lower tax amount: (i) marginal rate of 26% above the tax allowance, or (ii) flat rate of 20% on total income. The Isle of Man charges a 10% rate above the tax allowance, but also has a top average rate of 20%. Of these three jurisdictions, Guernsey currently has the lowest personal allowance threshold and would continue to do so even under Policy Option 3 where the allowance was increased to £14,000. Singapore and Luxembourg charge the top tax rates at high incomes.

In addition, the personal income tax caps and treatment for high earners vary, with Guernsey and the Isle of Man charging specific amounts of tax set at £260,000/£130,000 and £200,000 respectively as tax caps. Instead, Jersey charges 20% on income up to £725,000 and then 1% on income above £725,000. The result of this is that personal income tax in Jersey is lower than Guernsey's cap for individuals with annual worldwide income below £12,225,000.

Jersey alone levies a long-term care charge separate to either their PIT or SSC regimes, which is shown as a Health Tax in Table 3 below. This was implemented due to an increasing pensioner population and as a way of reducing the burden of funding long-term care.[57] It is set at a very low headline rate of 1.5% (with a marginal rate of 1.95%), which makes the impact at an individual level relatively small. Guernsey currently internally allocates some of its social security fund to a long-term care insurance fund.[58] However, from the perspective of the taxpayer, the social security contribution is consolidated. The form of Health Tax under consideration in this Report is similar to Jersey's long-term care charge, which is separate from SSCs and in form more aligned with the PIT system, though it should be noted that it is higher at a rate of 3% in Policy Option 1.

Social Security Contributions (SSC)

The rate of employee SSCs is 6.6% in Guernsey, which is higher than the level in Jersey (6%) but much lower than the headline level in the Isle of Man (11%). All policy options under consideration involve an increase in the employee rates of SSCs but none of these changes are sufficient to change Guernsey's position relative to the benchmark jurisdictions. The social security rates in Singapore are much higher in comparison to rates in the other jurisdictions. The rate of employee SSCs in Jersey is 6%, which is slightly lower than the current level in Guernsey of 6.6%. Further, in Jersey SSCs are charged up to £55,320, whereas the upper limit in Guernsey is much higher at £153,660. In both cases, the rate is lower than the 11% employee rate that exists in the Isle of Man; however, this drops to 1% for income in excess of £40,768. Each policy option under consideration by the States would see an increase in employee and employer rates in Guernsey but would also see the introduction of an SSC allowance that is aligned with the PIT allowance.

GST

Guernsey is unique amongst the benchmark jurisdictions in that it does not currently charge a GST. Options 2 and 3 involve the introduction of a GST at 8% and 5% respectively. A 5% GST would be aligned with Jersey, which is the lowest level amongst the benchmark jurisdictions that charge a GST. An 8% GST would be higher than the levels in Jersey and Singapore. The Isle of Man charges a relatively high standard GST rate of 20%. The Isle of Man and the UK pool these revenues and their common duties, and then share them in line with their Customs and Excise Agreement, which was updated in 2018.[59] Luxembourg's standard GST rate is 17%, with three other reduced rates. Jersey charges a standard GST rate of 5%, but with far fewer exemptions than the UK/Isle of Man system.

There are GST exemptions included with Policy Options 2 and 3 which will mean financial services organisations may be liable to pay exemption fees. These exemptions are modelled closely on Jersey's, which are detailed in Appendix A3 Table 10, alongside the other jurisdictions' exemptions. All benchmark jurisdictions exempt financial services from their respective GST rates. In addition to this, Singapore only exempts the sale and lease of residential land in addition to financial services. Isle of Man also exempts property transactions. Luxembourg and Jersey both exempt education and some medical and health services.

In sum, Guernsey currently relies on income taxation for the purpose of revenue raising. Option 1 would deepen this reliance whereas Options 2 and 3 would diversify the States of Guernsey's revenue base. Option 1 would see the sum of PIT and Health tax rates eclipse the level of Jersey. Option 3 would see an alignment with Jersey in the GST rate, whereas Option 2 would see the rate of GST exceed those of both Jersey and Singapore.

[57] "Long-term care for older people in Jersey" available at: https://statesassembly.gov.je/scrutinyreviewresearches/2008/s-31498-29419-10122008.pdf
[58] Actuarial Review of Guernsey Long-term Care Insurance Fund, available at: https://www.gov.gg/CHttpHandler.ashx?id=135486&p=0
[59] Agreement between the Government of the UK and the Isle of Man on Customs and Excise and associated matters, available at: https://www.gov.im/media/80147/cande-agreement-consolidated-v2018.pdf

Table 3: Tax rates across jurisdictions

	Guernsey	Jersey	Isle of Man	Luxembourg	Singapore
Tax revenue as a % of GDP	Current - 19%[60] Option 1 – 21.4% Option 2 – 21.7% Option 3 – 21.5%	23%	15%	39%	18%
Personal Income Tax (PIT) and Health Tax[61] (thresholds for individuals)	Current: 20% from £11,875 Option 1: 20% PIT + 3% Health Tax from £11,875 Option 2: 20% from £14k Option 3: 20% from £12.7k	Lower of 20% with no lower threshold & 26% from £16k 1% on income >£725k Health tax: 1.95% marginal rate (1.5% headline rate) with a £252,360 limit	10% from £14,250 20% above £20,750 Cap of £200k	8% from €11,265[62] (£9,796) & 42% from €200,005 (£173,917) on a progressive schedule 7% employment fund rate up to €150k (£130,435), 9% over	2% from SGD20k[63] (£10,870), 22% from SGD320k (£173,913) on a progressive schedule
Social Security Contributions	Current: Employee & employer 6.6% to £153,660 Option 1: Employee 9% & employer 7.5% from £11,875 up to £153,660 Option 2: Employee 8% & employer 7.5% from £14k up to £153,660 Option 3: Employee 9% & employer 7.5% from £12.7k up to £153,660	Employee - 6% up to £55,320 annually Employer - 6.5% up to £55,320, then 2.5% between £55,320 and £252,360	11% for employee (1% above £40,768 annually) 12.8% for employer	Maximum of: 12.45% for employee (11.05% up to €128,520 (£111,757)) 14.61% for employer (up to €128,520 (£111,757))	20% for employee 17% for employer
Goods and Services Tax (GST)	Current: No GST Option 1: No GST Option 2: 8% 0 ratings and exemptions as in Section 2.3.3 Option 3: 5% 0 ratings and exemptions as in Section 2.3.3	5% standard Limited 0 ratings & exemptions (financial & international services)	20% standard 5% reduced Wider 0 ratings & exemptions (financial & international services)	17% standard 14%, 8% & 3% reduced rates 0 ratings & exemptions (financial & international services)	7% standard 0 ratings & exemptions (financial & international services)
Company Tax	0% standard 10%/20% for specific income streams	0% standard 10%/20% for specific companies	0% standard 10%/20% for specific companies	15% up to €175k (£152,174), 17% above €200,001 (£173,914) Extra 7% for employment fund Net wealth tax of 0.5% - financial companies liable to a minimum of €4,815 (£4,186)[64]	17% flat rate

Source: See Appendix A2 (Figure 7 for row 1 and Table 3 for all else)

[60] This is Guernsey's 2019 tax revenue as a percentage of GDP, which differs from the total revenue as percentage of GDP working target of 24% as in the Fiscal Policy Framework. The 2019 total revenue as a percentage of GDP is 22%.
[61] Maximum tax paid capped at £260,000 for worldwide income (or £130,000 for non-Guernsey income). Other caps: £50,000 for Alderney residents; £50,000 open market cap for new residents and £40,000 standard charge for resident only individuals.
[62] The exchange rate used was £1 = €1.15, calculated on the 28th April 2021
[63] The exchange rate used was £1 = SGD 1.84, calculated on the 28th April 2021
[64] Other companies' minimum ranges from €535 to €32,100 depending on their balance sheet total as in https://www.parfigroup.eu/luxembourg-corporate-tax-guide/#_ftn1

3.2.3. Direct and indirect tax revenue

Countries usually raise revenues through a mixture of direct and indirect taxation. Direct taxes are taxes paid directly to the government and are applied to income, profits and wealth. Indirect taxes are collected by a third party (like a producer for production taxes and retailer for GST) and then paid to the government. Direct taxation includes personal income tax (PIT), corporate income tax (CIT), social security contributions (SSCs) and would include the Health Tax if introduced. Indirect taxes include taxes on production, consumption and imports such as GST, excise taxes and custom duties.

Consistent with the trend in OECD averages, Guernsey, Jersey, Luxembourg and Singapore have higher direct tax revenues than indirect tax revenues.[65] In the Isle of Man, more revenue is gained via indirect tax. These values are shown as a percentage of total tax revenue in Table 4. In addition, social security as a percentage of total tax revenue is expressed separately due to its high individual contribution. This is especially relevant because the social security scheme in Singapore, the Central Provident Fund (CPF), contributes the most to its tax revenue. The figure provided as part of Table 4 shows that the indirect share of total tax revenue is smallest in Guernsey at 10% compared to 14% in Jersey and 45% in the Isle of Man, which is higher due to its remittance agreement with HMRC in the UK on its GST. Guernsey's low indirect share of total tax revenue is as a result of not currently having a GST. This shows that with a GST, the extent of Guernsey's reliance on indirect tax revenues would remain in line with those of its benchmark jurisdictions.

Table 4: Tax components as a percentage of total tax revenue, 2019

	Direct tax (excluding social security) as a percentage of total tax revenue	Indirect tax as a percentage of total tax revenue	Social security as a percentage of total tax revenue
Isle of Man	29%	45%	26%
Singapore	38%	19%	43%
Luxembourg	43%	29%	28%
Jersey	57%	14%	24%
Guernsey (current)	60%	10%	30%
Guernsey – Option 1: HT & SSC	61%	9%	30%
Guernsey – Option 2: GST	52%	21%	27%
Guernsey – Option 3: GST & SSC	54%	17%	29%

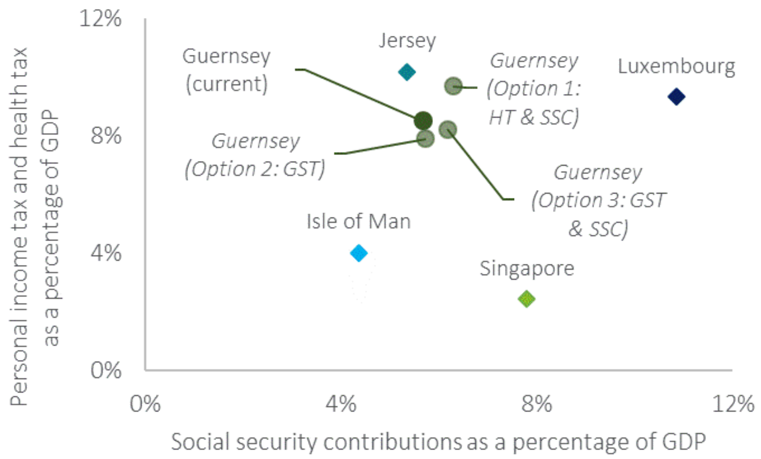
Note: Remaining 5% of Jersey's tax revenue classified as 'Other income'
Source: As in Appendix A2 Figure 7

Of the benchmark jurisdictions, Guernsey is currently most reliant on direct taxation; Policy Option 1 would further increase this reliance as the level of revenue raised through indirect taxation would fall from 10% to 9%. By contrast, under Policy Options 2 and 3, which would see the introduction of a GST at 8% and 5% respectively, the share of tax revenue raised through indirect taxation would increase to 21% under Option 2 and 17% under Option 3.

Direct tax revenue is driven by PIT revenue for two of the above jurisdictions, at 9% relative to GDP for Guernsey and 10% relative to GDP for Jersey. In Luxembourg, the contributions of PIT and social security are quite similar and high, as seen in Figure 9. This figure also further illustrates the importance of social security in Singapore and the Isle of Man's overall lower reliance on direct tax revenue because of its inclusion in the UK's VAT regime. Importantly, it also shows that Guernsey's PIT and SSC revenues relative to GDP are within the range of the benchmark jurisdictions'. **Policy Options 2 and 3 only have a modest impact on Guernsey's position in terms of PIT and SSCs relative to the benchmark jurisdictions. By contrast, Policy Option 1 increases the level of revenue raised from PIT as a share of GDP to a similar level as observed in Jersey while also increasing SSCs as a share of GDP further beyond that of Jersey.**

[65] OECD e-book, "Revenue Statistics 2020", available at: https://www.oecd-ilibrary.org/sites/8625f8e5-en/index.html?itemId=/content/publication/8625f8e5-en

Figure 9: Personal income tax (PIT) and social security contributions as a percentage of GDP



Source: As in Appendix A2 Figure 7

Consistent with the other main direct taxes, Luxembourg has the highest CIT relative to GDP, at 6%. Singapore is the only jurisdiction where CIT revenue is higher than PIT revenue, at 3% of GDP. Guernsey and Jersey follow at 2% each and the Isle of Man has the lowest CIT relative to GDP of 1% as it only applies a 10% rate to income received by banking business and to large retailers with taxable income over £500,000.[66] In Guernsey, larger retailers fall in the 20% tax band and the financial services income streams charged at 10% do not only include banking business (income from various other regulated financial services activities is taxable at 10%). This difference in design and application explains why the Isle of Man's CIT contribution is lower than those of Jersey and Guernsey despite their similar approaches on the zero-10 corporate tax regime. Thus, the Crown Dependencies are on the lower end of CIT relative to GDP but are not exceedingly different to the other two jurisdictions. The States are considering changes to CIT to comply with the OECD work-stream on corporate taxes, but this is not within the scope of analysis in this Report. While not in the scope of the Report, an assumption has been provided by the States for analytical purposes and this assumption is set out in more detail in section 2.3.

The dominance of indirect tax revenue in the Isle of Man is mainly a consequence of its GST. This is because of the GST revenue sharing agreement between the Isle of Man and the UK as described in 3.2.2. Indirect tax revenue is also driven by GST for the other benchmark jurisdictions, as shown in Table 5. **The exception is Guernsey, which is atypical in that no GST is charged. In comparison, GST accounts for between 8% and 40% of total tax revenue across the benchmark jurisdictions. Under Policy Options 2 and 3, which would see the introduction of a GST, the relative contribution of the GST to indirect and total tax revenue in Guernsey would be comparable to those of other benchmark jurisdictions.** Under Policy Option 2, where a GST of 8% would be introduced, the contribution of the GST to indirect tax revenue would be 58%, which is equal to Jersey's. The share is only greater than for one other jurisdiction, Luxembourg; however, GST revenue as a share of total tax revenue would be higher than in Jersey but lower than in Luxembourg, Singapore and the Isle of Man. Under Policy Option 3, where a lower rate GST is introduced, the contribution of the GST to indirect taxation

[66] Business and Corporations tax information, Isle of Man Government website, available at: https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/business-and-corporations/

would be lower than in any other benchmark jurisdiction at 47%, and the share of total tax revenue would be joint lowest with Jersey at 8%.

Table 5: GST as a percentage of indirect tax revenue and total tax revenue

	GST as a percentage of indirect tax revenue	GST as a percentage of total tax revenue
Isle of Man	89%	40%
Singapore	62%	12%
Luxembourg	53%	15%
Jersey	58%	8%
Guernsey (current)	No GST	
Guernsey (Option 1: HT & SSC)	No GST	
Guernsey (Option 2: GST)	58%	12%
Guernsey (Option 3: GST & SSC)	47%	8%

Source: As in Appendix A2 Figure 7 & Isle of Man Government Accounts for VAT data, 'Detailed Government Accounts – year ended 31 March 2020', available at https://www.gov.im/categories/tax-vat-and-your-money/government-accounts/

3.2.3.1. Low rate and broad-based GST

In addition to the benchmark jurisdictions', New Zealand's GST system is also considered in this Report. This is because New Zealand's low-rate, broad-based GST is similar to the one being considered by the States.[67] Studies have shown that a broader based, lower-rate GST (as opposed to the higher rate European style with GST rates in excess of 20%), due to its more efficient nature, is considered more conducive to growth in the long run than a higher standard rate.[68]

New Zealand's GST was introduced in 1986 at a level of 10% and has since increased to 15%. It has minimal exemptions, and financial services, residential accommodation and exports are zero-rated. This is similar to the GST structure applied in Jersey and that being considered for Guernsey under Options 2 and 3. New Zealand's GST was revenue neutral at the time of introduction, as income tax was redesigned to have two rates and the company tax rate was lowered.[69] Taking the regressive nature of this structure of tax into account, a one-off benefit adjustment was provided to pensioners, low paid workers and social security beneficiaries. For the last two groups, a compensatory income supplement was also provided.[70]

Having few exemptions was a deliberate policy choice made at the time New Zealand's GST was introduced.[71] It's C-efficiency (the most widely used indicator of GST efficiency) is double that of the UK's and is much higher than the OECD average.[72] In the year that the GST was introduced, New Zealand's price levels were impacted significantly; however, this was already a period when New Zealand was experiencing high inflation. The positive impact of the GST on price levels dropped out a year after introduction, over 1987 to 1988 – a 5 percentage point drop, which was the second largest factor driving the year's fall in CPI.[73]

Jersey and Singapore's GST systems are modelled after New Zealand's. The Isle of Man and Luxembourg follow the European style of GST, which is characterised by one or more reduced rates and a relatively high standard rate, given the

[67] "The New Zealand GST and its Global Impact 30 Years On", available at: https://www.researchgate.net/publication/315782694_The_New_Zealand_GST_and_its_Global_Impact_30_Years_On
[68] IMF working paper, "The Value Added Tax and Growth: Design Matters", available at: https://www.imf.org/en/Publications/WP/Issues/2019/05/07/The-Value-Added-Tax-and-Growth-Design-Matters-46836
[69] "An International Perspective on VAT", available at: https://www.oecd.org/ctp/consumption/46073502.pdf
[70] "Tax Design Insights from the New Zealand Goods and Services Tax (GST)) Model", available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2046352
[71] "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks", available at: https://www.nber.org/system/files/working_papers/w13264/w13264.pdf
[72] OECD e-book, "Consumption Tax 2020: VAT/GST and Excise Rates, Trends and Policy Issues", https://www.oecd-ilibrary.org/sites/152def2d-en/index.html?itemId=/content/publication/152def2d-en
[73] Reserve Bank of New Zealand bulletin, "Causes of the Fall in Inflation: 1985-88", available at: https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Bulletins/1989/1989sep52-3hodgettsclements.pdf?revision=949a0e34-7253-41e1-90c6-642d15bdd24e

EU directive of at least 15%. Table 10 in Appendix A3 fully highlights the GST details of all the benchmark jurisdictions and New Zealand.

Singapore's GST was introduced in 1994 and, like New Zealand's, is a broad-based, low rate GST. Its introduction was accompanied by a permanent decrease in headline PIT and ongoing compensatory payments to low-income households and individuals.[74] It was initially set at a 3% rate and has increased steadily over the years to the current 7% rate.

3.2.4. Other taxes

In addition to the main taxes discussed above, other taxes charged in Guernsey and in the benchmark jurisdictions include property tax and excise taxes. Of all the benchmark jurisdictions, only Luxembourg charges an inheritance tax and capital gains tax. These taxes are not currently charged in Guernsey and are not included in the illustrative tax levers provided by the States. Therefore, they are only briefly described and compared across benchmark jurisdictions in this section.

CIT

Guernsey, Jersey and the Isle of Man have encountered equivalent scrutiny from outside organisations such as the OECD and the EU Code of Conduct Group. They all introduced new corporate tax regimes, zero-10, which took effect in the Isle of Man in April 2006, in January 2008 for Guernsey and January 2009 for Jersey. The standard rate of 0% is applicable to companies that are tax resident in Guernsey. The '10' refers to an intermediate 10% rate levied on specific financial services income streams.[75] Under the CIT scenario used in this report it is assumed that Guernsey's CIT system would remain broadly aligned with those of Jersey and the Isle of Man; more details of the specific assumptions made regarding CIT are provided in section 2.3.

Other Taxes

All five jurisdictions charge excise duties on alcohol, tobacco and fuel with variation in the respective rates.[76] For example, Luxembourg charges a rate of approximately 31p per litre on automotive diesel, the Isle of Man charges 57.95p per litre and Guernsey charges 73.4p per litre on road diesel.[77] Guernsey stopped charging annual motor tax fees from 2008, when a relatively high rate of excise duty on road diesel was introduced to recover the lost revenue.[78] Guernsey is currently considering road pricing in addition to its motor fuel duties, but this is driven by environmental factors and the erosion of revenues as people transition to increasingly efficient or electric cars. It is not centred around raising tax revenue and is thus not considered here.

Taxes on property are also charged differently. Jersey charges 'Rates' of 0.74p per rateable value or quarter for domestic land and 1.05p per rateable value or quarter for non-domestic land.[79] The rateable unit is assessed based on size, location, accommodation, condition, land use and the quality of any building on the land. Guernsey charges a maximum of £2.98 per square metre of domestic buildings and a maximum of £48.55 per square metre of non-domestic buildings owned by utilities providers.[80] Luxembourg property tax rates range from 0.7% to 1% of the property value depending on property use and location.[81] At a higher level, revenue generated from property taxes is 9.7% of tax revenue for Luxembourg (the

[74] "Value Added Tax Policy and Implementation in Singapore", available at: https://cri-world.com/publications/qed_dp_128.pdf
[75] Furthermore, the States also charge a higher tax rate of 20% on company income arising from telecommunications, ownership of local land and buildings, large retail operations with taxable profits over £500,000, the business of the cultivation or use of the cannabis plant, the business of the prescribed production or prescribed use of controlled drugs, and the importation and supply of gas or hydrocarbon oil, Fifth Schedule of The Income Tax (Guernsey) Law, 1975, available at: https://www.guernseylegalresources.gg/CHttpHandler.ashx?documentid=80761
[76] The aim of these taxes is to incentivise behaviour, such as a reduction in consumption of alcohol and tobacco. As such, many OECD countries take fuel efficiency levels into consideration whilst taxing cars, to encourage the use of vehicles that have lower emissions.
[77] Luxembourg - https://www.fuelseurope.eu/knowledge/refining-in-europe/economics-of-refining/fuel-price-breakdown/, Isle of Man - https://www.gov.im/categories/tax-vat-and-your-money/customs-and-excise/technical-information-vat-duty-and-interest-rates/, Guernsey - https://www.gov.gg/CHttpHandler.ashx?id=134733&p=0
[78] Resolutions, Billet XVII, Made On 25th, 26th And 27th October 2006: https://www.gov.gg/CHttpHandler.ashx?id=5698&p=0
[79] Jersey government Rates website, available at: https://parish.gov.je/pages/rates.aspx
[80] States Tax on Real Property (TRP) System and States Tax on Real Property Tariffs for 2021, available at: https://www.gov.gg/cadastre & https://www.gov.gg/CHttpHandler.ashx?id=135987&p=0
[81] PWC worldwide tax summaries, available at: https://taxsummaries.pwc.com/luxembourg/individual/other-taxes

highest amongst the benchmark jurisdictions) in comparison to Guernsey where the figure is 4%, while Jersey generates just 1% of revenue from property taxes (the lowest amongst benchmark jurisdictions).[82]

With regards to the capital gains tax in Luxembourg, individuals are subject to personal income base rates ranging from 8% to 42%.[83] Capital gains from the sale of a main residence are exempt.[84] Likewise, companies are subject to corporate income tax rates on gains, ranging from base rates of 15% to 17% depending on the company's taxable income. Gains from company holdings, where an individual has over 10% of the company's share capital, are taxed at half of the average rate.[85] Dividends received may be tax exempt in Luxembourg, according to the participation exemption regime, if certain conditions are met. The other jurisdictions do not charge a capital gains tax, as previously highlighted, and this could be as a result of the distortions this tax could cause. Taxes on capital gains discourage savings and investment while also encouraging tax evasion and capital flight.[86] Thus, it can have a negative effect on the economy while lowering the jurisdiction's appeal to high net worth individuals and the financial sector, as they would be more likely to own assets that generate capital gains.[87] A recent study has shown that in terms of efficient redistribution, taxing labour and capital is better than taxing labour alone.[88]

Luxembourg's inheritance tax is levied on the entire estate at variable rates depending on the relationship between the beneficiary and the deceased.[89] The maximum base rate is 15% and the maximum total incremental rate due to the value of the estate share received is 48%.[90] There is a tax-free allowance of €1,250 on small estates and €38,000 for spouses without children.[90] In addition, any acquisitions made with a partner at least 3 years before death are exempt. As the inheritance tax is a tax on wealth, maintaining attraction to HNWIs could be a reason why the other jurisdictions do not charge an inheritance tax.

[82] Luxembourg - https://data.oecd.org/tax/tax-on-property.htm, Guernsey - property tax revenue provided by the States, Jersey – Island rates https://opendata.gov.je/dataset/government-of-jersey-accounts/resource/b9bc6bb3-a74a-4c6e-bd20-b5e6a9464b1f
[83] PWC worldwide tax summaries, available at: https://taxsummaries.pwc.com/luxembourg/individual/other-taxes
[84] IBFD note on Luxembourg Individual taxation, available at: https://www.ibfd.org/sites/ibfd.org/files/content/pdf/European%20Tax%20Handbooks%202015_Indiv.pdf
[85] IBFD note on Luxembourg Individual taxation, available at: https://www.ibfd.org/sites/ibfd.org/files/content/pdf/European%20Tax%20Handbooks%202015_Indiv.pdf
[86] "Taxing Wealth and Capital Income", available at: https://www.cato.org/tax-budget-bulletin/taxing-wealth-capital-income
[87] "The economic effects of capital gains taxation", available at: https://www.researchgate.net/publication/293267376_The_economic_effects_of_capital_gains_taxation
[88] "Capital taxation: A survey of evidence", available at: https://voxeu.org/article/capital-taxation-survey-evidence
[89] PWC worldwide tax summaries, available at: https://taxsummaries.pwc.com/luxembourg/individual/other-taxes
[90] Estate and inheritance tax in Luxembourg, available at: https://www.expatica.com/lu/finance/taxes/luxembourg-inheritance-tax-1024768/

3.3. Key changes in comparators taxation and impacts overview

This section summarises some key changes in the core tax levers in some of the benchmark jurisdictions and the impacts of these changes on key economic indicators.

Figure 10: Overview of relevant tax changes in benchmark jurisdictions

Introduction of GST in Jersey in May 2008

3% rate, with exemption fee applicable for financial services and income support for low-income households

GST revenue of £32 million in 2008, about 4% of total tax revenue

1.9 percentage point increase in Retail Price Index (RPI) which was temporary and dropped out in June 2009.

As of 2019, the financial services exemption fee receipts were 10% of total GST revenue

Increase in Jersey GST in June 2011

Rate increased from 3% to 5% as part of initial medium-term plan

GST revenue of £66 million in 2011, about 8% of total tax revenue

RPI increased by 1.3 percentage points and the impact dropped out in June 2012

Introduction of Long-Term Care Charge in Jersey in 2015

Introduced to supplement the States' funding for those with daily care needs

Set at 0.5% before increasing to 1% in 2016 and is now at a headline rate of 1.5% above the income tax personal allowance

Raised £8.4 million in 2015, 0.2% of GDP

Introduction of charge specifically tied to introduction of the long-term scheme in Jersey

Increase in Singapore Top Tax Rate in 2015

Increased from 20% to 22% above 320,000 SGD (£173,913)

PIT revenue as a percentage of GDP went up from 2.2% in 2015 to 2.4% in 2016

Part of a policy focus on fiscal sustainability designed to boost social security and support the ageing population and low- or middle-income families

Source: See Appendix A2

Key Insights

The four benchmark jurisdictions chosen and agreed with the States were: Jersey, the Isle of Man, Luxembourg and Singapore; New Zealand is also analysed with regard to its GST due to the similarities with the GST under consideration in this report. **These jurisdictions were selected according to economic structure, tax structure, tax as a share of GDP and the size of the economies, with a focus on the financial sector.**

Guernsey sits in the middle of its comparators in terms of the size of the economy and is second only to Jersey in terms of the importance of the financial sector. **Guernsey's tax as a share of GDP is 19%, higher than the lowest value, which is the Isle of Man (15%), but considerably lower than the highest value, which is Luxembourg (39%). The tax policy options under consideration in this report would increase the ratio of tax revenue to GDP to more than 21% in each case but in none of these scenarios is the change sufficient to alter Guernsey's position relative to the benchmark jurisdictions. When combined with other revenues Policy Options 2 and 3 are capable of raising the States' working target of total government revenues relative to GDP, 24%, while Option 1 would raise 23.8%.**

Guernsey currently has a lower tax-free allowance for PIT than both Jersey and the Isle of Man. Under Options 2 and 3 this tax-free allowance would increase but it would not exceed the level in these jurisdictions. While the PIT rate is unchanged under all policy options, Option 1 includes the introduction of a Health Tax of 3% which is higher than in Jersey where there is a 1.5% headline rate. Of all jurisdictions considered, Guernsey has the lowest share of tax revenue raised through indirect taxation. Option 1 would further increase this reliance. Option 2 would significantly reduce this reliance moving Guernsey above Jersey and Singapore in terms of tax revenue raised through indirect sources. Option 3 sits as an intermediate case, raising the indirect revenue share but not above the level in Singapore.

The restructures in social security contributions considered in Options 1, 2 and 3 increase social security contributions as a share of GDP but not by a sufficient amount to change the position of Guernsey relative to its peers (above the Isle of Man and Jersey but below Singapore and Luxembourg). Options 2 and 3 *reduce* the level of PIT revenue raised as a share of GDP slightly but not by enough to change Guernsey's position relative to the benchmark jurisdictions. Policy Option 1, by contrast, would see a more notable increase in the level of tax revenue raised from income taxation bringing Guernsey above Luxembourg and near to parity with Jersey.

The GST rates amongst the comparators range from 5% in Jersey to 20% in the Isle of Man. Consequently, GST accounts for between 8% and 40% of total tax revenue across the benchmark jurisdictions that charge a GST. Of all the benchmark jurisdictions, **Guernsey alone does not charge a GST. As a result, Guernsey's indirect tax share is the lowest, at 10%. The GST rates of 8% under Option 2 and 5% under Option 3 sit at the bottom end of the range amongst benchmark jurisdictions, with the 8% GST being higher than the 5% rate currently in place in Jersey.** Under Policy Options 2 and 3 GST tax revenue as a share of total tax revenue would be 12% or 8% respectively which is at the bottom end of the range found amongst benchmark jurisdictions. In Jersey, a 5% GST accounts for 8% of total tax revenue.

In Jersey, a GST was introduced at 3% in 2008 and then increased to the current 5% in 2011. **The effects of both GST changes on price levels, 1.9 percentage points and 1.3 percentage points increase respectively, dissipated after one year**. **New Zealand's 1986 broad-based GST with minimal exemptions and few zero ratings is a model followed by Jersey and Singapore. The illustrative GST option in this report is also similar to this.** New Zealand's GST is reported to have a high level of efficiency.

Overall, the States' reliance on tax revenues is less than some of its benchmark jurisdictions'. However, it is heavily reliant on its income tax structure, which is less progressive than that of other benchmark jurisdictions considered here. Guernsey does not levy a capital gains tax or inheritance tax, providing an attractive tax environment for higher earners and high net worth individuals (HNWIs). This, along with changes to the PIT regime, could ensure that Guernsey remains competitive and continues to attract highly skilled individuals. Furthermore, the States have stated that any changes to CIT will consider how Guernsey compares to jurisdictions such as Jersey and the Isle of Man. Finally, introducing a low rate GST is unlikely to impact Guernsey's overall competitiveness considering that it is currently the only one of the jurisdictions considered that does not have a GST.

4 Economic impacts

Option 1, which is based on income taxation, is likely to have short-term impacts on the economy through household consumption, output and employment but is more progressive than a GST. Options 2 and 3, which are based on consumption taxation, lead to a short-term increase in inflation; GST is typically less distortionary to labour markets and is empirically found to be a more efficient tax.

The tax policy options under consideration within this Report can be categorised as changes to income taxation (either through changes in the tax-free allowance, the introduction of a Health Tax or changes in the structure of social security contributions) and tax on consumption through a GST. These tax changes may have impacts on the economy of Guernsey that can be split into two dimensions. First, macroeconomic impacts such as through a change in GDP growth, the level of employment or the rate of inflation, which also include sectoral impacts on key sectors of focus for Guernsey. Second, distributional impacts on individuals across the income distribution.

Impacts of tax changes are highly dependent on the specific structure of the economy. The revenue raised through the potential tax increases considered in this Report would be used to fund increased government spending in Guernsey. The States have posited that this spending is necessary to maintain current service levels given the demographic and fiscal challenges the States are facing. The net impact of the taxation on economic activity can be expected to be relatively small as a result of the increase in expenditure. However, it must be noted that the introduction of some of the tax changes may cause short term impacts, as spending to boost economic activity may not follow immediately. Furthermore, the introduction of a new tax such as a GST will involve extra administration and compliance costs both initially and over time.

The impacts of tax increases can be both direct and indirect. Direct impacts include, for example, a reduction in disposable income as a result of a PIT increase, which leads to households consuming less. Conversely, indirect impacts include effects on investment and employment in sectors as a result of a reduced level of demand for their goods and services. Indirect impacts also include the boost to the economy provided as a result of additional government expenditure funded by the tax revenues raised through each of the tax policy options.

This section outlines the economic impacts of the tax policy options being considered by the States of Guernsey, in the context of Guernsey's fiscal needs and its economy. A key measure reported for all tax policy options is the tax revenue impact, showing how much revenue each scenario could raise towards the working target. The overall revenue target, provided as a working assumption by the States, is 24% of GDP within the next five years.[91]

4.1.1. Macroeconomic Impact

The macroeconomic impact analysis of the tax changes focuses on three key economic indicators: GDP growth, employment and inflation. The analysis also considers any sectoral impacts, particularly in relation to the financial sector and those sectors which are more labour intensive or would be most impacted.

The approach in this report is to use empirical studies that estimate the effect of the policy options outlined above. These estimated impacts are discussed in the specific context of Guernsey's economy. The absence of an economic model outlining the details of Guernsey's economy (for example, using input output tables) means that the results from this analysis should be considered as directional, rather than precise impacts on the economy. For GST, studies on the impact

[91] The overall revenue itself is made up of a combination of streams on which tax revenue is the largest, but also includes revenue from fees and departmental revenues.

of its introduction in New Zealand and Jersey are analysed given their relevance to the GST structure being proposed by the States.

In the case of employer social security contribution increases, the direct impact is estimated using the most recent data on employee remuneration by sector in Guernsey as provided by the States. The impact on different sectors is considered in the context of each sector's contribution to GVA and overall labour productivity.

4.1.2. Distributional Impact

The distributional impact analysis examines the effect of each tax policy option on households across the income distribution. For each of the tax policy options, the impact on each household is estimated by the States.[92] Using the same household income data,[93] household gross unequivalised income ranges for each quintile can be established as listed below. By estimating the impact of each policy option on average within these quintiles,[94] this report assesses the distributional consequences of each policy option:[95]

- **Q1**: 0 - £23,953
- **Q2**: £23,954 - £44,328
- **Q3**: £44,329 - £69,909
- **Q4**: £69,910 - £108,890
- **Q5**: £108,891 and above

The analysis of tax impacts and the tax burden on household income, is performed for each income quintile. The magnitude of the impact is assessed relative to household income and household expenditure. The impact relative to expenditure is estimated using data from the latest Household Expenditure Survey Report.[96] The expenditure items are split into essential and non-essential expenditure with food and non-alcoholic drinks and housing, fuel and power classified as essential. As a result, the average expenditure by quintile on essentials relative to total expenditure, shown in Figure 20.

The GST tax burden on each household by category of expenditure has been provided to us by the States. By categorising expenditure into essential and non-essential items, the differences in tax burdens are studied across household quintiles and compositions.

4.1.2.1. Impact on Higher Earners

To analyse the impact of PIT changes on the income of higher earners, we use data provided by the States for the top 5% of households in terms of household income. As individual income is not available, household income is used as a proxy. This is declared household income as individuals who pay the PIT cap are not obliged to declare their full income. Thus, the impacts calculated as a proportion of overall household income may be an overestimation for these higher earners. We contextualise these results using insights contained in this dataset, including information on employment sector and the length of time resident in Guernsey.

4.2. Impacts on revenue

Guernsey currently raises approximately 19% of its GDP as tax revenues. The breakdown of this is shown in Table 6.

[92] Household composition broadly includes single adult households, one or more pensioner households, multiple adult households and multiple adult households with children. These are included in the household data as well.
[93] The income distribution data used is as observed by the States and does not include capital income or any measure of household wealth. As a result, it (and by extension, the distributional analysis) does not accurately reflect the spending power of households that are reliant on these other means which are not captured.
[94] Impact within each quintile is calculated by dividing the average change in tax liability as a result of the policy option by the average level of gross household income.
[95] The household income and ranges do not take into account differences between household composition (e.g. number of children, adults, pensioners) at this stage.
[96] Guernsey Household Expenditure Survey Report, available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0

Table 6: Types of taxes and the revenues raised through each of them

Tax	Tax revenues raised as a % of GDP (2021 forecast)
Personal Income Tax (PIT)	8.6%
Corporate Tax	2.2%
Social Security	5.7%
Other taxes	2.8%
Miscellaneous and operating income	3.1%

Source: Tax revenue data and 2021 GDP forecast provided by the States

As discussed in Section 3, this is less than in some of Guernsey's benchmark jurisdictions. In addition to tax revenue, Guernsey also generates revenue from operating income and other sources,[97] the value of which is in the region of 2 to 3% of GDP. Total revenue relative to GDP was 21.9% prior to COVID-19. The States have requested a working assumption that they may seek to raise revenues of up to 24% of GDP by 2026. Each of the considered tax policy options may raise between 1.9% and 2.2% of GDP according to the revenue analysis provided by the States.

Policy Option 1 relies on changes in personal income taxation through a Health Tax and SSCs for revenue raising. Policy Option 2 relies on the introduction of a GST with a reduction in PIT and a marginal increase in SSCs also present. Policy Option 3 is chiefly based on a GST but is accompanied by a smaller reduction in PIT and a greater increase in SSCs than under Option 2.

Given that CIT changes will consider how Guernsey compares to jurisdictions such as Jersey and the Isle of Man, it is not included in the scope of this Report. For analytical purposes the States have provided an assumption regarding CIT, which is presented in section 2.3. The assumption involves broad alignment between comparators and estimated revenues from introducing the OECD Pillar 1 and 2 proposals.

Table 7 shows the additional tax revenues raised as a percentage of GDP as forecast for 2021 for each tax policy option (and core elements).

Table 7: Additional tax revenues raised as a percentage of GDP from proposed tax measures

Proposed Tax	Option elements	Additional tax revenues raised as a % of GDP (2021 forecast)
Option 1	SSC restructure - *rates increased to 9% for employees and 7.5% for employers*	0.63%
	Health Tax - *administered in a similar way to PIT of 3%*	1.20%
	Corporate income tax	0.31%
	Peak forecast revenue lost from secondary pensions	-0.25%
	Option 1 Total	**1.9%**
Option 2	SSC restructure - *rates increased to 8% for employees and 7.5% for employers*	0.06%
	8% GST	2.68%
	PIT allowance increase to £14,000	-0.60%
	Corporate income tax	0.31%
	Peak forecast revenue lost from secondary pensions	-0.25%
	Option 2 Total	**2.2%**
Option 3	SSC restructure - *rates increased to 9% for employee and 7.5% for employers*	0.51%
	5% GST	1.75%
	PIT allowance increase to £12,700	-0.29%
	Corporate income tax	0.31%
	Peak forecast revenue lost from secondary pensions	-0.25%
	Option 3 Total	**2.1%**

Source: Based on tax impact data provided by the States

[97] These include housing rental income, company fees, dividend income from States Trading, court fines and rental income on commercial property.

The SSC restructure present in all options under consideration involves an increase in the SSC rates, although this is to a greater extent for Options 1 and 3 than for Option 2. The SSC restructure also includes a move away from an equal rate for both employers and employees, with employees' rates higher in all options. Despite this shift, SSC revenue from employers remains higher than that from employees. Currently, employers' revenue share is 51% while employees' share is 49% for Class 1 contributions. For Option 1, employers' SSC revenue share is 59% while employees' is 41%. With Option 2, employers' SSC revenue share is lower than for Option 1 at 55% while employees' is higher at 45%. Option 3 has employers' and employees' revenue shares between Option 1 & 2 at 56% and 44% respectively. This increase is as a result of the changes in income treatment for both employers and employees.

As GDP grows over the next few years, the levels of tax revenues raised will also increase. Studies have shown that in developed countries, tax buoyancy is approximately equal to unity, in both the short and long term.[98] This means that in general, for a 1% increase in GDP, revenues from taxes will also increase by 1%, implying that the tax to GDP ratio will not change.

To estimate overall growth in the economy up to the end of 2026, the GDP growth forecast as provided by the States is used. This forecasts that GDP will contract by 4.2% in 2020, increase by 4.1% in 2021 and then increase by less than 1% annually. Using this growth forecast, the overall growth expected in Guernsey by the end of 2026 is 1.03%. This would imply an approximate increase of 1.03% in tax revenues as well.

By design, each of the policy options under consideration produces a similar increase in tax revenue as a share of GDP in 2021. The impact of Policy Option 2 is greatest at 2.2% of GDP, the next largest impact arises from Option 3 at 2.1% and the smallest impact would be under Option 1 at 1.9%. Under Option 1, total revenues as a percentage of GDP in 2026 would be 23.8%, which is marginally lower than the working target of 24% while it would be 24.1% under Option 2 and 24.0% under Option 3.

A small portion of the increase in tax revenues comes from the CIT change, which is constant across each of the policy options at 0.31% of GDP. Each tax policy option incorporates a variant of an SSC restructure. The most impactful restructure to SSCs is under Option 1, which would raise an additional 0.63% of GDP in tax revenue; Option 2 is smallest with a minimal impact of 0.06% and then Option 3 is similar to Option 1 in terms of impact on SSC revenue at 0.51%.

Policy Option 1 involves the introduction of a 3% Health Tax, which is estimated to raise an additional 1.2% of tax revenue as a share of GDP (equal to £38.9m), the largest contributor to the additionally raised revenue under Option 1. While Options 2 and 3 do not involve a Health Tax, both incorporate an increase in the tax-free allowance for PIT – which results in a reduction in tax revenue from PIT. Under Policy Option 1, there are a variety of changes to the level of social security contributions (SSCs). The net impact of these changes is an increase in the level of revenue generated through SSCs to the tune of £20.4m. **In sum, the impact of Policy Option 1 is to increase the level of revenue raised from taxes on income by approximately £59.3m.**

The tax revenue increases from Options 2 and 3 are chiefly based on the introduction of a GST. The impact of the GST is greater for Option 2 where a GST of 8% is introduced, which results in an increase in tax revenue raised as a share of GDP of 2.68%. Option 3 involves the introduction of a GST at a lower level of 5%, which produces a smaller increase in tax revenues from GST equal to 1.75% of GDP.

Policy Option 2 involves an increase in the PIT tax-free allowance, which will reduce the level of revenue raised through PIT by £19.5m or 0.6% of GDP. The restructure of SSCs that forms part of Policy Option 2 would result in an increase in the level of revenue generated through SSCs to the tune of £2.1m. **In sum, the impact of Policy Option 2 is to decrease**

[98] Tax buoyancy is the relationship between the percentage change in tax revenues and the percentage change in GDP. If tax buoyancy is not different from unity, this implies that a 1% growth in GDP is linked to a 1% increase in tax revenues, leaving the tax revenues to GDP ratio constant. See IMF working paper, "How Buoyant is the Tax System? New Evidence from a Large Heterogeneous Panel", available at: https://www.imf.org/~/media/Files/Publications/WP/wp1704.ashx

the level of revenue raised from taxes on income by £17.4m. In addition, Policy Option 2 involves the introduction of a GST at 8%, meaning that **£86.9m would be raised by consumption taxation under Option 2**.

Policy Option 3 involves an increase in the PIT tax-free allowance, which will reduce the level of revenue raised through PIT by £9.2m or 0.29% of GDP. The restructure to SSCs that forms part of Policy Option 3 would result in an increase in the level of revenue generated through SSCs to the tune of £16.7m. **In sum, the impact of Policy Option 3 is to increase the level of revenue raised from taxes on income by £7.5m.** In addition, Policy Option 3 involves the introduction of a GST at 5%, meaning that **£56.5m would be raised by consumption taxation under Option 3.**

4.3. Macroeconomic impact

As discussed in Section 2, the impacts of the tax changes considered are discussed in the context of changes in the taxation of individual income (changes in the PIT tax-free allowance, increased social security contributions and a Health Tax) and the introduction of a GST.

4.3.1. Impact of Individual Income Tax Increase

4.3.1.1. GDP Growth

While an increase in individual taxation, as would result from the implementation of Policy Options 1 or 3, may impact disposable income and consumption, it is important to consider that the overall impacts on GDP growth in this scenario depend on how the government decides to use the additional revenue raised. Since it is anticipated that the States will use the raised revenue to increase spending in order to maintain current service levels, this may offset the reduction in household consumption, ensuring that the overall impacts on the economy are limited. For Policy Option 2, under which there would be a reduction in the level of revenue raised through income taxation, all impacts discussed in this section would be reversed.

A study by the OECD considers the impact of increasing tax revenues on GDP growth using both a top-down cross-country regression approach and a bottom-up simulation approach.[99] Based on the top-down approach, this study estimates that for developed countries a 10 percentage point increase in tax revenues as a percentage of GDP could reduce growth by about 0.5 percentage points, all else being equal.[100]

Furthermore, studies that do show a negative impact on GDP growth tend to show that this impact is transitory and that it is absorbed in around two years.[101] A study using US data shows that for a 1 percentage point increase in the tax to GDP ratio, the impact on growth is not significantly different from zero, three years after the change is implemented.[102] Similarly, a study based on 18 OECD countries showed that there are no significant impacts on growth if tax increases are applied to higher earners, as the level of consumption by these households does not vary much as a result of changes in personal income taxation.[103]

Following the empirical evidence, and the decision that government expenditure will increase alongside the tax changes, the overall impacts on GDP growth will be limited and transitory in nature. However, there will be significant short-term transitory impacts associated with compliance costs, behavioural impacts and administration costs as businesses, individuals and the government learn to navigate the new systems. Furthermore, there will be impacts if there are delays to the government increasing expenditure.

---

[99] OECD working paper, "Taxation and Economic Performance", available at: https://www.oecd-ilibrary.org/economics/taxation-and-economic-performance_668811115745

[100] The same paper conducts a bottom up simulation approach which finds that a reduction in tax to GDP ratio of 10 percentage points is estimated to increase growth by 0.5-1 percentage points

[101] "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks", available at: https://www.nber.org/system/files/working_papers/w13264/w13264.pdf

[102] "How Large Are the Effects of Tax Changes", available at: https://www.researchgate.net/publication/46474949_How_Large_Are_the_Effects_of_Tax_Changes

[103] "Optimal Taxation of Top Labour Incomes: A Tale of Three Elasticities", available at: https://www.nber.org/system/files/working_papers/w17616/w17616.pdf

These impacts would be largest for Policy Option 1, given that it raises an additional £59.3m through taxes on income. In the case of Policy Option 3, only £7.5m would be raised through taxes on income meaning any impacts on GDP growth would be significantly reduced. Under Policy Option 2 there would actually be a decrease in the level of revenue generated through income taxation by £17.4m, which would have the opposite impact and potentially provide an increase in growth.

4.3.1.2. Sectoral impacts

Whilst the increase in the level of individual income taxation under Policy Options 1 and 3 (and the decrease under Policy Option 2) are unlikely to impact the overall levels of economic activity in Guernsey, the overall structure of the economy may be impacted. As a result of households potentially reducing consumption in response to increased taxation, sectors such as wholesale, retail and repairs, and transport and storage may shrink. However, these sectors currently comprise 10% of total GVA, meaning that overall impacts on the economy may be limited. In addition, some of the more labour-intensive sectors like education, hostelry, and transport and storage will also be negatively impacted given the increased cost of labour.

40% of Guernsey's economy is derived from the financial services industry. This activity is almost entirely driven by services provided to off-island beneficiaries.[104] This implies that the demand for services in this industry is not adversely impacted even in the scenario where household disposable income reduces as a result of increases in individual taxes on income. In addition, professional, business, scientific and technical activities comprise 13% of the overall economy in Guernsey. This sector is also unlikely to be adversely impacted, as its services generally have inelastic demand as they are consumed by higher earners or the finance sector, which is unlikely to be impacted.

A further 9% of Guernsey's GVA results from the activities of the government and public administration sector, which is likely to expand given the anticipated increase in government expenditure for which tax revenues are being raised and that is required in order to maintain current service levels in light of the ageing population and other fiscal pressures. The health and care sectors[105] are also likely to expand for the same reason. This expansion is, however, likely to be influenced by the availability of health and care professionals. To a lesser extent, the capital investment in infrastructure may also positively impact the construction sector.

It is also worth noting that the public administration sector relies less on imports than sectors such as wholesale, retail and repairs, real estate, etc. This implies that as public administration expands, while more import driven sectors shrink, Guernsey will rely more strongly on its own assets and less on imports.

4.3.1.3. Employment

Theoretically, there is both a labour supply and a labour demand response following an increase in individual taxation. Impacts on labour demand come through the indirect effects of income tax. As a result of a reduction in consumption of certain goods and services, firms begin producing less and therefore demand less labour. On the supply side, taxing income disincentivises work as the value of work post-tax falls (income effect) and incentivises work more as a result of a reduction in post-tax income (substitution effect). For lower income earners, low wages may often make labour supply inelastic. This is because at very low wages, individuals do not have the choice to work less as their essential expenses often equate to a significant part of their income.

The downward pressure on GDP in Guernsey in the short term may also impact employment. In general, the largest sectors by employment are finance and the professional, business, scientific and technical sectors. Together, they employ approximately 28% of Guernsey's labour force. As discussed above, these sectors are unlikely to see a large impact on economic activity and therefore on employment. Furthermore, at 17%, the government and public administration sector

[104] The Channel Islands and the EU – Financial Services, available at: https://www.channelislands.eu/wp-content/uploads/2011/12/FS-background-note-September-2016.pdf

[105] In Guernsey, healthcare provided directly by the States is captured under "public administrative". Private health and care providers such as GP practices and care homes are captured as in the health and care sector even where their activity is heavily subsided.

also employs a large percentage of the labour force. Considering the increases in expenditure and services, employment within the public sector, and to a larger extent within the health sector, may increase.

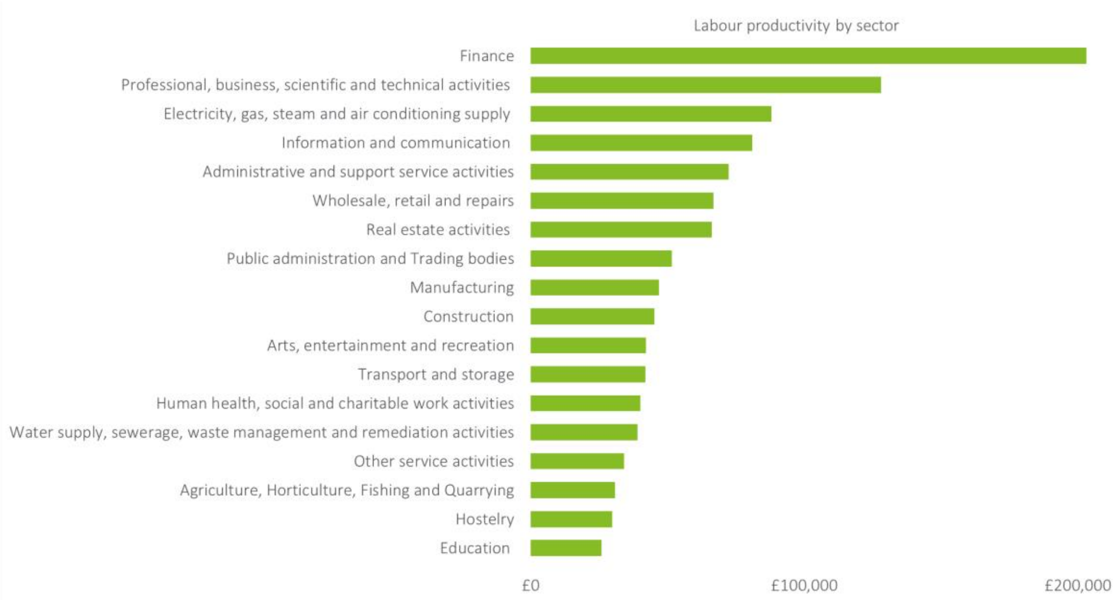
Adverse impacts on employment are most likely to be felt in the sectors that may have larger decreases in GVA. Some of the largest sectors (by employment) that are likely to be more adversely impacted are construction, wholesale, retail and repairs, hostelry, transport and storage, and administrative and support service activities. These sectors together comprise 35% of the labour force and contribute 19% of GVA.[106]

However, given that a portion of the revenue from tax increases will be spent on capital infrastructure,[107] some of the adverse impacts on sectors such as construction may be negated. In comparison to industries such as wholesale, retail and repairs, real estate, administrative and support services, sectors such as public administration, healthcare and construction rely more on labour than capital. This implies that as the economy structurally changes to expand sectors such as public administration, healthcare and construction, the overall impact on jobs may be positive as the loss in jobs from reduced consumption may be offset by the creation of new jobs in labour intensive sectors.

4.3.2. Impact of social security increases on employers in different sectors

An increase in the level of social security contributions, which occurs in each policy option though to a much lesser extent under Policy Option 2, will impact employers in different sectors to a varying extent. Social security contributions will impact sectors that rely more on labour than capital, as they increase the cost of labour. This includes sectors such as hospitality, which often work on low margins and have lower labour productivity. Figure 11 shows the labour productivity, calculated as GVA divided by the number of employees by sector. This figure shows that sectors such as finance, and professional, business, scientific and technical activities have high labour productivities whilst those such as agriculture, sewage and waste management, and hostelry have lower labour productivity.

Figure 11: Labour productivity by sector (£)



Source: The States government website, 'Supplementary GVA and GDP Data 2019', available at https://www.gov.gg/gdp & 'Facts and Figures 2020 Supplementary Data: T 2.16, F 2.16 - Employment by economic sector', available at https://www.gov.gg/ff

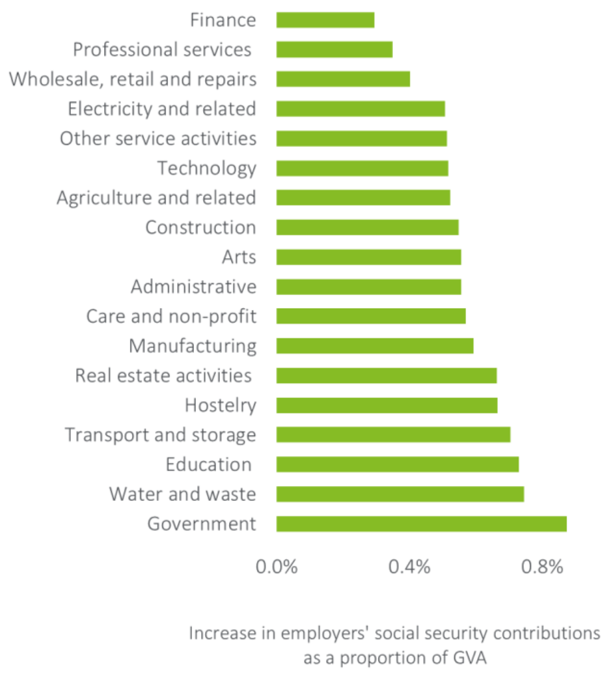
By applying the considered SSC restructure to the data provided on remuneration by sector, we can estimate the change in the social security burden on sectors. As overall remuneration is highest in sectors such as finance and professional,

[106] Guernsey Facts and Figures, 2020, States, Nominal GVA All Sectors - available at: https://www.gov.gg/CHttpHandler.ashx?id=131184&p=0
[107] Guernsey 2019 report, "The Review of the Fiscal Policy Framework and Fiscal Pressures", available at: https://www.gov.gg/CHttpHandler.ashx?id=122178&p=0

business, scientific and technical activities, these sectors bear the largest impact of social security increases in absolute terms. However, when this is compared to their GVA, the sectors that rely more on labour than capital are seen to be impacted more. Figure 12 shows the social security impact as a proportion of GVA for each sector.

As expected, key sectors of focus including the financial services sector are largely not adversely impacted as a percentage of their GVA (at 0.29% for all options). In comparison, sectors such as hostelry, transport and storage, education, and water management are impacted by as much as 0.6% to 0.8% of their GVA for all options. While these impacts are on the higher end of the range relative to GVA, as stated in section 2.3.2, there is evidence to suggest that about two thirds of this burden may be passed on to employees. This may imply a more limited impact on sectors than is provided by these estimates.

Figure 12: Increase in social security contributions for employers as a proportion of GVA



Source: Latest sectoral renumeration data provided by the States

4.3.3. Impact of GST

The GST (which would be introduced at 8% in Option 2 and 5% in Option 3) is a relatively more efficient tax in comparison to PIT because its base does not include mobile capital income. The GST causes fewer distortions as it does not directly impact the cost of capital or labour.[108] Furthermore, the GST decreases in efficiency with higher rates and the addition of exemptions.[109]

Empirical evidence shows that income tax changes have a larger impact than GST on output, private consumption and investment in the short run.[110] As a result, the impact of a GST on the economy is expected to be more limited. To this end, this section reviews the potential impacts that a GST could have on Guernsey's price levels and sectoral performance.

[108] OECD working paper, "Taxation and Economic Growth", available at: https://www.oecd-ilibrary.org/economics/taxation-and-economic-growth_241216205486
[109] IMF working paper, "The Value Added Tax and Growth: Design Matters", available at: https://www.imf.org/en/Publications/WP/Issues/2019/05/07/The-Value-Added-Tax-and-Growth-Design-Matters-46836
[110] "The Macroeconomic Effects of Income and Consumption Tax Changes", available at: https://ideas.repec.org/p/shf/wpaper/2017008.html

Given the relative reliance of the different policy options on the GST for revenue raising and the relative efficiency of the GST, Policy Option 1, which relies solely on income taxation to raise revenue, is likely to be less efficient than Option 3, which incorporates a 5% GST. Option 3 is in turn likely to be less efficient than Option 2, which relies exclusively on GST for revenue raising and is accompanied by a *decrease* in income taxation.

There are a number of empirical studies in the literature that estimate the impact of introducing a GST. An analysis of 53 GST changes in 14 developed countries suggests that aggregate consumption and economic growth increases just before GST is raised, decreases as it is raised and then increases again afterwards.[111] These findings are consistent with a temporal substitution effect of a GST increase, as consumption is brought forward in response. The findings are also consistent with the impact of a GST increase on inflation being temporary in nature.[112] In the long term, a GST increase is not found to adversely impact economic growth.[113] This result is in part driven by countries also increasing government expenditure alongside these tax changes (e.g. compensating low-income households or funding social welfare), which matches the options under consideration for Guernsey.[114]

4.3.3.1. Impact of GST introduction on price levels

In general, the introduction of a GST leads to higher price levels in the short-term as a result of the direct impact on the prices faced by consumers. Empirically, it has been noted that this effect is usually temporary and dissipates after around 4 quarters. A study of the macroeconomic effects of GST introduction in New Zealand, Australia and Canada reported a temporary effect on inflation for all three countries.[115] A separate analysis of the GST effect on inflation in Australia confirms this transitory impact. Australia introduced the tax at a 10% rate in July 2000, thus simplifying its existing sales tax system.[116] It had a higher number of exemptions than New Zealand and was slightly revenue expansionary.[117] A one-off national effect of this GST introduction is reported on price levels at 2.8%, this impact was observed only in the September quarter with no lasting impacts observed beyond this point.[118]

The study of the macroeconomic effects of the GST introduction in New Zealand, Australia and Canada also reviewed the percentage change in GDP arising as a result and reported no common GDP impacts.[119] This result is supported by findings in a paper comparing the effect of the income tax rate and GST rate cuts, showing that a reduction in the GST rate had no significant impact on GDP and its components.[120]

As Guernsey and Jersey have several similarities in their economic structures, the impacts of Jersey introducing a GST are also considered. In Jersey, both the introduction of a GST at 3% and then a subsequent increase to 5% had similar impacts, whereby 1% of GST was associated with an increase in price levels of approximately 0.65% but did not impact inflation beyond the span of one year. Considering Jersey as a close comparator, the introduction of a GST of 5% in Guernsey, as under Policy Option 3, may therefore lead to an increase in price levels of approximately 3.25 percentage points. However, following the Jersey case study, as well as evidence from other countries, the impact this has on inflation can be expected

---

[111] "The Effect of the VAT Rate Change on Aggregate Consumption and Economic Growth", available at: https://academiccommons.columbia.edu/doi/10.7916/D86W9JX0/download
[112] "Quantifying the Effect of GST on Inflation in Australia's Capital Cities: An Intervention Analysis", available at: http://eprints.qut.edu.au/423/1/Valadkhani_153.pdf
[113] "The Effect of the VAT Rate Change on Aggregate Consumption and Economic Growth", available at: https://academiccommons.columbia.edu/doi/10.7916/D86W9JX0/download
[114] Examples of countries mentioned in the paper and details of the changes: Canada's 1991 introduction of a 15% GST also involved a GST credit scheme for low-income households, Japan's 3% GST introduction in 1989 was used to fund social welfare spending and the Netherlands' 2001 GST increase by 1.5% was accompanied by a 8% drop in PIT rate
[115] "An Empirical Note on the Comparative Macroeconomic Effects of the GST in Australia, Canada and New Zealand", available at: https://www.une.edu.au/__data/assets/pdf_file/0006/67947/econ-2004-17.pdf
[116] "The New Zealand GST and its Global Impact: 30 Years On", available at: https://www.researchgate.net/publication/315782694_The_New_Zealand_GST_and_its_Global_Impact_30_Years_On
[117] "An Empirical Note on the Comparative Macroeconomic Effects of the GST in Australia, Canada and New Zealand", available at: https://www.une.edu.au/__data/assets/pdf_file/0006/67947/econ-2004-17.pdf
[118] "Quantifying the Effect of GST on Inflation in Australia's Capital Cities: An Intervention Analysis", available at: http://eprints.qut.edu.au/423/1/Valadkhani_153.pdf
[119] "An Empirical Note on the Comparative Macroeconomic Effects of the GST in Australia, Canada and New Zealand", available at: https://www.une.edu.au/__data/assets/pdf_file/0006/67947/econ-2004-17.pdf
[120] "The Macroeconomic Effects of Income and consumption tax Changes", available at: https://ideas.repec.org/p/shf/wpaper/2017008.html

to dissipate after one year as prices adjust to a new base level. Under Policy Option 2, where a GST of 8% would be introduced, it is reasonable to expect a greater price effect than in the 5% case.

With the introduction of a GST, compliance costs are worth considering. Several countries, especially in the EU, have GST rates with several exemptions and zero-rated sectors. Whilst zero-rated or exempt sectors can help reduce the regressivity of the tax, they lead to higher compliance costs and erode revenues. Furthermore, these costs especially impact smaller businesses. A study commissioned by New Zealand's Inland Revenue Department after the GST was introduced estimated compliance costs of 7.3% relative to GST revenue.[121] However, when split by the size of the firm, it showed that for smaller firms (less than $30,000) compliance costs were as high as 2.6% of turnover, whilst for larger firms with turnover between $1 and $2 million, the estimate was only 0.2%.

In this respect, the GST under consideration with minimal zero-rating and an exemption for small firms at a threshold similar to Jersey's of less than £300,000 would be beneficial for a reduction in overall compliance costs. In general, compliance costs are also transitory as businesses get used to new systems and develop the know-how to register and comply with new legislation. The States of Guernsey have posited that the annual administration costs associated with the introduction of the GST would be equal to approximately £0.8m.

4.3.3.2. Impact of GST introduction on sectors

The impact of GST on specific sectors in Guernsey will depend on the GST treatment applied, and whether the sectors are exempted or zero-rated, or other mitigating strategies are employed. Whilst zero-rating helps alleviate any adverse effects on consumption, it imposes an administrative or, even more complex, some compliance burden as businesses need to register for GST and then apply to reclaim any GST paid on all their inputs.

Given that a GST will raise the prices of goods consumed by households by the tax rate, it is reasonable to expect that a concentrated effect of the introduction will be felt in the wholesale, retail and repairs sector. As will be highlighted within the distributional analysis in Section 4.4, the percentage of household expenditure spent on essentials is relatively high for lower-income households. This reduces the avenues through which expenditure can be reduced and for these households may prompt a shift towards lower price items.

The medium- and high-income households spend a smaller share of their income on essentials, as is seen in Figure 20, and are likely to find this GST cost minimal in comparison to their total expenditure. Hence, they are less likely to reduce their expenditure in response. On balance, this may shift the expenditure components around but not materially impact the sector's output.

4.3.4. Overall macroeconomic impacts

Overall, based on the empirical evidence in the literature and the fact that the tax changes proposed by the States are expected to be accompanied by equivalent expenditure increases, this implies that **overall impacts to GDP growth will be limited and transitory** in nature as the economy restructures. Therefore, while GDP growth may not be impacted significantly in the long term, **there will be short-term transitory impacts associated with compliance costs, behavioural impacts and administration costs as businesses, individuals and government learn to navigate the new systems.** Furthermore, there may also be impacts associated with government expenditure being delayed, for example as a result of a labour shortage for healthcare professionals to fulfil the increased capacity resulting from greater expenditure. The **introduction of a GST at 5% is likely to impact price levels by approximately 3 percentage points**; however, it is expected that this will not have any long-term impact on inflation as price levels settle to a new base level after a year.

Whilst the overall level of economic activity in the jurisdiction is unlikely to be impacted significantly, the structure of the economy will likely change as a result of the tax changes and increased government expenditure. This may include a

[121] "Reflections on the introduction of Value Added Tax in the United Kingdom and Goods and Services Tax in New Zealand", available at: https://core.ac.uk/download/pdf/12824616.pdf

reduction in the size of sectors such as wholesale, retail, and repair, hostelry and transport and storage, and an expansion in the size of the health and care, and public administration sectors. Key industries such as financial services, and other professional, technical, business and scientific activities are unlikely to be adversely impacted.

With respect to employment, the key industries including **financial services, and other professional, technical, business and scientific activities are unlikely to be adversely impacted**. The **recessionary impact may be felt in the short term in industries such as construction, wholesale retail and repair, hostelry, and transport and storage**. However, even within some of these industries, some of the negative impacts may be counteracted considering that the government aims to spend some of the extra revenues raised from taxes on providing physical infrastructure in the jurisdiction. Furthermore, the structural changes in the economy may lead to an expansion in jobs, especially in the healthcare and public administration sector. These estimated impacts are summarised in Table 8 below, this is then mapped onto the policy options under consideration in Table 9.

Table 8: Overall impacts of individual tax increases and GST introduction

	Overall expected impacts of increases to individual tax	Introduction of a GST
Household consumption	short-term ⇩	Consumption brought forward, but no significant impact ⇔
GDP growth	short-term ⇩	No significant impact ⇔
Employment	short-term ⇩	No significant impact ⇔
Inflation	No significant impact ⇔	short-term ⇧

Table 9: Impacts of tax policy options

	Policy Option 1 (income tax based)	Policy Option 2 (GST based)	Policy Option 3 (GST and income based)
Household consumption	short-term ⇩	short-term ⬀ due to decreased level of income taxation	short-term ⬂
GDP growth	short-term ⇩	short-term ⬀ due to decreased level of income taxation	short-term ⬂
Employment	short-term ⇩	short-term ⬀ due to decreased level of income taxation	short-term ⬂
Inflation	⇔	short-term ⇧	short-term ⬀

4.4. Distributional Impact

4.4.1. Impact by quintile and household composition

Each of the potential illustrative tax changes considered will have varying impacts on different types of households. This section discusses the impacts of each of the proposed tax increases by quintile and household composition (as set out in Section 4.2). When examining the impact by income quintile, we consider impacts relative to total expenditure, essential expenditure and gross household income. As highlighted in Figure 20 in the Appendix, the lower quintiles spend a higher proportion of their expenditure on essential items. Given that such expenditure is less income elastic, seeing how the tax impact relative to essential expenditure is reflected across the quintiles is an indicator of progressivity. In addition, some elements of essential expenditure may be exempt in the policy options which include a GST thus making the view of tax impact relative to essential expenditure of interest.

4.4.1.1. Policy Option 1: 3% Health Tax and SSC restructure

Policy Option 1 involves the introduction of a 3% Health Tax administered in a similar fashion to PIT, along with an SSC restructure. The 3% Health Tax will impact all households whose taxable income is above the personal allowance threshold. The introduction of an SSC allowance will reduce the tax burden for those with lower incomes. The increased rates for employees will lead to greater tax payments as will the change in the nature of income treatment, which sees SSCs levied on all income rather than earnings from employment alone. Policy Option 1 also involves an automatic reduction in the level of income support as a result of the increase in income due to the introduction of a tax-free SSC allowance.

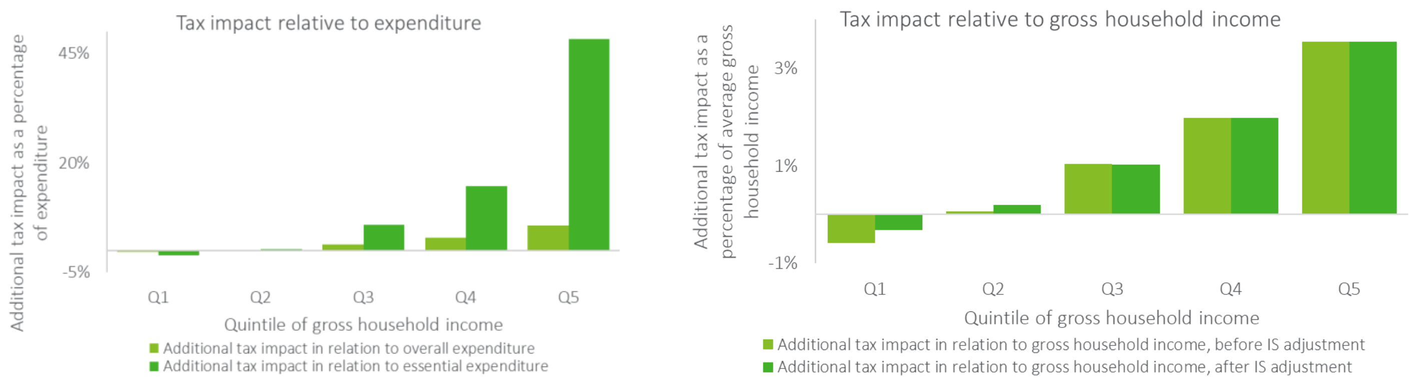
Figure 13 shows the impact of Policy Option 1 by income quintile relative to expenditure in the leftmost panel and relative to gross household income in the rightmost panel. The lighter bars in the left panel shows the impact by quintile relative to *overall* expenditure, the darker bars illustrate the impact relative to *essential* expenditure. The items classified as essential are food and non-alcoholic drinks and housing, fuel and power.

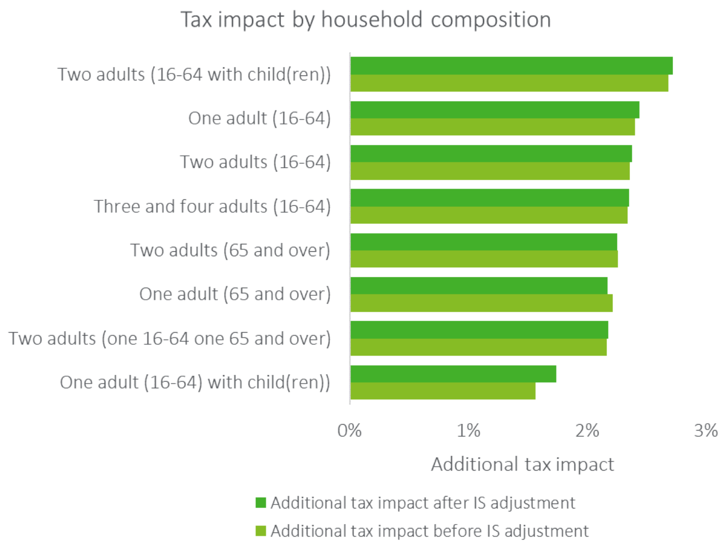
The lighter bars in the right panel show the impact as a share of gross household income before the adjustment in income support whereas the darker bar shows the impact after this adjustment. While residents only observe the impacts after the income support adjustment, it is useful to understand the impact of the tax levers themselves before the States' mitigating interventions.

In the left panel the y-axis shows the additional tax impact as a share of expenditure whereas the y-axis on the right panel shows the additional tax impact as a share of gross household income.

The final chart in Figure 13 shows the impacts by household composition before and after the income support adjustment.

Figure 13: Analysis of the additional tax impact of Policy Option 1





Source: Expenditure data from Guernsey Household Expenditure Survey Report, available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0. Household income data and tax impact data as provided by the States

Policy Option 1 is associated with a decrease in the tax take from those in the first quintile of the income distribution because of the benefit gained from the allowance on SSCs. For those in the second income quintile there is a marginal increase in their tax burden. **Policy Option 1 is therefore progressive as the proportionate tax impact relative to both income and expenditure is increasing with income.** For quintile 1, the tax impact after income support adjustment is -0.32% compared to 3.54% for quintile 5. The impact relative to essential expenditure is significantly greater than when compared to overall expenditure for those in the third, fourth and fifth income quintiles as a result of essential expenditure constituting a smaller share of total expenditure for these higher income households.

Under Option 1 there are no additional income support mitigations. As a result of the introduction of the SSC allowance the take-home income of lower income households is increased. This increase in take-home income results in the States making a lower level of income support payments, which offsets the impact of the SSC reduction. The impact of this automatic fiscal stabiliser from the income support adjustment is felt entirely by those in the first and second quintiles of income (as illustrated in the rightmost panel where the dark green bars pertain to greater values than the light green bars).

When the impact of Policy Option 1 is compared across the different household composition types, on a proportionate basis the greatest share of the burden is borne by two working age adult households with children, with the smallest impact coming for a household with one working age adult and children. Further, the automatic income support adjustment compounds this impact. The income support adjustment is only beneficial for households with one or two adults aged 65 and over.

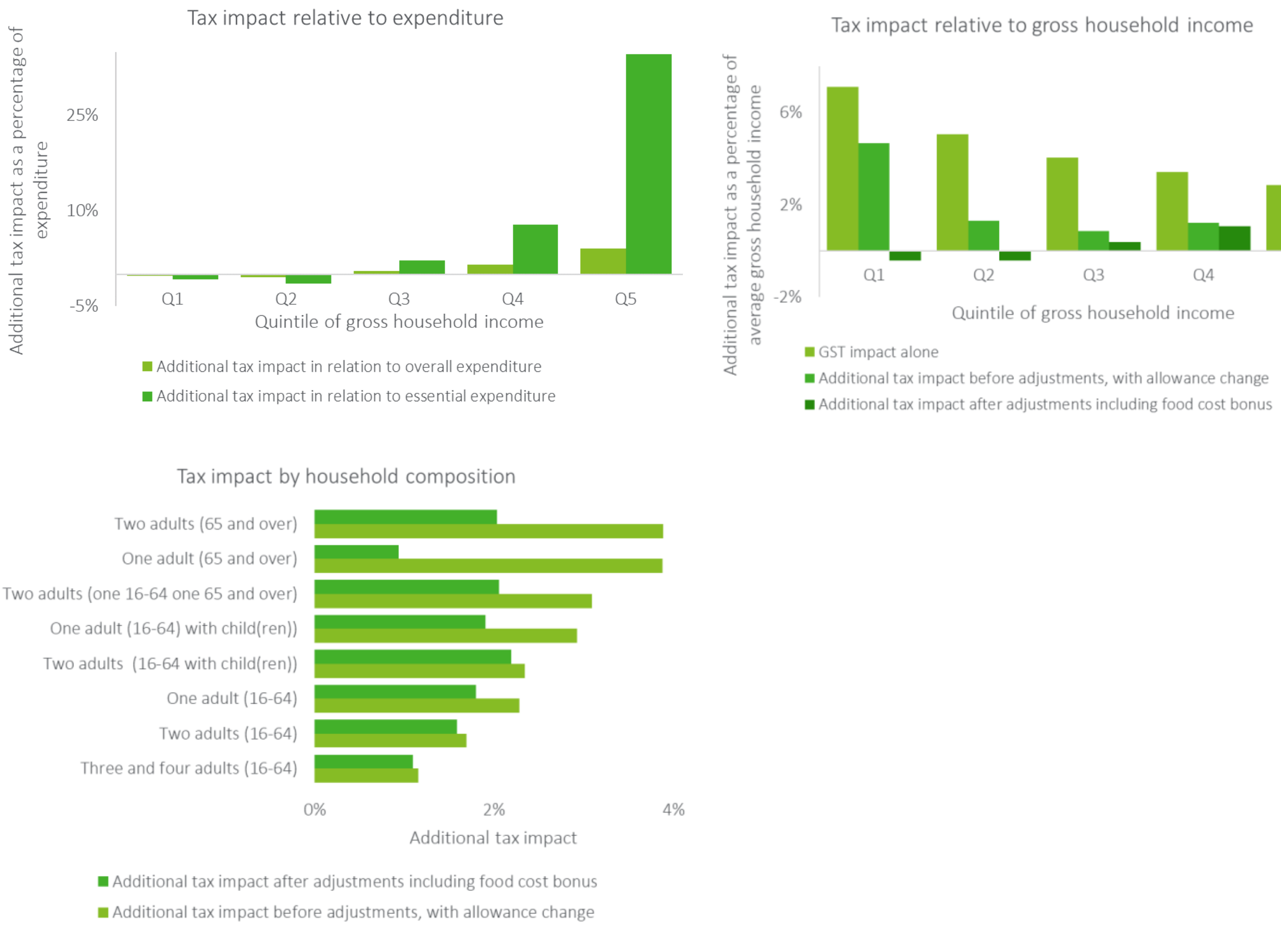
4.4.1.2. Policy Option 2: 8% GST, PIT allowance increase and SSC restructure

Policy Option 2 involves the introduction of a GST at 8% administered in a similar fashion to the GST in Jersey, along with an SSC restructure and an increase in the PIT allowance. The 8% GST will impact all households through its application to all eligible expenditure. The SSC restructure involves the introduction of an allowance in alignment with the PIT allowance and an increase in SSC rates.

Policy Option 2 also involves an automatic reduction in the level of income support as a result of the increase in income due to the introduction of a tax-free SSC allowance. The fact that the GST applies to all eligible expenditure means that it is potentially regressive. To alleviate this, the States of Guernsey have allocated £6m to £9m to increase income support for affected individuals and households and an additional allowance of £0.5m to £2.5m for further mitigation.

Figure 14 shows the impact of Policy Option 2 by income quintile relative to expenditure in the leftmost panel and relative to gross household income in the rightmost panel. The lighter bars in the left panel show the impact by quintile relative to *overall* expenditure, the darker bars illustrate the impact relative to *essential* expenditure. The lighter bars in the right panel show the impact as a share of gross household income for GST alone, the intermediately coloured bars also include the impact of the allowance change and change in the structure of SSCs and finally the darkest bars add to this the impact of offsetting adjustments. The final chart in Figure 14 shows the tax impacts by household composition before and after the income support adjustment.

Figure 14: Analysis of the additional tax impact of Policy Option 2



Source: Household income data and tax impact data as provided by the States & Expenditure data from Guernsey Household Expenditure Survey Report, available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0. Household income data and tax impact data as provided by the States

Policy Option 2 is associated with an increase in the tax take in income quintiles 3 to 5; however, those in income quintiles 1 and 2 would see a decrease in their tax burden. The tax impact as a share of both overall and essential expenditure is increasing along the income distribution. When the tax impact is assessed relative to essential spending, the proportionate impact increases more substantially for those in the fourth and particularly fifth quintiles. This occurs because essential expenditure is a smaller proportion of total expenditure for those in the upper echelons of the income distribution.

Policy Option 2 is progressive when analysed relative to gross household income and considered after the inclusion of mitigating measures. Quintile 1 has tax impact of -0.42% while the tax impact for quintile 5 is 2.54%. For those in income quintiles 1 and 2, the net effect of Option 2 is a decrease in their net tax burden. The GST in isolation (the lightest bar) is regressive such that the tax impact relative to gross household income is higher for those at the lower end of the income distribution. The other elements of Option 2, which include the increased PIT allowance and SSC allowance, help to alleviate the regressivity of Option 2. The main contributing factors to this are the increased PIT allowance, which reduces the tax burden for those in income quintiles two to four, and the offsetting measures for GST cost, which especially alleviate quintile one's tax burden. Those in income quintile five are less affected by the other elements of tax Policy Option 2. This is because of the tax cap and the proportionately smaller role that the withdrawal of tax allowances plays in their tax affairs.

The final bar in the rightmost graph shows the tax impact as a share of gross household income after also adjusting for the offsetting interventions by the States of Guernsey. On a proportionate basis, the impact of these offsetting interventions would be greatest for those in the lowest income quintile. The net effect of Policy Option 2 after mitigations is therefore that the tax impact as a proportion of gross household income increases along the income distribution.

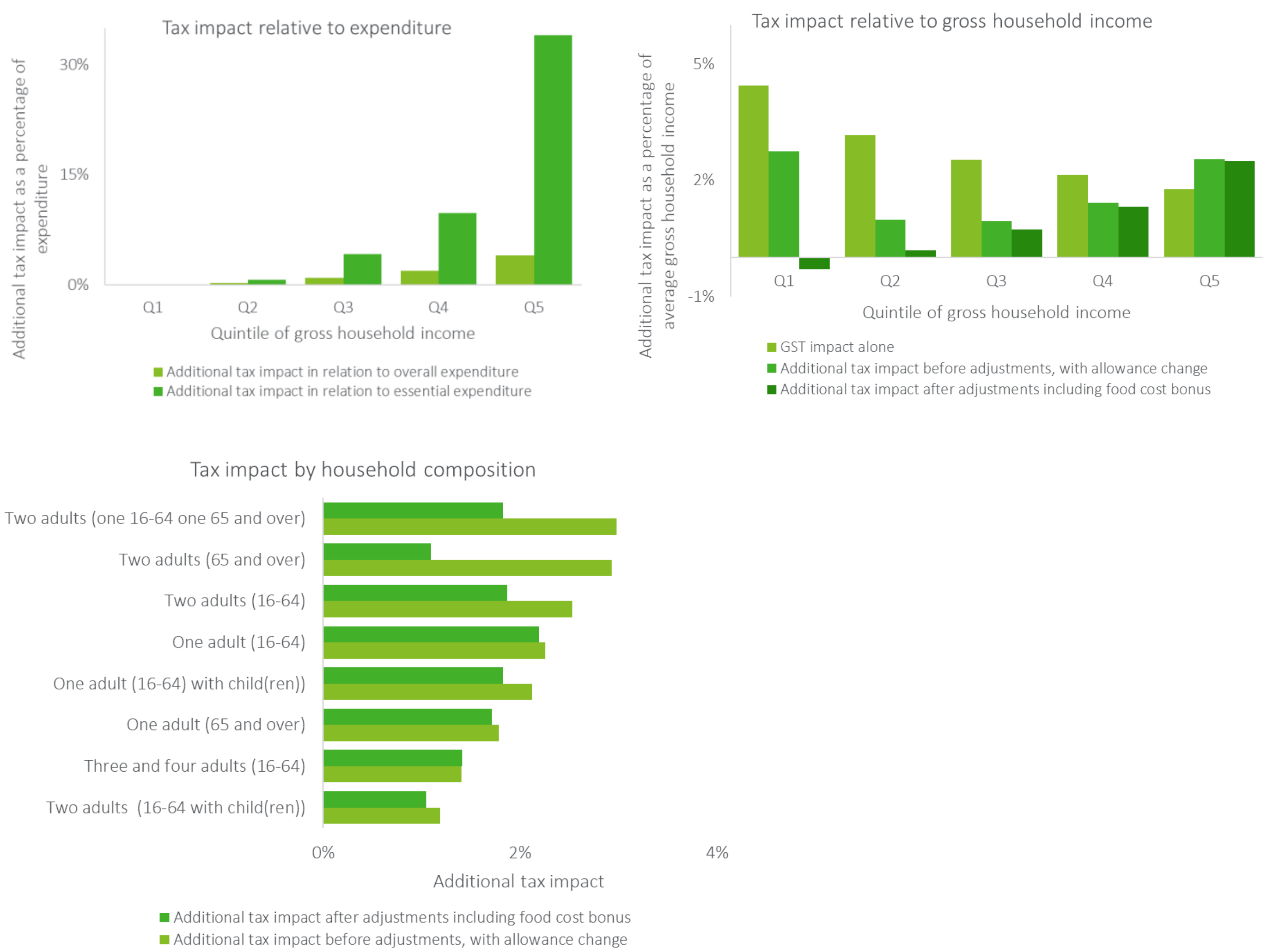
The final chart in Figure 14 shows the impact of Policy Option 2 across household types before adjustments (lighter bar) and post-adjustment (darker bar). The tax impacts before the adjustments are greatest for households containing adults aged 65 and over. However, these households benefit most from the adjustments bringing the impact to a level comparable to other household types. Households with one adult aged over 65 benefit particularly significantly from the adjustments. Prior to the adjustments they rank 2nd amongst household types in terms of impact magnitude and after the adjustments, the tax impact is smallest for this group.

4.4.1.3. Policy Option 3: 5% GST, PIT allowance increase and SSC restructure

Policy Option 3 involves the introduction of a GST at 5% administered in a similar fashion to the GST in Jersey, along with an SSC restructure and an increase in the PIT allowance. The 5% GST will impact all households through its application to all eligible expenditure. The introduction of an SSC allowance and increase in the PIT allowance will reduce the tax burden for those with lower incomes and the increased SSC rates for employees will lead to greater tax payments for these individuals as will the change in the nature of income treatment. Policy Option 3 also involves an automatic reduction in the level of income support as a result of the increase in income due to the introduction of a tax-free SSC allowance. The fact that the GST applies to all eligible expenditure means that it is potentially regressive. To alleviate this, the States of Guernsey have allocated £4m to £5m to increase income support for affected individuals and households and an allowance of £0.3m to £0.7m for additional mitigations.

Figure 15 shows the impact of Policy Option 3 by income quintile relative to expenditure in the leftmost panel and relative to gross household income in the rightmost panel. The lighter bars in the left panel show the impact by quintile relative to *overall* expenditure; the darker bars illustrate the impact relative to *essential* expenditure. The lighter bars in the right panel show the impact as a share of gross household income for GST alone, the intermediately coloured bar also includes the impact of the allowance change and change in the structure of SSCs and finally the darkest bar adds to this the offsetting adjustments. The final chart in Figure 15 shows the impacts by household composition before and after the income support adjustment.

Figure 15: Analysis of the additional tax impact of Policy Option 3



Source: Expenditure data from Guernsey Household Expenditure Survey Report, available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0. Household income data and tax impact data as provided by the States

Policy Option 3 is associated with an increase in the tax take from those in income quintiles 2 to 5; however, those in the lowest income quintile would see a decrease in their tax burden. The tax impact as a share of both overall and essential expenditure is increasing along the income distribution. When the tax impact is assessed relative to essential income the proportionate impact increases more substantially for those in the fourth and particularly fifth quintiles. This occurs because essential expenditure is a smaller proportion of total expenditure for those in the upper echelons of the income distribution.

The final (darkest) bar in the rightmost graph shows the tax impact as a share of gross household income after also adjusting for the offsetting interventions by the States of Guernsey. On a proportionate basis, the impact of these offsetting interventions would be greatest for those in the lowest income quintile. **After accounting for the adjustments, Policy Option 3 is progressive and for those in the lowest income quintile the tax burden would actually be *reduced*. The tax impact for quintile 1 is -0.30% while the tax impact for quintile 5 is 2.49%.**

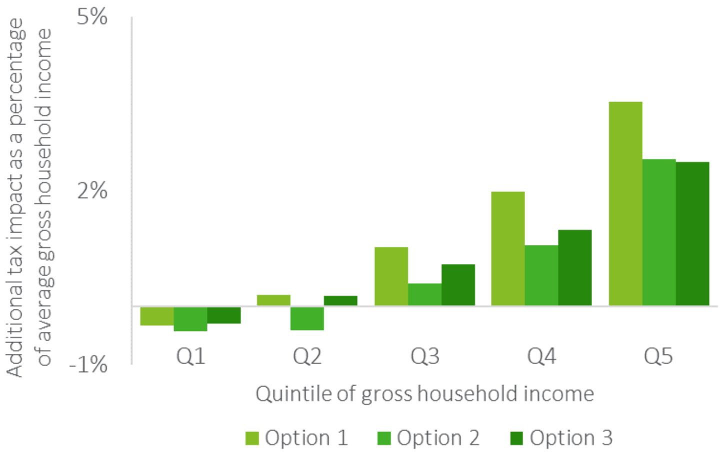
When the tax impact of Policy Option 3 is assessed relative to gross household income, the GST in isolation (the lightest bar) is regressive. This regressivity means that on a proportionate basis those in the first income quintile are more affected than those in the second, who are more affected by those in the third and so on. When the other changes included as part of Policy Option 3 are accounted for, the regressivity of the tax is reduced slightly for the fourth quintile but, in contrast, increased for the fifth quintile since the tax allowance change and mitigations such as income support have much less of an impact on their tax liability. Those in income quintiles one to three are most affected by the other elements of tax Policy Option 3 as they benefit from the change in allowance (more so in the case of second and third quintiles) and the additional mitigations (particularly the case of the first quintile).

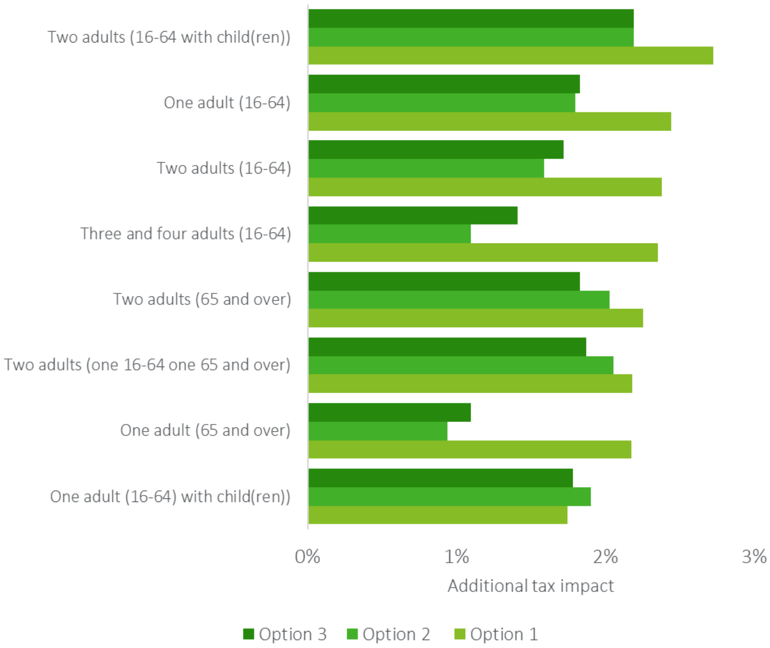
The final chart in Figure 15 shows the impact of Policy Option 3 across household types before adjustments (lighter bar) and post-adjustment (darker bar). The impact before the adjustments is greatest for multi-adult households containing individuals aged 65 and over. Two working-age adult households with children and households with three to four working-age adults are least affected. The adjustments have the largest impacts for the most affected households. In particular, households with two adults aged 65 and over benefit significantly from the adjustments, taking them from being the second most affected household group to the second least affected group. After adjustments, the most impacted household type is a household with only one working age adult.

4.4.1.4. Overall impacts of policy option, by income quintile

The purpose of this section is to facilitate easy comparison of the distributional consequences of the different policy options under consideration. The first chart in Figure 16 shows the tax impact across the income distribution relative to gross household income. The second chart in Figure 16 shows the tax impacts for the different types of household.

Figure 16: Impacts of policy options relative to gross household income





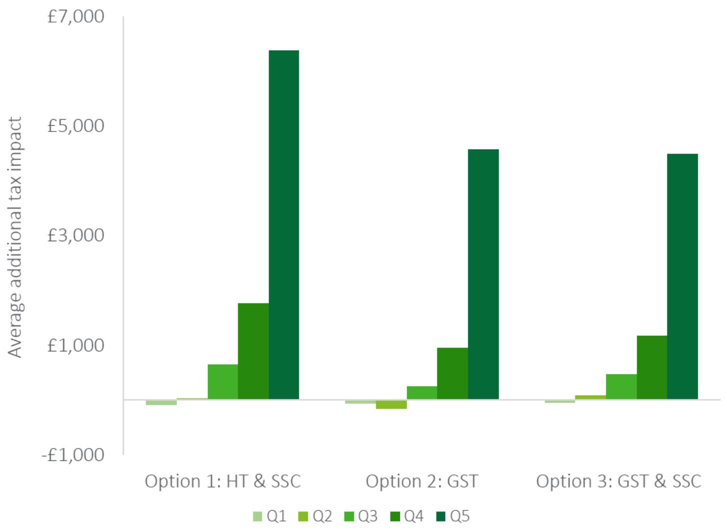
Source: Household income data and tax impact data as provided by the States

All three tax policy options are progressive, with Option 1 being the most progressive. Under all options, the most affected household type is a household with two working age adults with children.[122] There are numerous examples of notable changes in the magnitude of the tax impacts across the different household types. The impact for households containing a single adult aged 65 and over is significantly higher under Option 1, and this is also true for households with multiple working age adults without children. For the single pensioner households, this is because Options 2 and 3 include old age pension adjustments and pension support scheme along with the introduction of GST rates. The impact for single parent households is slightly greater under Option 2 compared to Options 1 and 3. Across the households, Option 1 has a higher tax impact than Options 2 and 3 as some of the revenue raised from the latter options are from tourist spend and the ISE scheme.

An additional view of the distributional impact of each tax policy option is shown in Figure 17 below, which illustrates the additional tax impact from each option by income quintile. For all options, the largest impact is seen in the fifth quintile, which includes those with the highest income levels. Each preceding quintile for Options 1 and 3 has less of a tax impact, meaning less tax liability. This is partly the same for Option 2, except in the case of the first and second quintiles; on average, quintile 2 results in less of a tax liability than quintile 1.

[122] These households have higher incomes on average across the household compositions.

Figure 17: Additional tax impact from each policy option by income quintile



Source: Household income data and tax impact data as provided by the States

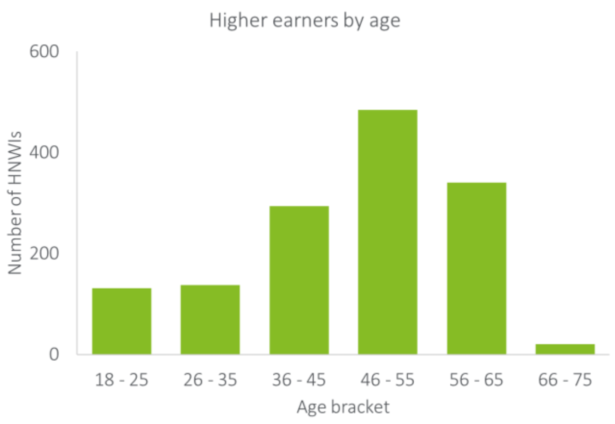
4.4.2. Higher Earners (Part of Top 5%)

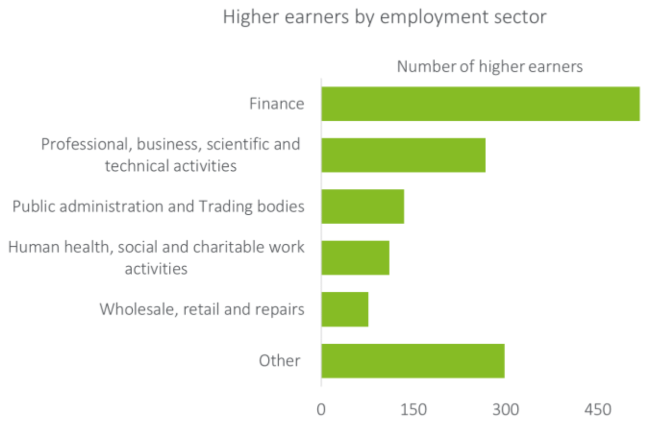
Of the illustrative tax changes being considered, the PIT changes would be most likely to impact higher earners. Impacts on higher earners are therefore considered in the context of the different policy options under consideration. Furthermore, the demographics of these higher earners are studied to discuss impacts to specific sectors in the scenario that these individuals move out of Guernsey.

4.4.2.1. Demographics of Higher Earners

Overall, a total of 1,406 higher earners have been identified from data on the top 5% of households in the income distribution, as provided by the States. These higher earners are employed and self-employed individuals in 1 to 4 person households and employed and self-employed individuals chosen from 5 to 6 person households based on aggregate household income reflecting a high number of higher earners. Almost 80% of these individuals are between 45 and 65 years of age. Furthermore, 56% of these higher earners are employed either in the finance sector or in the professional, business, scientific, and technical activities sectors. Their distribution by age and employment sectors is shown in Figure 18.

Figure 18: Distribution of higher earners by age and employment sectors (five largest)

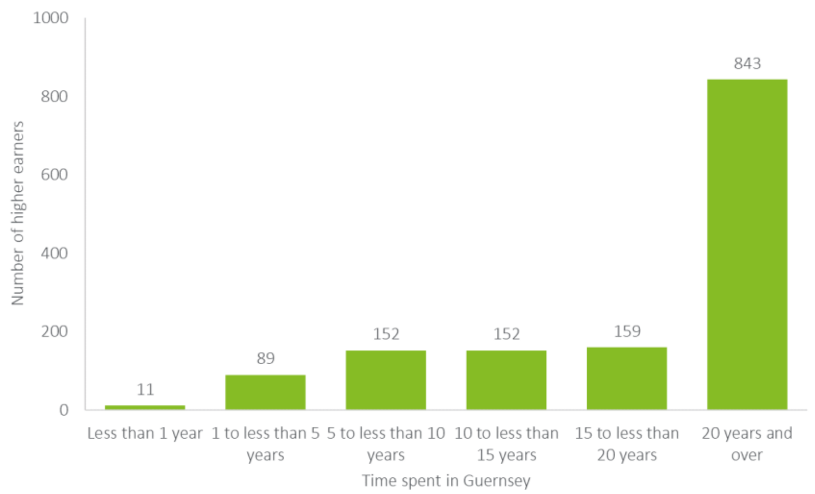




Source: Household income data for the top 5% of households as provided by the States

When looking at time spent resident in Guernsey, 60% of higher earners have spent over 20 years in Guernsey, and 82% of higher earners have spent over 10 years in Guernsey. Figure 19 shows the distribution by the amount of time spent in Guernsey.

Figure 19: Higher earners by time spent in Guernsey



Source: Household income data for the top 5% of households as provided by the States

4.4.2.2. Impact on income of higher earners as a result of proposed changes in income taxation

Overall, it is seen that the largest proportion of those individuals who are categorised as higher earners would see an **impact of 3% to 4% on their household income under Option 1 and impact of between 2% and 3% of household income under both Option 2 and Option 3.**[123] For the small number of individuals who make use of the States' tax cap this impact will be zero. Under each policy option the impact on higher earners is 5% or less for at least 80% of households. In the event that these tax changes are large enough to incentivise higher earners to relocate to minimise their income tax

[123] As individual income is not available, household income is used as a proxy. This is declared household income as individuals who pay the personal income tax (PIT) cap are not obligated to declare their full income. Thus, the impacts calculated may be an overestimation.

burden, the finance and professional activities sectors may be adversely impacted as they employ over 50% of the higher earners.

However, given the PIT ranges seen in comparable jurisdictions in the benchmarking analysis in Section 3, it is **unlikely that the tax changes illustrated here will lead to a material change in factors that make Guernsey an attractive location for some higher earners. For the few high net worth individuals who make use of the tax cap, their location choice is more likely to be sensitive to changes in the tax cap and capital taxes, which are unchanged for each of the options under consideration in this report**. Further, higher earners generally tend to be more adversely impacted by increases in capital gains taxes, which are not currently applied in Guernsey.

Considering the distribution of time spent in Guernsey, this may suggest that about 82% of higher earners have ties to the island which could make them less sensitive to tax reform. On this basis, the improvement of the health and care sector, as a result of the planned expenditure, relative to the counterfactual where the spending does not take place, will help to retain Guernsey's attractiveness as a jurisdiction of residence. This still leaves 18% of this group who may have a more limited local connection and could be fairly mobile and sensitive to their direct tax burden. Given their large contribution to the tax base, the loss of even a small number could be significant for the States. This also does not consider whether the changes in direct taxation may impact Guernsey's ability to attract such individuals in the first place. Higher earners differ from the high net worth individuals (HNWIs), which are much smaller in number, more mobile and would be most influenced by the tax cap and any taxes on capital.

Key Insights

Government revenue in Guernsey, before 2020 and the impacts of COVID-19, was 21.9% of GDP, which is lower than the States' target of 24%. The first element of the economic impact study presented in this report is to consider whether the illustrative tax reforms considered in this Interim Report would lead to a sufficient increase in government revenue.

The three tax reforms under consideration include changes to existing tax policy as well as the introduction of new forms of taxation. The first option involves the introduction of a 3% Health Tax administered in a similar fashion to PIT along with restructured (increased) SSC rates. The second option involves the introduction of an 8% GST administered in a manner similar to the GST in place in Jersey, along with a marked increase in the PIT allowance and restructured (increased) SSC rates. The third option involves the introduction of a 5% GST administered in a manner similar to the GST in place in Jersey, along with an increase in the PIT allowance and restructured (increased) SSC rates.

Implementing Policy Option 1, which is based on the Health Tax, would increase the ratio of tax revenue to GDP to 23.8% by 2026. If Policy Option 2, which is based on the GST, were implemented, it would increase the ratio of tax revenue to GDP to 24.1% by 2026. If Policy Option 3, which is a balance between relying on the GST and changes in SSCs, were implemented, it would increase the ratio of tax revenue to GDP to 24.0% by 2026. While the analysis presented in this report suggests that the policy options under consideration may be sufficient to lead to an increase in government revenue, there are also likely to be wider economic impacts associated with their introduction.

Increases in individual taxation (PIT, social security and Health Tax) will lead to a short-term decrease in household consumption, a short-term decrease in GDP growth, a short-term decrease in employment and have no impact on price levels. The introduction of a GST will lead to household consumption being brought forward but not with any significant total impact, no significant impact on GDP growth, no significant impact on employment and a short-term increase in inflation.

While the aggregate impacts of changes in taxation may be somewhat limited, the impacts for individual sectors and the distributional consequences of reform may be greater. Changing the higher rate of PIT is most progressive, while the impact of changing social security contributions and introducing a Health Tax is limited for those in the top income quintile as a result of the tax cap.

The GST is least progressive as the burden falls predominantly on lower income households; this impact has been mitigated in other jurisdictions by introducing accompanying compensatory policies. **When the impact of mitigations is included all policy options under consideration are found to be progressive in terms of expenditure or income and in absolute terms.**

82% of higher earners have spent more than 10 years in Guernsey, which, when combined with the position of Guernsey's tax regime relative to its benchmark jurisdictions, suggests that the reforms considered in this report are unlikely to be sufficient to result in a material change in the incentives of such higher earners. However, it could be the case that some individuals who are more mobile and have less significant ties or time spent in Guernsey may consider their position, and this would have wider consequences for the people that such individuals employ as well as their overall contributions to Guernsey's tax base.

5 Conclusion and next steps

Guernsey's current tax regime is broadly comparable to those of its benchmark jurisdictions and would continue to be so after accounting for the tax policy options considered in this report. Nevertheless, the options analysed will cause changes to Guernsey's tax regime across the different dimensions considered. The direction of these changes is specific to each option. The economic impacts of the tax policy options are likely to be transitory but may have important repercussions for certain sectors.

The States currently have an expected operating deficit of £64 million in 2020. The States are considering three tax policy options to increase revenues such that the States meet the future needs of their ageing population and are capable of the 24% of revenue to GDP target. This Report analyses the options put forward by the States, which include changes to their key tax levers. It does so by first benchmarking Guernsey's current tax regime and the tax regime that would prevail under each of the three options, relative to comparable jurisdictions, and second considering the economic impact of implementing these options to increase revenues.

The first tax policy option involves the introduction of a 3% Health Tax and a restructured social security contribution system with rate increases. The second option involves the introduction of a GST at a rate of 8% along with a social security contributions restructure. The third option involves the introduction of a GST at a rate of 5%, a social security contribution system restructure with rate increases. Outside the tax policy options analysed in this report, the States have provided the assumption applicable to MNEs in line with the OECD work-stream on corporate taxes, that changes to the CIT would raise an additional £10m in revenue. Importantly, with regard to Jersey and the Isle of Man, the States are likely to seek to maintain alignment and the comparative position would remain broadly the same.

The States have posited that the revenue raised by any one of the options chosen will be reinvested in the economy as a result of increasing demand for health and aged care. Based on this and the empirical evidence, **the considered tax levers' overall impacts on GDP growth may be limited and transitory in nature.** However, there may be impacts in the short term that are associated with government expenditure being delayed, for example as a result of a labour shortage for healthcare professionals required to increase capacity in the sector. It is also likely that the **economy will experience structural change** resulting from both changes to the tax system and increased government expenditure. Sectors such as **wholesale, retail, and repairs, and transport and storage may be negatively affected**, as household consumption is adversely impacted. By contrast, sectors such as **health and care and public administration may expand in line with increased spending necessary to maintain existing service levels.** Consideration may need to be given to investing in upskilling labour to support the labour market in transitioning to a restructured economy.

Any tax reforms are likely to be accompanied by adjustment costs, these costs will be more pronounced where new systems are being introduced, such as a GST in the case of Guernsey. Furthermore, the introduction of a GST itself **may increase price levels in the short-term** increasing prices by approximately 3 percentage points for Option 3 and even more so for Option 2, based on impacts observed in Jersey. However, this is expected to **not have any long-term impacts on inflation** as prices settle to a new baseline after a year.

As discussed in Section 3, **Guernsey currently raises less tax as a proportion of its GDP relative to some of the benchmark jurisdictions**. **Guernsey's position remains the same when all three options are considered**. Amongst the benchmark jurisdictions, **Guernsey is the only one that does not currently have a GST in place. However, Options 2 & 3 present a**

change to this as a result of introducing GST at different rates. Guernsey's GST contribution to total revenue would increase with both options, bringing Guernsey to the lower end of the benchmark range.

Guernsey's share of direct tax as a proportion of total tax revenue is currently the highest amongst the benchmark jurisdictions considered in this report. Option 1 would increase Guernsey's direct tax reliance, maintaining its position across the range. This is largely driven by the introduction of a 3% Health Tax charged in the same way as PIT but also by the increase in SSC rates and the broader SSC restructure. Options 2 & 3 would reduce Guernsey's direct tax reliance as a result of introducing a GST, with Option 2 causing change of a higher magnitude due to its higher GST rate.

Furthermore, depending on the taxes implemented, the impacts on different parts of the income distribution will vary. **Option 1 with the 3% Health Tax is the most progressive of the three tax policy options, with impact increasing from the first to fifth quintile.** This is a result of Guernsey's current PIT structure and the SSC restructure as part of Option 1 to match the current PIT structure.

The introduction of a GST could be regressive in nature without any accompanying mitigations, particularly as no essentials are being zero-rated or taxed at a lower rate. Attempts to mitigate this regressivity in other jurisdictions have been made by providing means-tested benefits to lower income households. **The States have included a change in the PIT and SSC allowance as well as mitigation measures such as a food cost support bonus to Options 2 and 3. As a result, the options involving a GST as presented by the states are progressive after making these adjustments.**

The impacts on higher earners have been studied in the context of each individual option. It is seen that higher earners are mostly employed in high-skilled sectors such as finance and that a large majority of them have spent over 10 years in Guernsey. Given the nature of their high-skilled employment, it is unlikely that the employment status of these individuals will be adversely impacted as a result of the structural changes in the economy given that changes in the marginal personal income tax rate are unlikely to be a significant factor when companies choose where to locate. **Furthermore, given that Guernsey's structures for capital gains tax, inheritance tax, and corporate tax are comparable to those of its benchmark jurisdictions, it is unlikely that the tax changes illustrated here will lead to a material change in factors which make Guernsey an attractive location for some higher earners. For some of the more mobile higher earners who may have weaker ties to the Island, the changes under consideration may cause them to reconsider their residence in Guernsey.** For the few high net worth individuals who make use of the tax cap, their location choice is more likely to be sensitive to changes in the tax cap and any taxes on capital.

Appendix

A1. Identification of higher earners

The States have provided us with household-level data for the top 5% of households by household income. To further classify these individuals as higher earners:

- The household income data provided by the States is first filtered by quintile 5 households only.
- This subset is then filtered by large household sizes and these households are examined to determine the validity of their inclusion in this sample.
- For the 7 to 11 person households in the distribution, when income per working individual was calculated, the values were quite small. These households therefore have a large household income as a result of several adults living in one household. These individuals from these households were all removed from the sample.
- For 5 and 6 person households, all individuals with employment status "Full Time Education", "Incapacitated", "Non-Employed", "Other", or "Unemployed" were removed. The remaining individuals were then manually categorised as higher earners or not based on household income.
- For 1 to 4 person households, all individuals with employment status "Full Time Education", "Incapacitated", "Non-Employed", "Other", or "Unemployed" were removed. The rest were all classified as higher earners as the remaining dataset was too large to manually sort.

A2. Figures and source data

- Figure 7:
  1. **Department of Statistics Singapore**, 'Gross Domestic Product at Current Prices, By Industry (SSIC 2015 Version 2018), Annual', available at: https://www.tablebuilder.singstat.gov.sg/
  2. **Statistics Portal Luxembourg,** 'National Accounts: Annual Accounts - Aggregates by branch: Gross value added by activity', available at: https://statistiques.public.lu/en/economy-finances/index.html
  3. **Isle of Man's National Income**, 'National Income Report 2018-19' - Banking, Insurance and Other Finance and Business Services computed to make up the Finance Sector, available at: https://www.gov.im/about-the-government/departments/cabinet-office/economic-affairs-division/national-income/
  4. **The States government website**, 'Supplementary GVA and GDP Data 2019', available at: https://www.gov.gg/gdp
  5. **Jersey's Open Data Website**, 'GVA in real terms in constant 2019 values', available at: https://opendata.gov.je/dataset/national-accounts

- Figure 8:
  1. **Department of Statistics Singapore**, 'Gross Domestic Product at Current Prices, By Industry (SSIC 2015 Version 2018), Annual', available at: https://www.tablebuilder.singstat.gov.sg/ & **Singapore Public Data**, 'IRAS' Collection by Tax Type Annual' and Singapore CPF website, 'CPF Statistics', available at: https://data.gov.sg/dataset/iras-collection-by-tax-type-annual & https://www.cpf.gov.sg/Members/AboutUs/about-us-info/cpf-statistics
  2. **Statistics Portal Luxembourg,** 'National Accounts: Annual Accounts- Main aggregates: three approaches (filter by production approach)' & 'Economy and finance: Public finances: Taxes and social benefits – Total General Government, available at: https://statistiques.public.lu/en/economy-finances/index.html
  3. **Isle of Man National Income webpage**, available at: https://www.gov.im/about-the-government/departments/cabinet-office/economic-affairs-division/national-income/ **& Isle of Man in Numbers**, 'Isle of Man in Numbers 2020: Treasury Receipts', available at: https://www.gov.im/about-the-government/government/open-data/economy/

4. **The States of Guernsey Annual GVA And GDP Bulletin 2019**, available at: https://www.gov.gg/gdp & tax data from the States
5. States **Jersey's Open Data Website**, 'Annual income, expenditure and reserves', 'Contributions and the States Grant to the Social Security Fund' & 'GDP in real terms in constant 2019 values', available at: https://opendata.gov.je/organization/statistics

- Figure 10:
  1. **Introduction of GST in Jersey in May 2008 : Jersey 2005 Fiscal Strategy**, available at: https://statesassembly.gov.je/AssemblyPropositions/2005/14968-27446-832005.pdf**, Jersey 2008 Financial Report and Accounts**, available at: https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/FD%20SOJAccounts2008%2020090529%20TR.pdf, **Jersey September 2008 Retail Prices Index Report**, available at: https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/FD%20SOJAccounts2008%2020090529%20TR.pdf, **Jersey June 2009 Retail Prices Index Report**, available at: https://www.gov.je/SiteCollectionDocuments/Government and administration/R RetailPricesIndexJun09 20090715 SU.pdf, **Jersey government website ISE information**, available at: https://www.gov.je/TaxesMoney/GST/InternationalServiceEntities/Pages/Registration.aspx
  2. **Increase in Jersey's GST in June 2011: Jersey government website tax receipts**, available at: https://www.gov.je/Government/JerseyInFigures/GovernmentAccounts/Pages/TaxReceipts.aspx#anchor-1 **, Jersey June 2012 Retail Prices Index Report**, available at: https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20RPIJune2012%2020120720%20SU.pdf
  3. **Introduction of Long-Term Care Charge in Jersey in 2015: Jersey government website long-term care scheme page**, available at: https://www.gov.je/Benefits/LongTermCare/Pages/LongTermCareAbout.aspx, **General information on Jersey's long-term care scheme**, available at: https://www.gov.je/SiteCollectionDocuments/Benefits%20and%20financial%20support/LTC%20General%20Information%20Booklet%2020170417%20JJ.pdf**, Combination of Long-Term Care Fund data from States of Jersey Financial Report and Accounts 2015, States of Jersey Annual Report and Accounts for 2017, and 2019 Annual Report and Accounts**, available at https://www.gov.je/Government/PlanningPerformance/BudgetAccounts/Pages/StatesofJerseyAccounts.aspx, **Jersey 2018 review of the long-term care scheme**, available at: https://statesassembly.gov.je/scrutinyreports/2018/report%20-%20long-term%20care%20scheme%20-%2028%20march%202018.pdf
  4. **Increase in Singapore Top Tax Rate in 2015: National Archives of Singapore - 2015 budget**, available at: https://www.nas.gov.sg/archivesonline/data/pdfdoc/20150302005/fy2015_budget__statement_(20150223_2000hrs).pdf, **Singapore Public Data, 'IRAS' Collection by Tax Type Annual' and Singapore CPF website, 'CPF Statistics'**, available at https://data.gov.sg/dataset/iras-collection-by-tax-type-annual & https://www.cpf.gov.sg/Members/AboutUs/about-us-info/cpf-statistics

- Table 3:
  1. **The States: PIT rate** https://www.gov.gg/tax**, social security rate** https://www.gov.gg/SScontributions**, CIT rate** https://www.locateguernsey.com/your-business/tax/
  2. **Jersey: PIT rate** https://www.gov.je/TaxesMoney/IncomeTax/Individuals/PayingTaxEarnings/Pages/CalculatingTaxAssessment.aspx , **social security** https://www.gov.je/Working/Contributions/Pages/ContributionLevels.aspx**, Health Tax (long-term care charge)** https://www.gov.je/Benefits/LongTermCare/Pages/LongTermCareContributions.aspx**, GST rate** https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/GSTQuickGuide.aspx & https://www.gov.je/TaxesMoney/GST/InternationalServiceEntities/Pages/Understanding.aspx**, CIT rate** https://www.gov.je/taxesmoney/incometax/companies/historiccompanyguidancenotes/pages/2018companytaxreturnguidancenotes.aspx
  3. **Isle of Man: PIT rate and social security (national insurance)** https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/individuals/residents/rates-and-allowances/, **GST rate**

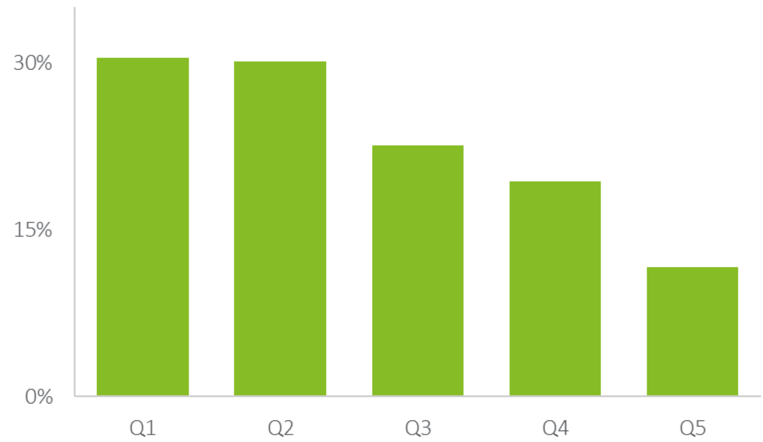
https://www.gov.im/categories/tax-vat-and-your-money/customs-and-excise/technical-information-vat-duty-and-interest-rates/vat-rates/, **CIT rate** https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/business-and-corporations/

4. **Singapore: PIT rate** https://www.iras.gov.sg/irashome/Individuals/Locals/Working-Out-Your-Taxes/Income-Tax-Rates/, **social security (CPF) rate** https://www.cpf.gov.sg/Employers/EmployerGuides/employer-guides/paying-cpf-contributions/cpf-contribution-and-allocation-rates, **GST rate** https://www.iras.gov.sg/irashome/GST/GST-registered-businesses/Learning-the-basics/Goods-and-Services-Tax--GST---What-It-Is-and-How-It-Works/, **CIT rate** https://www.iras.gov.sg/irashome/Quick-Links/Tax-Rates/Corporate-Tax-Rates/,
5. **Luxembourg: PIT rate and social security** https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/tax/lu-individual-pocket-tax-guide.pdf, **GST rate** https://guichet.public.lu/en/entreprises/fiscalite/tva/notions/tva.html, **CIT rate** https://guichet.public.lu/en/entreprises/fiscalite/impots-benefices/benefices-soc-capitaux/impot-revenu-collectivites.html & **net wealth tax** https://www.parfigroup.eu/luxembourg-corporate-tax-guide/#_ftn1

- Table 10:
    1. **Jersey government website**, 'GST taxed on goods and services' & 'Registering your business for GST', available at: https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/GSTQuickGuide.aspx & https://www.gov.je/TaxesMoney/GST/Businesses/Registration/Pages/ShouldIBe.aspx
    2. **Isle of Man government website** 'VAT rates' and 'Registering for VAT', available at: https://www.gov.im/categories/tax-vat-and-your-money/customs-and-excise/technical-information-vat-duty-and-interest-rates/vat-rates/
    3. **Luxembourg government website and VAT details**, available at: https://guichet.public.lu/en/entreprises/fiscalite/tva.html & https://www.taxexpense.com/luxembourg-taxes/luxembourg-vat-gst-sales-tax
    4. **Singapore government agency website**, available at: https://www.iras.gov.sg/IRASHome/GST/Non-GST-registered-businesses/Learning-the-basics/How-GST-Works/
    5. **New Zealand Inland Revenue website,** available at: https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir300---ir399/ir375/ir375-2021.pdf

A3. Other Figures and Tables

Figure 20: Proportion of total expenditure spent on essentials



Source: Expenditure data from Guernsey Household Expenditure Survey Report, available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0.

Table 10 below details the GST rates applied to each jurisdiction alongside a summary of some other GST treatments. It also highlights the exemption of financial services, which is important to each of these jurisdictions' economies.

Table 10: GST rates, zero ratings, exemptions and business threshold for each jurisdiction

	Jersey	Isle of Man	Luxembourg	Singapore	New Zealand
Standard Rate	5%	20%	17%	7%	15%
Other Rates	-	5% Children's car seats, home energy, domestic property repairs and accommodation provided by hotels	14% - Certain wines, solid mineral fuels, washing and cleaning products 8% - shoes and leather goods, clothing, household linen and hairdressing; 3% - Foodstuffs, soft drinks, children's clothing and footwear		-
Zero rated items	Exports of goods, housing, international services	Exports, most food and children's clothes, books and newspapers	Intra-community supplies, international transport and exports	Exports of goods and provision of international services	Exports, sales of ongoing business, sale of land
Exemptions	Financial services, insurance, postal services, medical and paramedical supplies made by registered professionals or institutions, registered childcare, school fees, supplies by charities, some burial and cremation services	Postage stamps, financial and property transactions	Medical services, health services, supplies of postage, welfare services, education and financial services	Sale and lease of residential land and financial services	Financial services, donations, private rent sale of private property and penalty interest
Business threshold	£300,000	£85,000	€35,000 (£30,435)	SGD 1 million (£543,478)	NZD 60,000 (£31234)

Source: See Appendix A2 Table 10, the exchange rates used for business threshold values were £1 = €1.15, £1 = SGD 1.84, and £1 = NZD 1.92, all calculated on the 28th April 2021

B1. References

Bastani, S and Waldenström, D. (2020). "Capital taxation: A survey of evidence", available at: https://voxeu.org/article/capital-taxation-survey-evidence/2018/report%20-%20long-term%20care%20scheme%20-%2028%20march%202018.pdf

Bolton, T. and Dollery, B. (2004). "An Empirical Note on the Comparative Macroeconomic Effects of the GST in Australia, Canada and New Zealand", available at: https://www.une.edu.au/__data/assets/pdf_file/0006/67947/econ-2004-17.pdf

Breen, J., Bergin-Seers, S., Roberts, I. and Sims, R. (2002). "The Impact of the Introduction of the GST on Small Business in Australia", available at: https://www.emerald.com/insight/content/doi/10.1108/eb060751/full/html

Bumpei, M. (2011). "The Effect of the VAT Rate Change on Aggregate Consumption and Economic Growth", available at: https://academiccommons.columbia.edu/doi/10.7916/D86W9JX0/download

Channel Islands Brussels Office. (2016). “The Channel Islands and the EU – Financial Services”, available at: https://www.channelislands.eu/wp-content/uploads/2011/12/FS-background-note-September-2016.pdf

Charlet, A. and Owens, J. (2010). “An International Perspective on VAT”, available at: https://www.oecd.org/ctp/consumption/46073502.pdf

Dickson, I. and White, D. (2008). “Tax Design Insights from the New Zealand Goods and Services Tax (GST)) Model”, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2046352

European Commission. (2019). “VAT refunds and reimbursements: A quantitative and qualitative study”, available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/20190620_final_report_vat_reimbursements.pdf

Favero, C. and Givazzi, F. (2009). “How Large Are the Effects of Tax Changes”, available at: https://www.researchgate.net/publication/46474949_How_Large_Are_the_Effects_of_Tax_Changes

González-Páramo, J. and Melguizo, Á. (2013). “Who really pays social security contributions and labour taxes?” available at: https://voxeu.org/article/who-really-pays-social-security-contributions-and-labour-taxes

Goudswaard, K. and Caminada, K. (2016). “Social security contributions: Economic and public finance considerations”, available at: https://www.researchgate.net/publication/297713926_Social_security_contributions_Economic_and_public_finance_considerations

Guajardo, J., Leigh, D. and Pescatori, A. (2014). “Expansion Austerity? International Evidence”, available at: https://onlinelibrary.wiley.com/doi/abs/10.1111/jeea.12083

Hungerford, T. (2012). “The economic effects of capital gains taxation”, available at: https://www.researchgate.net/publication/293267376_The_economic_effects_of_capital_gains_taxation

International Bureau of Fiscal Documentation. (1998). “Value Added Tax Policy and Implementation in Singapore”, available at: https://cri-world.com/publications/qed_dp_128.pdf

International Monetary Fund. (2017). “How Buoyant is the Tax System? New Evidence from a Large Heterogeneous Panel”, available at: https://www.imf.org/~/media/Files/Publications/WP/wp1704.ashx

International Monetary Fund. (2019). “The Value Added Tax and Growth: Design Matters”, available at: https://www.imf.org/~/media/Files/Publications/WP/2019/WPIEA2019096.ashx

James, S. and Alley, C. (2009). “Reflections on the introduction of Value Added Tax in the United Kingdom and Goods and Services Tax in New Zealand”, available at: https://core.ac.uk/download/pdf/12824616.pdf

Maples, A. and Sawyer, A. (2017). “The New Zealand GST and its Global Impact 30 Years On”, available at: https://www.researchgate.net/publication/315782694_The_New_Zealand_GST_and_its_Global_Impact_30_Years_On

Nguyen, A., Onnis, L. and Rossi, R. (2017). “The Macroeconomic Effects of Income and Consumption Tax Changes”, available at: https://ideas.repec.org/p/shf/wpaper/2017008.html

Organisation for Economic Co-operation and Development. (2020). “Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues”, available at: https://www.oecd-ilibrary.org/sites/152def2d-en/index.html?itemId=/content/publication/152def2d-en

Organisation for Economic Co-operation and Development. (2020). “Revenue Statistics 2020”, available at: https://www.oecd-ilibrary.org/sites/8625f8e5-en/index.html?itemId=/content/publication/8625f8e5-en

Organisation for Economic Co-operation and Development. (1997). “Taxation and Economic Performance”, available at: https://www.oecd-ilibrary.org/economics/taxation-and-economic-performance_668811115745

Organisation for Economic Co-operation and Development. (2008). "Taxation and Economic Growth", available at: https://www.oecd-ilibrary.org/economics/taxation-and-economic-growth_241216205486

Piketty, T., Saez, E. and Stantcheva, S. (2011). "Optimal Taxation of Top Labour Incomes: A Tale of Three Elasticities", available at: https://www.nber.org/system/files/working_papers/w17616/w17616.pdf

Reserve Bank of New Zealand. (1989). "Causes of the Fall in Inflation: 1985-88", available at: https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Bulletins/1989/1989sep52-3hodgettsclements.pdf?revision=949a0e34-7253-41e1-90c6-642d15bdd24e

Romer, C. and Romer, D. (2007). "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks", available at: https://www.nber.org/system/files/working_papers/w13264/w13264.pdf

The States, "Provisional Financial Position 2020" [Received: 26th March 2021]

The States. (2019). "2019 Actuarial Review of Guernsey Insurance Fund", available at: https://gov.gg/CHttpHandler.ashx?id=135485&p=0

The States. (2019). "The Review of the Fiscal Policy Framework and Fiscal Pressures", available at: https://www.gov.gg/CHttpHandler.ashx?id=122178&p=0

The States. (2020). "Guernsey Annual GVA and GDP Bulletin", available at: https://gov.gg/CHttpHandler.ashx?id=133037&p=0

The States. (2020). "Guernsey Facts and Figures", available at: https://www.gov.gg/CHttpHandler.ashx?id=131184&p=0

The States. (2020). "Household Expenditure Survey 2018-2019 Report", available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0

States of Jersey. (2018). "Health and Social Security Scrutiny Panel - The Long-Term Care Scheme", available at: https://statesassembly.gov.je/scrutinyreports/2018/report%20-%20long-term%20care%20scheme%20-%2028%20march%202018.pdf

States of Jersey. (2008). "Long-term care for older people in Jersey", available at: https://statesassembly.gov.je/scrutinyreviewresearches/2008/s-31498-29419-10122008.pdf

Tait, A. (1991). "Value-Added Tax: Administrative and Policy Issues", available at: https://asean.elibrary.imf.org/view/IMF084/07774-9781557751843/07774-9781557751843/ch01.xml

Valadkhani, A. and Layton, A. (2004). "Quantifying the Effect of GST on Inflation in Australia's Capital Cities: An Intervention Analysis", available at: http://eprints.qut.edu.au/423/1/Valadkhani_153.pd

Deloitte.

Appendix 3. States of Guernsey Strategic Tax Review: Review of Corporate Tax Options

States of Guernsey Strategic Tax Review: Review of Corporate Tax Options

30 September 2022

Building a better working world

Contents

Executive Summary

Background

This study was commissioned by the Government of Guernsey as part of the Strategic Tax Review. The purpose of the report is to assess the extent to which various changes to the Corporate Income Tax system could contribute to the sustainability of Guernsey's overall tax receipts.

The current environment in Guernsey

Guernsey's economy is dominated by the Finance sector, which accounts for some 40% of the total GVA of the economy (2019 figures). Within that sector, the bulk of GVA is created by the funds sector (41%), followed by fiduciary (18%), banking (24%) and insurance (11%).

The current tax system

Guernsey's current Corporate Income Tax system is designed to raise tax revenues in a manner which maintains Guernsey's economic competitiveness while being compliant with international tax norms including the European Union's Code of Conduct on Business Taxation.

In 2019, Guernsey's Corporate Income Tax collected £62.3m (with a further £10.2m being raised through personal income tax on Distributed Profits). Within that total, the *Finance* sector accounted for 78% of all corporate income tax revenue. Within the *Finance* sector, the top three sub-sectors (*Private and other banking*, *Domestic retail banking* and other *Holding companies)*, accounted for about 60% of corporate income tax receipts. Within non-finance sectors, the top three sub-sectors were *Wholesale, retail and repairs*, *Rental property* and *Information and communication*. They accounted for 12% of corporate income tax.

Behavioural responses to tax changes

The key risk in any reform to Corporate Income Tax is that companies will respond to increased taxation by relocating business to other jurisdictions. An analysis of elasticities shows that companies in the Finance sector would display the greatest propensity to move when faced with increased tax cost. For a low-tax economy which is heavily dependent on the Finance sector, such as Guernsey, this raises the risk that companies, faced with a new or additional tax charge might relocate to other locations, reducing the economy of Guernsey.

In addition to the elasticities analysis, this study estimates the expected second round effects of changes in activity in the Finance sector on other sectors including supply chain impacts on professional services and impacts of reduced consumer spending.

Developing options for reform

The starting point for the current study was the identification of three potential reform options, being:

- A Territorial Corporate Tax regime
- A worldwide Corporate Tax regime
- A flat rate levy or charge

Initial analysis of the options revealed that in, the context of the Guernsey economy, a worldwide regime would be practically indistinguishable from a Territorial regime (given the broad absence of foreign branches of Guernsey companies).

In addition, an option was developed to raise additional revenue through the existing 0/10/20 regime. A further sub-option of the Territorial regime was also developed in order to test the impact of excluding "red line" finance sectors from changes proposed under the options.

Modelling outcomes and economic impacts

Consequently, the following options were modelled:

- Option 1: maintaining the 0/10/20 structure but increasing the tax rate to 20% for selected sectors
- Option 2: a territorial regime with a headline rate of 15%, with the “red line” financial sectors not being subject to an increased rate
- Option 2a: a territorial regime with a headline rate of 15%, with the “red line” financial sectors included in the tax base
- Option 4: a flat-rate levy.

Summary of impacts

Table 1: Summary of impacts

Source: EY analysis

Option	Tax impact	GVA impact	
Option 1	£19.2m	(£40.1m)	(1.3%)
Option 2	£18.4m	(£34.3m)	(1.1%)
Option 2a	£9.1m	(£352.7m)	(11.1%)
Option 4	£16 – 20m		

Assessment of the options

Revenue raising

All four options have the capacity to raise additional revenues. However, this increase in tax receipts will result in inevitable reductions in GVA.

In the context of the future tax regime for Guernsey, it should be noted that the examples given here represent approximately a quarter of the capacity that the government is looking to raise. Finally, some revenue under these reforms will be generated from companies with global revenues in excess of €750m, and as such could in the future be taxed under the Global Minimum Tax proposed under “Pillar 2” of the Inclusive Framework on Base Erosion and Profit Shifting (which we understand led to the working assumption by the government of Guernsey as being of the order of £10m).

Compliance with the Code of Conduct

All of the options could be designed to avoid straying clearly into non-compliant territory. Option 1, by retaining the current 0/10/20 structure, is unlikely to disrupt the current regime’s “compliant” status. The move to a territorial regime would also be likely to be compliant, but also to result in a reassessment of Guernsey by the Code of Conduct Group which could lead to some time spent on the “grey list” while the process was finalised. Option 4 should be seen as outside the scope of Code of Conduct.

Impact on competitiveness

Guernsey’s competitiveness as an international financial centre rests on a range of factors which are not all directly impacted by changes to the tax system. The impact of tax changes under these options are designed to be minimal in the case of Option 1 and will potentially be significant under Option 2. While Option 4 is not a tax option, since it raised revenues, it will increase the cost of doing business in Guernsey. The design and implementation of the increase should be carefully managed with a view to ensuring that these costs are not sufficiently material to trigger behavioural change. It is, in general, good practice to consult with industry stakeholders before proceeding to the policy development stage of the Strategic Review.

Conclusions

In the context of the Strategic Review, Corporate Income Tax options have the capacity to deliver additional tax revenue in ways which should not stray clearly into non-compliant territory under the Code of Conduct. As such, the key focus of further work on Corporate Income Tax options would be on their competitiveness impact and their fit with Guernsey's wider tax strategy.

1. Introduction

This report has been produced as a contribution to Guernsey's Strategic Tax Review and in response to the Request for Quotation[1] ("RFQ") issued on 7 March 2022. In the RFQ, the States of Guernsey ("Guernsey") requested an independent analysis of three tax policy options to raise additional sustainable revenues from the taxation of company profits, along with the identification of strengths and weaknesses of those options.

1.1 The options for reform

The options set out in the RfQ were:

1. A territorial regime, conditional on meeting substance requirements
2. A worldwide regime, with a headline rate at a material rate, such as 9%
3. A low rate or fixed amount of tax payable by every company operating in Guernsey, thereby ensuring that a minimum amount is paid by every company

Additionally, EY was invited to recommend alternative options that might be a potentially suitable fit for Guernsey.

These initial options were refined and agreed with the Policy and Resources Committee, as described further in Section 4.

1.2 The scope of this report

The fundamental questions which the report seeks to answer are:

- How much would a change in Corporate Income Tax raise and how would this compare to the amount specified as needed to meet Guernsey's long-term needs?

- What impact would a reformed Corporate Income Tax have on Guernsey's international competitiveness as a financial centre

- What impact would a reformed Corporate Income Tax have on Guernsey's compliance with international and other standards, such as those set by the EU's Code of Conduct Group.

[1] States of Guernsey Strategic Tax Review - Independent analysis on corporate tax options

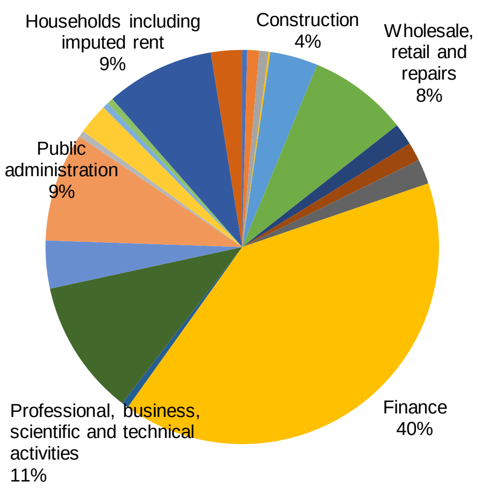
2. Current environment in Guernsey

In order to consider the impact of any policy options, it was important to obtain a clear articulation of the current state of the economic environment in Guernsey. Access was provided to aggregated economic information and used to create a model of the economy, against which various options could be tested. This Section sets out the "shape" of the economy as it has been captured within the model.

2.1 The economic environment

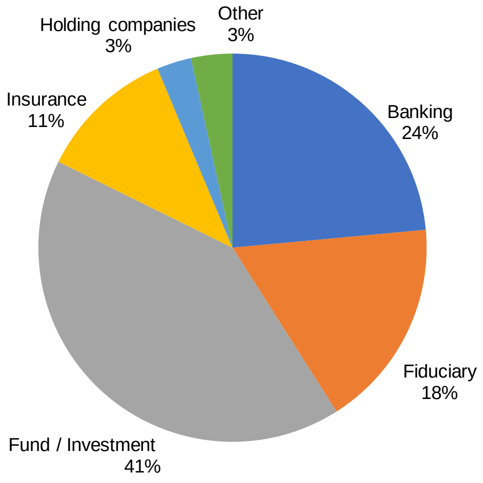
To understand what is driving economic activity in Guernsey, contributions to Gross Value Add ("GVA") by key sectors were analysed.

Figure 1: Composition of Guernsey GVA by key sectors in 2019



Source: States of Guernsey

Figure 2: Composition of the Finance sector GVA in Guernsey by sub-sector in 2019



Source: States of Guernsey

Guernsey's economy is dominated by the Finance sector, which accounted for 40.1% (£1.3b) of total GVA in 2019[2]. Funds/Investment is the largest sub-sector within Finance, followed by Banking and Fiduciaries.

Other sectors making substantial contributions to GVA are:

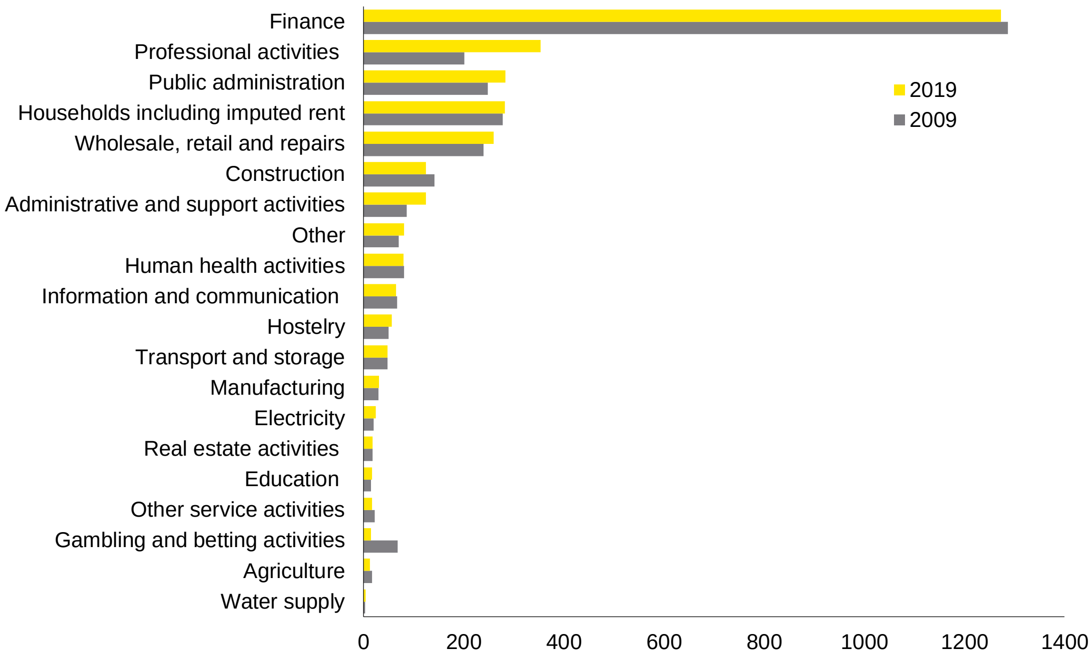
- Professional, business, scientific and technical activities at 11.2%,
- Public administration at 8.9%,
- Households including imputed rent at 8.9% and
- Wholesale, retail and repairs at 8.2%

Professional, business, scientific and technical services include accounting and legal services, and a large proportion of their activity supports the financial services sector.

To consider how the composition of Guernsey's economy has developed over time, a comparison has been made with GVA in 2009 (see Figure 3).

[2] 2019 has been selected as a reference year for the analysis as 2020 was disrupted by the impact of the COVID pandemic on the economic activity.

Figure 3: Composition of Guernsey GVA by sector in 2009 and 2019 (£k 2019 prices)

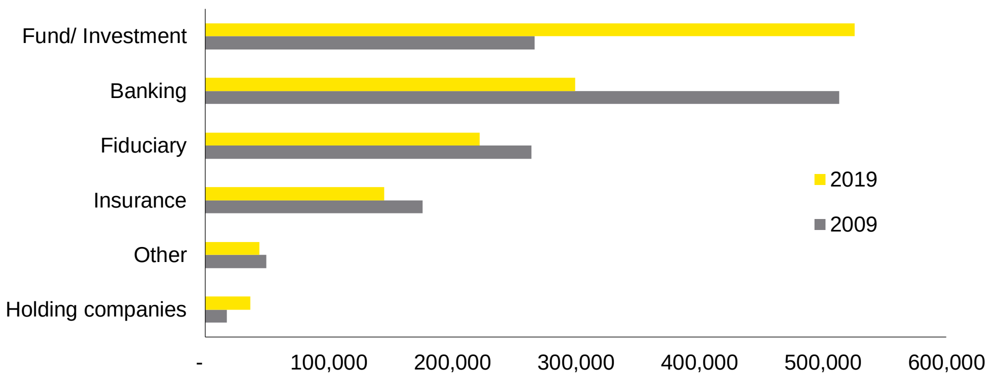


Source: States of Guernsey

The sector that saw the most growth during the ten years to 2019 was Professional, business, scientific and technical activities, which expanded by 75.8% in real terms (£153m in 2019 prices). During the same period, the Finance sector saw a slight decline, with its contribution to total GVA falling by 1.1% in real terms (£14m in 2019 prices).

The evolution of GVA of the Finance sector in Guernsey between 2009 and 2019 is presented on Figure 4 below.

Figure 4: Composition of Guernsey GVA within Finance sector in 2009 and 2019 (£k 2019 prices)



Source: States of Guernsey

The contraction in GVA of the Finance sector is caused by a decline in Banking by 41% in real terms (£214m in 2019 prices) due to the global contraction in banking activity and persistent low interest rate environment, as well as falls in Fiduciary and Insurance.[3] This decline is partially offset by the expansion in GVA of Funds by 97% (£259m in 2019 prices).

[3] States of Guernsey, January 2022, Guernsey Economic and Financial Stability Overview.

In conclusion, Finance continues to be Guernsey's largest economic sector, dominated by Funds, Banking and Fiduciary, while an increasingly important role is played by Professional, business, scientific and technical activities.

2.2 The "red line" sectors

Given the central importance of the financial services sector to the Guernsey economy and the importance of Alderney's gambling sector, a guiding principle adopted by this study has been that proposed changes to the tax system should not have a negative impact on the key elements of those sectors (as confirmed by the Policy & Resources Committee). In order to ensure this, a "red line" has been drawn round those elements of the key sectors, effectively declaring them "off-limits" for any changes in tax treatment.

The sectors contained within the red line[4] share the key characteristic that they might be expected to be display a high propensity to relocate in response to changes in how they are taxed.

Initially, the "red line" applied broadly to all Financial services sectors other than domestic banking and domestic insurance. However, following discussion with the Policy and Resources Committee and analysis of the propensity of the Captive Insurance sector to relocate, this sector was placed outside the "red line".

2.3 Tax system and impact

The main design features of current Guernsey's Corporate Income Tax regime are:

- Sustainable – the regime aims to be sustainable in the long-term, so that it can generate sufficient revenues to support the provision of public services provided in Guernsey

- Non-discriminatory – the regime does not offer preferential regimes/advantages only to non-residents, nor in respect of transactions carried out only with non-residents, meeting international standards and accepted by the European Union as being in line with the Code of Conduct on Business Taxation

- Transparent – Guernsey's law and statements of practice setting out administrative guidelines are published, and operated, in a transparent manner, with the rules for profit determination not departing from internationally accepted principles. Guernsey is also an active jurisdiction promoting transparency and ensuring effective information exchange

In terms of the tax regime itself, companies which are resident for tax purposes are taxed on their worldwide income. Guernsey operates a 0/10/20 regime, under which a different rate of tax is applied to the profits arising from different forms of income. Since the tax rates applied depend upon the type of income received, rather than to a company as a whole, a company might have different income streams taxed at different rates:

- Company higher rate: A rate of 20% applies to trading income from:
  - Conducting activities regulated by the Guernsey Competition and Regulatory Authority[5]
  - The ownership of Guernsey land and buildings
  - The import and/or supply of hydrocarbon oil or gas in Guernsey
  - Large trading profits[6] by retail business carried on in Guernsey
  - Cultivation or use of the cannabis plant
  - Prescribed production or prescribed use of controlled drugs

[4] The sectors protected by the "red line" would be: Private banking; Other fiduciary; Holding companies; Funds / Investment – other; Managers of funds, investments and securities; Investment General Partner (regulated); Stockbroker services, trading in commodities; Investment advisors; Commercial General Insurers; Commercial Reinsurers; Commercial life insurers; Special purpose vehicles; Other finance; Gambling and betting activities – other.
[5] broadly Guernsey utilities such as electricity, post and telecommunications
[6] taxable profit of more than £500,000

- ► Property development and exploitation of land

► Company intermediate rate: A rate of 10% applies to:

- ► Specified banking business
- ► Domestic insurance business
- ► Insurance intermediary business and insurance manager business
- ► Fund administration businesses
- ► Fiduciary business
- ► Administration of controlled investments
- ► Provision of custody services
- ► Provision of investment management individual client services
- ► Operation of an investment exchange
- ► Compliance and other related activities, and
- ► Income from operating an aviation registry.

► Company standard rate: All other income and profits are taxable at the general rate of 0%.

The 0/10/20 percent rates apply to both resident corporate taxpayers and to non-resident corporate taxpayers operating in Guernsey. Double tax relief or unilateral tax relief is available (up to a limit) if income has already suffered tax in another jurisdiction. Investment income, such as bank or bond interest, royalties and dividends, is taxable at the company standard rate of 0%, though investment income would generally be treated as disregarded income for non-resident companies. Companies engaged in collective investment (funds) activities may apply for exemption from tax, and are treated as non-Guernsey resident for tax purposes.

Where a resident company pays a dividend to a Guernsey tax resident individual from profits that have been taxed at the 0% or 10% rate, the company is required to deduct tax from the dividend, such that the total tax suffered in relation to the distribution reaches the 20% rate applied to personal income for Guernsey resident individuals (essentially applying a top-up rate of 20% or 10% respectively). As such, for profits that are distributed to Guernsey resident individuals, the 0/10 regime acts as to defer some or all of the tax charge until distribution. However, for shareholders who are not Guernsey resident, distributions are not taxable in Guernsey, but may be taxable in the recipients' home jurisdiction.

From an international perspective, the Guernsey tax regime can be seen to be a worldwide regime, which taxes only certain forms of income. Tax regimes can generally be analysed across four quadrants, representing the interaction of active income (e.g. trading) and passive income (e.g. interest) on one side and domestic and foreign on the other. The nature of the Guernsey corporate income tax system currently is that it taxes active income that is both domestic and foreign, but does not generally expose passive income to taxation. The interaction with Tax on distributions, however, means that all profits distributed to Guernsey residents will have been taxed at 20% once distributed.

Figure 5: Treatment of income under Guernsey's current system

Type Source	Active income	Passive income
Domestic	TAX (0%, 10%, 20%)	0%
Foreign	TAX (0%, 10%, 20%)	0%

From an international perspective, the lack of taxation of passive income on non-resident shareholders can be seen as a form of tax neutrality. In common with other countries, the application of a zero rate of taxation to passive income can be seen to be a mechanism for avoiding double taxation, allowing Guernsey to operate in an international arena without the extensive network of double tax treaties a larger jurisdiction would be expected to hold. The use of economic substance provisions helps to protect against the risk of double non-taxation.

In practice, whilst Guernsey taxes foreign active income, no significant revenues were identified as coming from such a source (e.g. a foreign branch), indicating that the regime operating currently could be considered to raise the same revenue as a territorial regime (subject to the fact that the taxation of foreign active income may be a deterrent to moving domestic income offshore).

Based on 2019 data, 85% of Guernsey's GVA was exempt or taxed at the 0% level.

2.4 Effective tax rates

This section presents a summary of effective tax rates by sector for 2019 for the corporate income tax and tax on distributions.[7] The effective rate represents the actual tax due as a percentage of reported profits. Since companies can have income streams taxable at different rates, these can differ from the 0%/10%/20% rates applied.

As described in Section 2.3 above, where a company's income is taxed at a rate less than 20%, distributions paid to Guernsey residents give rise to tax on distributions[8]. Tax on distributions is paid on behalf of the individual, rather than the company. This 'tops-up' the tax rate paid on taxable profits to 20% – the rate payable on personal income. Therefore, the analysis in this study uses change in the combined corporate income and distributed profits effective tax rate as the basis for economic modelling.

Table 2 below shows the effective corporate income tax rate and effective corporate income tax plus tax on distributions rate for each sector in Guernsey in 2019.

Table 2: Effective tax rates by sector in Guernsey in 2019

Source: States of Guernsey

Sector	Share of GVA	Corporate income tax	Corporate income and tax on distributions
Rental property	0.6%	18.0%	20.0%
Information and communication	2.0%	8.9%	19.2%
Wholesale, retail and repairs	8.2%	12.0%	15.6%
Manufacturing	1.0%	3.8%	15.3%
Agriculture	0.4%	10.6%	15.1%
Transport and storage	1.5%	8.4%	13.5%
Authorised managers	0.2%	10.2%	10.2%
Insurance intermediaries	0.4%	10.2%	10.2%
Domestic insurers	0.1%	10.2%	10.2%
Hostelry	1.8%	2.7%	9.5%
Regulated fiduciary	2.8%	7.7%	8.5%
Administrators of funds	1.2%	8.0%	8.1%
Domestic retail banking	4.2%	7.8%	7.8%
Private and other banking	5.3%	7.8%	7.8%
Construction	3.9%	2.1%	7.8%
Water supply	0.1%	5.8%	5.8%
Professional activities	11.2%	0.2%	4.2%

[7] Effective tax rates have been calculated by taking tax receipts as a proportion of net assessable profits for each sector. Where a detailed sub-sector breakdown was not available, assumptions have been made to disaggregate broader sector data. For Insurance and Funds, data on the number of firms in each sub-sector has been used to disaggregate profit data. For Banking sectors, client data on the split of total banking profits has been used for disaggregation. More detail on source files can be found in Appendix A.

[8] GOV.GG. *Tax information for Companies*. https://www.gov.gg/RevenueService/Companies

Sector	Share of GVA	Corporate income tax	Corporate income and tax on distributions
Human health activities	2.5%	0.2%	3.7%
Other finance	1.4%	3.0%	3.0%
Administrative and support activities	3.9%	0.6%	2.6%
Holding companies	1.2%	1.8%	2.5%
Gambling and betting activities	0.5%	2.1%	2.1%
Other fiduciary	4.2%	1.3%	1.4%
Electricity	0.8%	0.6%	0.6%
Stockbroker services	0.04%	0.0%	0.1%
Investment advisors	0.4%	0.0%	0.1%
Managers of funds	0.7%	0.0%	0.1%
Funds / Investment - other	14.2%	0.0%	0.1%
Captives	2.2%	0.0%	0.0%
Commercial General Insurers	0.6%	0.0%	0.0%
Commercial Reinsurers	0.3%	0.0%	0.0%
Commercial life insurers	0.2%	0.0%	0.0%
Special purpose vehicles	0.5%	0.0%	0.0%
Education	0.5%	0.0%	0.0%
Other service activities	0.5%	0.0%	0.0%

Given the above, the following should be noted:

- Guernsey accounts data for the *Rental property* sector gives rise to an effective corporate income tax rate of 23.3%[9] and an effective combined corporate income and tax on distributions rate of 26.0%. These higher-than-expected values may have been driven by the impact of timing differences or one-off transactions and therefore have been adjusted within the analysis such that the combined rate does not exceed the maximum rate of 20%.[10]

- Sectors such as *Information and Communication, Manufacturing* and *Hostelry* have a much higher combined effective tax rate than effective corporate income tax rate alone, at 19.2%, 15.3% and 9.5% respectively. This reflects that a substantial proportion of profits are distributed to Guernsey residents in these sectors.

- *Insurance* sectors that generate active income in Guernsey are taxed at an effective corporate income tax rate of 10.2%. These sectors are *Authorised Managers, Insurance Intermediaries* and *Domestic Insurers*.

- Both *Domestic retail banking* and *Private and other banking* pay corporate income tax at an effective rate of 7.8%. No tax on distributions is reported for these sectors.

- Although the *Agriculture sector* is largely subject to a headline corporate income tax rate of 0%, a 20% rate is charged on income from land and property where fields and buildings are rented out, and cannabis related industries are subject to a 20% tax rate (although this only accounts for a small proportion of profits within the sector). This results in an effective rate of 10.6% for the sector.

- Similarly, whilst the *Retail, wholesale and repairs sector* is largely taxed at 0%, large retail (with a taxable profit of more than £500k) is subject to corporate income tax at a headline rate of 20%. Additionally, some rental income is taxed at 20%. This results in an effective rate of 12.0% for the sector, because the small number of large retailers who pay at the 20% rate account for a large proportion of profits in the sector.

[9] Effective rates exceed 20% for the rental property sector due to deductible expenses.
[10] Net assessable profits for the Rental property sector have been adjusted to revise effective tax rates for the sector.

- Whilst the *Transport and storage sector* is largely subject to corporate income tax at a rate of 0%, the sector includes postal services, which are regulated and taxable at 20%. This explains why the sector is subject to an effective rate of 8.4%.
- The *Information and communication sector* is mostly subject to tax at a headline rate of 0%. However, certain activities in the telecoms sub-sector are regulated by CIRCA and thus taxable at 20%, accounting for the 8.9% effective corporate income tax rate.
- While *Holding companies* are largely subject to corporate income tax at a rate of 0%, they may receive (and be taxed on) rental income. This contributes to them paying at an effective rate of 1.8%. Holding companies may include holding companies for trading groups outside of the *Finance* sector that make distributions; once the tax on distributions is included, the effective rate amounts to 2.5%.

2.5 Tax receipts

Guernsey's Corporate tax system collected £62.3m in 2019, whilst total tax on distributions receipts amounted to £10.2m. Corporate income tax is the second largest tax, collecting more than is raised from the self-employed (£27.4m), though considerably less than is collected via the income tax (Employees Tax Instalment, or ETI) (£276.6m).

Table 3 below shows corporate income and tax on distributions revenue for each sector in Guernsey in 2019.

Table 3: Corporate income and tax on distributions receipts by sector in Guernsey in 2019 (£000s)

Source: States of Guernsey

Sector	Corporate income tax	Tax on distributions	Total
Private and other banking	16,580	-	16,580
Domestic retail banking	13,027	-	13,027
Holding companies	7,641	3,176	10,817
Other	5,523	1,025	6,548
Regulated fiduciary	5,388	512	5,900
Wholesale, retail and repairs	3,816	1,127	4,943
Rental property	2,622	307	2,929
Administrators of funds	2,794	22	2,816
Information and communication	802	922	1,724
Other fiduciary	1,364	102	1,466
Professional activities	50	1,332	1,382
Construction	222	615	836
Insurance intermediaries	679	-	679
Other finance	614	-	614
Hostelry	123	307	431
Authorised managers	425	-	425
Agriculture	242	102	345
Transport and storage	168	102	270
Funds / Investment - other	-	263	263
Manufacturing	34	102	137
Administrative and support activities	29	102	131
Human health activities	6	102	108
Domestic insurers	106	-	106
Gambling and betting activities	22	-	22
Managers of funds	-	14	14
Water supply	13	-	13
Electricity	7	-	7
Investment advisors	-	7	7
Stockbroker services	-	1	1
Captives	-	-	-
Commercial General Insurers	-	-	-

Sector	Corporate income tax	Tax on distributions	Total
Commercial Reinsurers	-	-	-
Commercial life insurers	-	-	-
Special purpose vehicles	-	-	-
Education	-	-	-
Other service activities	-	-	-
Total	62,297	10,245	72,542

Given the above, the following should be noted:

- *Finance* sectors account for a large proportion of corporate income tax revenue in Guernsey. In 2019, 78% of all corporate income tax revenue was generated from *Finance*, amounting to £48.6m.

- Within the *Finance* sector, the top three sub-sectors, i.e. *Private and other banking*, *Domestic retail banking* and *Holding companies*[11], accounted for about 60% of corporate income tax receipts, or £37.2m in 2019.

- Non-finance sectors contributed the remaining 22% of corporate income tax revenue in 2019. This amounted to £13.7m.

- Within non-finance sectors, the top three sub-sectors were *Wholesale, retail and repairs*, *Rental property* and *Information and communication*. They accounted for 12%, or £7.2m, of corporate income tax revenue in 2019.

- Although the *Rental property* sector is subject to the highest combined effective tax rate, total corporate income and tax on distributions receipts of £2.9m accounted for 4.0% of total revenue. Total corporate income tax on rental income is allocated across sectors according to the sector that the company generating rental income sits within. For example, if a company in the *Agriculture* sector is taxed on rental income, this income and tax revenue will be reflected within the *Agriculture* sector.

[11] Holding companies may include holding companies for trading groups outside of the Finance sector that make distributions. The value of the tax payment by Holding companies also includes tax on rental income.

3. Behavioural responses to tax changes

As is implicit in the design of the current Corporate Income Tax system, the primary issue in designing changes to a tax system for an economy such as Guernsey's is the extent to which economic entities are likely to leave the island in response to changed tax treatment or be less attracted to invest in new business in Guernsey. The propensity of businesses or functions to relocate is the over-riding limiting factor, since both competitiveness and revenue raising capacity rest on the maintenance of a thriving economy and in particular a thriving financial services sector. A short term gain in tax revenue will be unsustainable if the businesses from which it is generated choose to leave in response to it.

3.1 Behavioural responses

It is expected that a tax change will result in a behavioural response from firms as they seek to move profits towards where they will be subject to a lower tax rate or where costs of business are lower.[12] There are two main mechanisms through which this can be done, the first being through migration and the second being through international profit shifting. As outlined by the IMF[13], common techniques used historically to shift profits between entities include intragroup (mis-) pricing, strategic location of management of IP and debt shifting through intercompany loans.

The loss of activity by migration implies not only the loss of any potential Corporate Income Tax receipts that may be generated by their activity but also the loss of the employment that supported it and the tax and contributions paid on that employment income. The behavioural change is therefore a significant consideration and can significantly reduce the potential revenue available from any steps taken to modify the Corporate Income Tax regime.

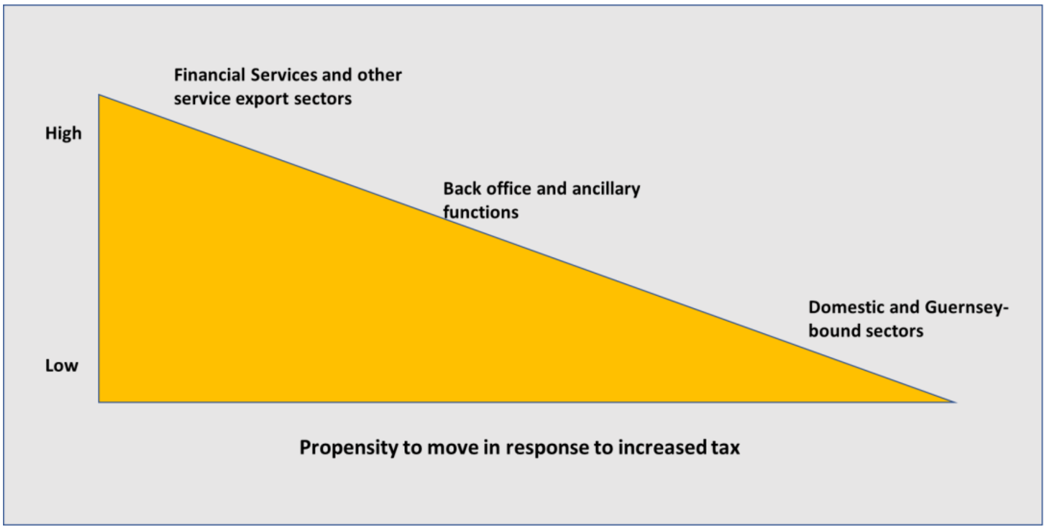
In order to assess the propensity of sectors or activities to relocate from Guernsey, the project has considered three criteria:

- **Can** they move: is it a practical proposition for the activity to be relocated?
- **Would** they move: what would be the likely trigger point for a move?
- **What collateral effects** would this have on others: which support and ancillary services could not survive other departures?

Applying the first criterion allows for an initial classification of the sectors in Guernsey into three broad groups along a continuum.

[12] For a fuller discussion of corporate mobility in response to tax changes, see e.g. Oversech et al (2008) *Who Cares About Corporate Taxation? Asymmetric Tax Effects on Outbound FDI.* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1521266.
[13] IMF. *International Corporate Tax Avoidance: A Review of Channels, Magnitudes and Blind Spots.* https://www.imf.org/en/Publications/WP/Issues/2018/07/23/International-Corporate-Tax-Avoidance-A-Review-of-the-Channels-Effect-Size-and-Blind-Spots-45999

Figure 6: The propensity of sectors to relocate



The impact on tax receipts is captured using two measures: static change and total change including behavioural response.

The static change illustrates the impact on tax receipts from the change in the tax rate only, while the tax base, i.e. net assessable profits, remains unchanged. In the static calculation, the tax on distributed profits is adjusted proportionately to the change in Corporate Income Tax rate.

The total change in tax receipts additionally covers the behavioural response, which includes the following impacts:

- Change in net assessable profits driven by the companies changing their behaviours in ways that would result in lower after-tax returns, including by relocating and shifting profits.
- Change in receipts from other taxes driven by reduced economic activity. For instance, income tax on individuals and social security contributions are reduced to reflect lower employment due to potential company relocations. Company fees decrease to reflect the reduction in the number of companies paying the charge due to potential relocations.

In addition to changes in tax receipts, this study estimates the change in Guernsey GVA driven by lower levels of economic activity. In particular, it reflects change in income components of GVA including compensation of employees by sector as a result of lower employment in Guernsey in relocating companies and gross operating surplus in line with the behavioural change in net assessable profits. Gross mixed income is assumed to be unchanged. The relative size of the change in GVA has been validated using literature review.[14]

3.2 Main behavioural assumptions

3.2.1 Semi-elasticities

The magnitude of the behavioural response is measured through use of sector-specific semi-elasticities, which are informed by the literature review.[15]

[14] See Mertens and Olea (2018) Marginal Tax Rates and Income: New Time Series Evidence, The Quarterly Journal of Economics, Volume 133, Issue 4, November 2018, Pages 1803–1884; and Romer and Romer (2007) The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks, NBER Working Paper 13264.

[15] A ‘semi-elasticity’ measures percentage change in one variable in response to an absolute (not percentage) change in another variable, as opposed to an ‘elasticity’ which measures percentage change in one variable in response to a percentage change in another variable.

The semi-elasticities used in this study quantify the percentage change in pre-tax profits in response to one percentage point change in the corporate income and distributed profits effective tax rate. It is understood that there are asymmetries in tax effects depending on the activities of a business, driven by differences in mobility and the degree of internationalisation.[16] For example, some financial services businesses are expected to be highly mobile, with relatively low relocation costs, and thus are more sensitive to a change in tax. This is captured by a higher semi-elasticity on the more mobile sectors.

The semi-elasticities have been sourced from Overesch et al. (2008) which estimates sector-specific semi-elasticities of the number of affiliates in a host country in response to a one percentage point change in the effective tax rate. Rather than the change in number of affiliates in a host country, the analysis requires an estimate of the response in terms of profits. Therefore, these semi-elasticities have been adjusted using an aggregate semi-elasticity of pre-tax profits in response to a one percentage point change in the tax rate from Dharmapal and Riedel (2012).[17]

Table 4 below summarises the elasticities inputs from the literature.

Table 4: Semi-elasticities by sector

Sources: Overesch et al. (2008), Dharmapal and Riedel (2012), EY analysis

Sector	Estimated semi-elasticity of number of affiliates	Implied semi-elasticity of pre-tax profits
All Manufacturing	(0.607)	(0.876)
Heavy Manufacturing	(0.820)	(1.184)
Non-Heavy Manufacturing	(0.488)	(0.705)
All Non-manufacturing	(0.712)	(1.028)
Business Services	(0.278)	(0.401)
Wholesale Trade	(0.524)	(0.757)
Financial Services	(1.620)	(2.339)
Research & Development	(1.530)	(2.209)
Holding Companies	(0.230)	(0.332)
Residual Group	(0.810)	(1.169)

A matching exercise has been carried out to allocate each Guernsey sector to one of the ten linear elasticities provided by the literature review. Matching has been refined according to the specific nature of the sectors within the Guernsey economy.

3.2.2 Mobility factors

In addition, the analysis considers whether some sectors and sub-sectors are relatively more or less mobile compared with aggregated sector elasticities found in the literature. The values of semi-elasticities are therefore adjusted to reflect the specific structure of the Guernsey economy.

In practice, there are few quantitative measures available to use to adjust the elasticities. Mobility factors have been informed by two key inputs which are indicative of the propensity of a sector to relocate following a change in tax rate:

- The share of HQ's that are overseas in each sector in Guernsey.[18] It is assumed that sectors with a higher proportion of overseas headquarters have a higher propensity to relocate following a change in tax.

- The share of each sector found in other Offshore Financial Centres, based on the country-by-country reporting of the Organisation for Economic Cooperation and

[16] Oversech et al. (2008). *Who Cares About Corporate Taxation? Asymmetric Tax Effects on Outbound FDI. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1521266*

[17] Overesch et al. (2008) Who Cares about Corporation Taxation? Asymmetric Tax Effects on Outbound FDI; Dharmapal and Riedel (2012) Earnings Shocks and Tax-Motivated Income-Shifting: Evidence from European Multinationals.

[18] Data provided by the States of Guernsey.

Development ("OECD"). It is assumed that sectors which are overrepresented in low tax jurisdictions have a higher propensity to relocate following a change in tax.

These inputs have been used to produce a ranking of sectors in terms of likelihood to relocate following a tax reform.[19] Based on this ranking and judgement[20], the study allocates mobility factors ranging from 0.8 to 1.2 across the sectors. A mobility factor of 0.8 reflects that a sector is less mobile than average, whilst a mobility factor of 1.2 reflects that a sector is more mobile than average. A mobility factor of 1 reflects that a sector has average mobility.

Table 5 below summarises the mobility assumptions for sectors used for country-by-country reporting by the OECD. Note that in some areas different assumptions have been made for different sub-sectors (e.g. domestic vs international Insurance) in this study; these more detailed assumptions are included in Table 6 in Section 3.2.4.

Table 5: Mobility factors by OECD sector

Sources: OECD, EY analysis[21]

OECD sector	Mobility factor
Regulated Financial Services	1.20
Insurance	1.20
Holding Shares or other Equity Instruments	1.20
Other	1.20
Research and Development	1.00
Manufacturing or Production	1.00
Provision of Services to Unrelated Parties	1.00
Internal Group Finance	1.00
Dormant	1.00
Holding or Managing Intellectual Property	0.80
Purchasing or Procurement	0.80
Sales, Marketing or Distribution	0.80
Administrative, Management or Support Services	0.80

Mobility factors by OECD sector have been mapped to Guernsey sectors used in this study as presented in Section 3.2.4 below. Where a sector is assumed to be completely immobile, i.e. there would be no significant relocation or profit shifting expected in response to a change in tax, a mobility factor of 0 is applied. These sectors include Agriculture, Electricity, Water supply, Hostelry, Education, Human health activities and Households including imputed rent.

3.2.3 Non-linearity

An increase in tax rate has been shown to have a much larger negative effect on reported profits in countries with substantially lower tax rates. In order to reflect the potential non-linear impacts on Guernsey's sectors which are currently taxed at 0% Corporate Income Tax rate, this study applies non-linear semi-elasticities replicating the quadratic relationship estimated in a paper by Bratta et al. (2017).[22]

For sectors identified as "red line", as well as Captives (which are currently subject to a 0% tax rate), non-linear (quadratic) elasticities have been applied. This reflects that these sectors are the most sensitive and therefore will have a larger behavioural response to a change in tax. This results in a relationship where, for the same sector-specific elasticity, there will be a more severe behavioural response if a sector had a very low effective tax rate, prior to a change in tax rate (i.e. the effect of a 1 pp. increase in the tax rate for an activity currently

[19] Both inputs have been assigned an equal weight when determining the ranking by sector.
[20] This judgement has been shared, tested and validated with the Policy and Resources Committee, but remains subjective.
[21] Sectors in this table represent OECD sectors as used for country-by-country tax reporting. Source: https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database.htm.
[22] Bratta et al. (2017) *Assessing profit shifting using Country-by-Country Reports: a non-linear response to tax rate differentials.*

taxed at 0% is higher than it would be for a sector activity taxed at 10%, even if their semi-elasticity is the same).

3.2.4 Summary of elasticities used

Within the analysis, mobility-adjusted semi-elasticities have been used to estimate the behavioural response of firms in terms of change in net assessable profits in response to a change in the effective corporate income and tax on distributions rate.

$$Mobility\ adjusted\ semi\ elasticity = \ Semi\ elasticity \times Mobility\ factor$$

Table 6 below summarises final semi-elasticities, mobility factors and mobility-adjusted semi-elasticities by sector in Guernsey.

Table 6: Semi-elasticities and mobility factors by Guernsey sub-sector

Sources: Overesch et al. (2008), Dharmapal and Riedel (2012), Bratta et al. (2017), OECD, EY analysis

Guernsey sub-sector	Linear semi-elasticity	Including non-linearity	Mobility factor	Mobility-adjusted
Agriculture	(0.40)	-	-	-
Electricity	(0.76)	-	-	-
Water supply	(0.76)	-	-	-
Hostelry	(1.03)	-	-	-
Education	(1.03)	-	-	-
Human health activities	(1.03)	-	-	-
Transport and storage	(0.40)	-	0.80	(0.32)
Domestic retail banking	(0.40)	-	0.80	(0.32)
Domestic insurers	(0.40)	-	0.80	(0.32)
Construction	(0.40)	-	1.00	(0.40)
Professional activities	(0.40)	-	1.00	(0.40)
Administrative and support activities	(0.40)	-	1.00	(0.40)
Other service activities	(0.40)	-	1.00	(0.40)
Information and communication	(0.40)	-	1.20	(0.48)
Rental property	(0.40)	-	1.20	(0.48)
Wholesale, retail and repairs	(0.76)	-	0.80	(0.61)
Manufacturing	(0.88)	-	1.00	(0.88)
Regulated fiduciary	(1.03)	-	1.00	(1.03)
Administrators of funds	(2.34)	-	1.00	(2.34)
Managers of funds	(1.03)	(2.80)	1.00	(2.80)
Captives	(1.03)	(2.80)	1.00	(2.80)
Authorised managers	(2.34)	-	1.20	(2.81)
Insurance intermediaries	(2.34)	-	1.20	(2.81)
Gambling and betting activities	(1.03)	(2.66)	1.20	(3.19)
Private and other banking	(2.34)	(5.16)	1.20	(6.20)
Other finance	(2.34)	(5.90)	1.20	(7.08)
Holding companies	(2.34)	(5.98)	1.20	(7.18)
Other fiduciary	(2.34)	(6.16)	1.20	(7.39)
Stockbroker services	(2.34)	(6.36)	1.20	(7.63)
Investment advisors	(2.34)	(6.36)	1.20	(7.63)
Funds / Investment - other	(2.34)	(6.36)	1.20	(7.63)
Commercial General Insurers	(2.34)	(6.37)	1.20	(7.64)
Commercial Reinsurers	(2.34)	(6.37)	1.20	(7.64)
Commercial life insurers	(2.34)	(6.37)	1.20	(7.64)
Special purpose vehicles	(2.34)	(6.37)	1.20	(7.64)

3.2.5 Second round effects

Given the importance of the Finance sector in Guernsey's economy, the potential decline in its activities is expected to have a significant knock-on impact on other sectors, in particular, Professional services and Administrative and business support activities, which are closely linked to the Finance sector.

A reduction in the level of economic activity and therefore a decline in compensation of employees throughout the economy would also affect demand for consumer-facing sectors such as Retail, Hostelry and Rental property. For example, a reduction in employee compensation would likely be associated with a decline in demand for restaurants, pubs and other consumer-facing services.

To account for these impacts, the following second round effects have been estimated:

- Supply chain impacts of reduced demand from Finance on professional services including Professional, business, scientific and technical activities; and Administrative and support services activities.
- Impacts of reduced consumer spending on Wholesale, retail and repairs; Hostelry; and Rental property.

Impacts of reduced demand from Finance

Supply chain impacts of reduced demand from Finance have been estimated as follows:

- Total spend on professional services as a proportion of Finance sector GVA has been estimated at 13% based on Input-Output tables for Luxembourg, due to the lack of Input-Output tables for Guernsey.[23]
- The change in spend of the Finance sector on professional services in Guernsey has been calculated based on the change in GVA of the Finance sector under each option. Given that there are two professional service-related sectors in Guernsey, the total decline in professional services GVA has been allocated on the basis of relative GVA by sector.
- The change in net assessable profits of the professional services sectors has been calculated using an appropriate multiplier[24], which captures the impact of professional services' spending in their own supply chains, and the ratio of net assessable profits to GVA in these sectors.
- The fall in profits associated with supply chain impact drives further movement in GVA and taxes on a sector level.

Impacts of reduced consumer spending

Total fall in compensation of employees associated with the behavioural response to a tax change has been used to estimate second round effects on consumer-facing sectors:

- A secondary fall in the profits of consumer-facing sectors is assumed to be proportionate with the total fall in compensation of employees for the whole Guernsey's economy.
- The fall in the profits associated with second round effects results drives additional movement in GVA and taxes at sector level.

[23] Luxembourg data has been used to estimate spend by the Finance sector on professional services due to its status as a low-tax jurisdiction and the availability of robust Input-Output tables published by OECD. Source: OECD, 2018 Luxembourg Input-Output tables (domestic only).
[24] An average UK Type 1 multiplier effect of 0.88 for all professional services sectors for 2019 has been used. These sectors include, but are not limited to Accounting, book-keeping and auditing services; Services of head offices; and Other professional, scientific and technical activities.

4. The evolution of the options

As noted in Section 1 above, the RfQ identified three options for the reform of Guernsey's Corporate Income Tax model. These were:

a. A territorial regime, conditional on meeting substance requirements

b. A worldwide regime, with a headline rate at a material rate, such as 9%

c. A low rate or fixed amount of tax payable by every company operating in Guernsey, thereby ensuring that a minimum amount is paid by every company

Additionally, EY was invited to recommend alternative options that might be a potentially suitable fit for Guernsey. All options recommended would need to be competitive, internationally acceptable and maintain tax neutrality.

4.1 Initial test of the options

As a first step, the project assessed each of the initial options in terms of the ability to successfully operate in the context of the Guernsey economy. Focusing on the different types and source of income which would come within the scope of a reformed Corporate Income Tax, it was noted that the key difference between a Territorial regime and Worldwide regime rests on the treatment of foreign sourced active income.

As illustrated in the Figure 7 below, the Territorial regime would focus on domestic sourced active income (that is the profits of companies operating in Guernsey), while active foreign sourced income and all passive income (from interest, royalties etc) would be outside the scope of the tax.

Figure 7: Treatment of income under a Territorial regime

Type Source	Active income	Passive
Domestic	TAX	No tax
Foreign	No tax	No tax

By comparison, a Worldwide regime would additionally draw foreign sourced active income into the tax net, as shown in Figure 8.

Figure 8: Treatment of income under a World Wide regime

Type Source	Active income	Passive income
Domestic	TAX	No tax
Foreign	TAX	No tax

In theory, these approaches offer quite distinct options. However, once analysed in the context of Guernsey's economy, this distinction collapses. This is because Guernsey's economy does not feature significant foreign source active income (such as income of foreign branches of Guernsey based companies). In effect, the active foreign income box represents an empty set, and a Worldwide regime for Guernsey would be, to all intents, identical to a Territorial one. For that reason it was agreed, in discussion with the Policy and Resources Committee that the Worldwide option should not be evaluated further.

4.2 Developing a 0/10/20 option

In order to test the capacity for reforms to the current Guernsey system to deliver the required outcomes, an additional option was developed which would retain the current 0/10/20 structure, but increase the rate of tax applied to domestic sectors and those which currently already pay Corporate Income Tax.[25] This option considers the semi-elasticities discussed previously and considers where the existing regime might be expanded with least impact.

4.3 Testing the "red line"

Given the size of the economic sectors which comprise the "red line", it is important to be able to test the basic premise that "red line" sectors would respond to the imposition of tax by relocating to other jurisdictions. Therefore, a sub-option of the Territorial regime was developed, under which the "red line" sectors would be brought within the charge to tax.

4.4 Refinement of the Levy option

Following discussion with the Policy and Resources Committee, the Levy option was refined to a variant which could be applied to all companies operating in Guernsey which do not currently pay Corporate Income Tax. This would provide a mechanism where even those not subject to tax would contribute.

4.5 Additional options

In addition to the above options, it was noted that the adoption of a global minimum tax (in the context of the "Pillar 2" initiative of the Inclusive Framework on Base Erosion and Profit Shifting) would enable Guernsey to introduce a qualifying domestic minimum tax ("QDMT"). Such a QDMT would mean that (broadly) companies with a group turnover of more that €750m would suffer tax at an effective rate of 15%.

In discussion with the Policy and Resources Committee, an additional option of an Environmental, Social and Governance ("ESG") voluntary tax designed to enable non-tax paying entities on Guernsey to opt to be taxed in line with their internal ESG requirements was raised.

These options fall outside the scope of the current project but should be considered in the context of the wider Strategic Review. The economic model developed for this project could be adapted to provide potential estimates of the impacts of such options.

[25] The list of sectors is provided in Section 5.1.1.

5. Modelling outcomes and economic impacts

This section sets out potential impacts of the policy reform options on tax receipts and Gross Value Added (GVA).

5.1 Option 1 – reforms within the existing structure

5.1.1 Background

This option retains the existing 0/10/20 regime, and increases the tax rate applied to domestic sectors and those which currently already pay Corporate Income Tax. As Option 1 considers where the existing regime might be expanded with least impact, these sectors have been selected based on their relatively low potential behavioural response.

The sectors which would be subject to an increase in the statutory Corporate Income Tax rate from 0% to 20% are: Agriculture; Manufacturing; Construction; Wholesale, retail and repairs; Hostelry; Transport and storage; Information and communication; Administrative and support service activities; Education; Human health activities; Other service activities[26].

The sectors which would be subject to an increase in the statutory Corporate Income Tax rate from 10% to 20% are: Domestic retail banking; Regulated fiduciary; Administrators of funds, Authorised managers (insurance); Insurance intermediaries; Domestic insurers.

5.1.2 Results

Table 7 and Table 8 below summarise the impacts under Option 1.

Table 7: Summary of impacts under Option 1, by tax type (£m 2019 prices)

Source: EY analysis

Tax type	Static change	Behavioural change	Total tax change
Corporate Income Tax	30.9	(4.9)	26.0
Income tax – individuals		(1.7)	(1.7)
Income tax – distributed profits	(3.8)	-	(3.8)
Social security contributions		(1.2)	(1.2)
Company fees		(0.1)	(0.1)
Total tax revenue	27.1	(7.9)	19.2

Table 8: Summary of impacts under Option 1, by sector (£m 2019 prices)

Source: EY analysis

Sector	Static change	Behavioural change	Total tax change	Change in GVA[27]
Agriculture	0.1	-	0.1	-
Manufacturing	0.0	(0.1)	(0.0)	(0.6)
Electricity	-	-	-	-
Water supply	-	-	-	-
Construction	1.3	(0.5)	0.8	(2.2)
Wholesale, retail and repairs	1.4	(0.5)	0.9	(5.6)

[26] While these sectors are subject to a 0% statutory Corporate Income Tax rate, many of them already pay some Corporate Income Tax rate as some revenue streams are charged at a non-zero rate. For the detail of the effective Corporate Income Tax rate by sector, see Section 2.4.

[27] In total, the relationship between change in GVA and change in tax receipts is consistent with benchmarks. However, it does vary across sectors, and in some sectors (e.g. Wholesale, retail and repairs; Professional activities; and Administrative and support activities) the trade-off is markedly less favourable, i.e. relatively little tax raised compared to the decline in GVA. For these sectors, this appears to reflect the limitations of the data available, with some large differences between the operational surplus component of GVA and net assessable profits as measured for tax purposes. Consequently, this ratio may not be a good guide for including/excluding sectors in the proposed policy option. In the event that this Option was to be developed as a practical policy option, it would be important to investigate the sector allocation further and the underlying data. Should robust data be obtained, further review of the sectors could be undertaken.

Sector	Static change	Behavioural change	Total tax change	Change in GVA[27]
Hostelry	0.5	(0.0)	0.4	(0.1)
Transport and storage	0.1	(0.1)	0.1	(0.4)
Information and communication	0.1	(0.0)	0.1	(0.1)
Domestic retail banking	13.0	(1.2)	11.8	(3.6)
Private and other banking	-	-	-	-
Regulated fiduciary	5.1	(2.3)	2.8	(8.5)
Other fiduciary	-	-	-	-
Holding companies	-	-	-	-
Funds / Investment – other	-	-	-	-
Administrators of funds	2.8	(1.7)	1.1	(9.3)
Managers of funds	-	-	-	-
Stockbroker services	-	-	-	-
Investment advisors	-	-	-	-
Authorised managers	0.4	(0.3)	0.1	(1.4)
Insurance intermediaries	0.6	(0.5)	0.2	(2.2)
Domestic insurers	0.1	(0.0)	0.1	(0.0)
Captives	-	-	-	-
Commercial General Insurers	-	-	-	-
Commercial Reinsurers	-	-	-	-
Commercial life insurers	-	-	-	-
Special purpose vehicles	-	-	-	-
Other finance	-	-	-	-
Rental property	-	(0.0)	(0.0)	(0.1)
Professional activities	-	(0.1)	(0.1)	(1.1)
Administrative and support activities	0.9	(0.6)	0.3	(4.6)
Education	0.0	(0.0)	0.0	-
Human health activities	0.5	-	0.5	-
Gambling and betting activities	-	-	-	-
Other service activities	0.1	(0.1)	(0.0)	(0.3)
Total	27.1	(7.9)	19.2	(40.1)

Given the above, the following should be noted:

- This tax reform option would generate an additional of £19.2m in post-behavioural tax receipts. This is based on a static increase of £30.9m due to the Corporate Income Tax rate change, adjusted for a decrease in the distributed profit tax (-£3.8m) and behavioural change (-£7.9m) due to potential company relocations and profits shifting.

- The largest change occurs in the Domestic retail banking sector, at £11.8m. This is a result of there being high net assessable profits in this sector, at £166.1m in 2019, and an 8-percentage point increase in the effective Corporate Income Tax rate.

- In some sectors, there is a relatively large decline in compensation of employees driven by lower employment[28], e.g. in Administrative and support services, Regulated fiduciary and Construction, which makes the relationship between GVA and tax receipts more adverse in these sectors. For instance, Construction would generate an additional £0.8m in post-behavioural tax receipts while experiencing a significant behavioural tax impact (-£0.5m), largely resulting from a fall in individual income tax and social security contributions for a relatively small change in net assessable profits. This is mainly driven by the high labour intensity of the construction sector.

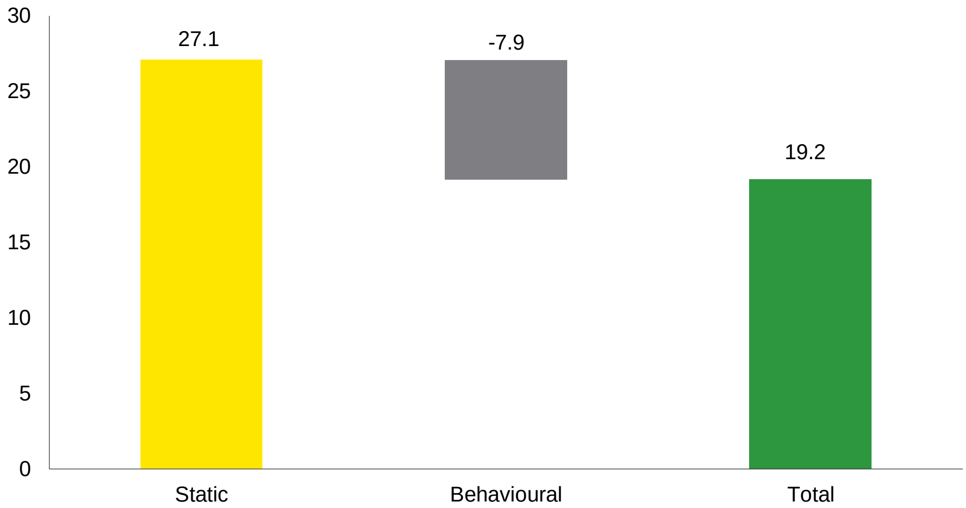
- For Administrators of funds, Authorised managers and Insurance intermediaries, a relatively large decline in GVA compared to the tax gain is driven by a relatively large

[28] This drop in employment is expected to lead to an increase in unemployment and a drop in net migration.

value of the elasticities applied based on the evidence from literature review and mobility assumptions.[29]

- The behavioural response includes second order effects of -£0.3m, of which -£0.1m is the impact of reduced Finance sector activity on professional services and administrative and support activities, and -£0.2m is the impact of reduced income on consumer-facing sectors of Guernsey's economy.
- The behavioural response from the increase in Corporate Income Tax would lead to an estimated decline in GVA by £40.1m, or 1.3%. This is generally consistent with the available literature on GDP response to changes in tax burden which suggests the range between 1.2% and 1.8%.[30]
- For £20m of tax revenue to be generated under the static impact, the new tax rate would have to be set at 17.3%. Accommodating for behavioural changes, this tax rate would need to be set at 20.3% to generate an additional £20m in tax revenue.

Figure 9: Summary of changes in tax under Option 1 (£m 2019 prices)



Source: EY analysis

5.2 Option 2 – a territorial regime excluding "red line" sectors

5.2.1 Background

Option 2 replaces the 0/10/20 structure with a single rate (15%) on all domestic active and passive income under a territorial regime. While this single rate increases the tax rate for most sectors, some sectors such as Rental property, which are subject to a 20% tax rate under the current regime, will benefit from a tax reduction. Sectors that have been identified as "red line" are not taxed within this option[31].

5.2.2 Results

Table 9 and Table 10 below summarise the impacts under Option 2.

[29] For a review of the approach to elasticities, see Section 3.2.
[30] The range has been inferred from the change in the ratio of tax revenue to GVA in Option 1 and parameters estimated in the literature. See Appendix A for the list of academic references used in this estimation.
[31] For the purposes of this Option is has been assumed that domestic and Captive insurance sits outside the "red line" with the tax applying where insurance is underwritten in Guernsey, as well as where the risk covered is in Guernsey

Table 9: Summary of impacts under Option 2, by tax type (£m 2019 prices)

Source: EY analysis

Tax type	Static change	Behavioural change	Total tax change
Corporate Income Tax	26.7	(2.5)	24.1
Income tax – individuals		(1.6)	(1.6)
Income tax - distributed profits	(3.1)	-	(3.1)
Social security contributions		(1.0)	(1.0)
Company fees		(0.1)	(0.1)
Total tax revenue	23.6	(5.2)	18.4

Table 10: Summary of impacts under Option 2, by sector (£m 2019 prices)

Source: EY analysis

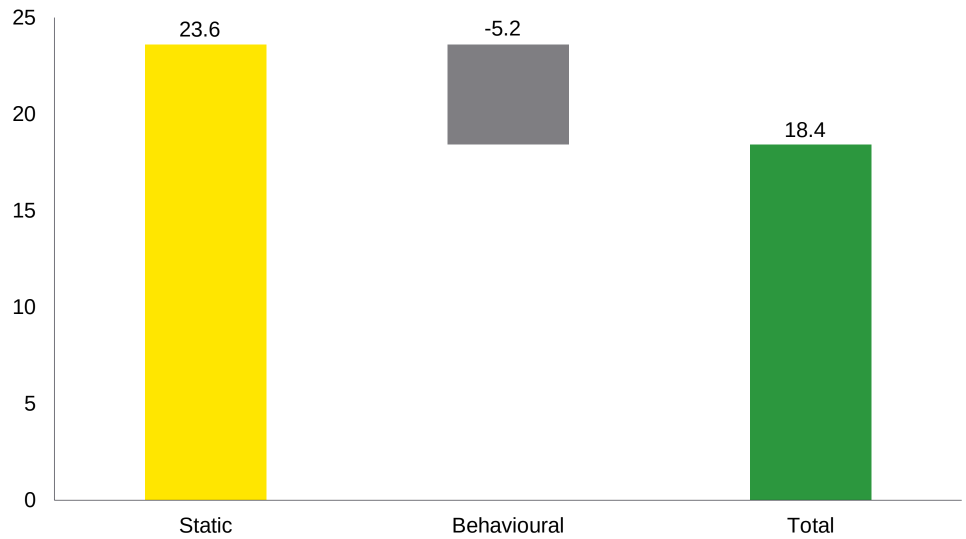
Sector	Static change	Behavioural change	Total tax change	Change in GVA
Agriculture	0.1	0.0	0.1	-
Manufacturing	0.0	(0.1)	(0.0)	(0.4)
Electricity	(0.0)	0.0	(0.0)	-
Water supply	(0.0)	0.0	(0.0)	-
Construction	0.9	(0.3)	0.6	(1.6)
Wholesale, retail and repairs	0.5	(0.2)	0.3	(2.6)
Hostelry	0.3	(0.0)	0.3	(0.1)
Transport and storage	0.1	(0.0)	0.0	(0.2)
Information and communication	0.0	(0.0)	0.0	(0.1)
Domestic retail banking	6.5	(0.3)	6.2	(1.2)
Private and other banking	-	-	-	-
Regulated fiduciary	2.5	(0.6)	1.9	(2.7)
Other fiduciary	-	-	-	-
Holding companies	-	-	-	-
Funds / Investment – other	-	-	-	-
Administrators of funds	1.4	(0.4)	1.0	(3.1)
Managers of funds	-	-	-	-
Stockbroker services	-	-	-	-
Investment advisors	-	-	-	-
Authorised managers	0.2	(0.1)	0.1	(0.7)
Insurance intermediaries	0.3	(0.2)	0.1	(1.1)
Domestic insurers	0.0	(0.0)	0.0	(0.0)
Captives	6.0	(1.3)	4.7	(7.3)
Commercial General Insurers	-	-	-	-
Commercial Reinsurers	-	-	-	-
Commercial life insurers	-	-	-	-
Special purpose vehicles	-	-	-	-
Other finance	-	-	-	-
Rental property	(0.4)	(0.0)	(0.5)	(0.0)
Professional activities	3.9	(1.1)	2.8	(9.7)
Administrative and support activities	0.7	(0.4)	0.3	(3.4)
Education	0.0	0.0	0.0	-
Human health activities	0.0	0.0	0.0	-
Gambling and betting activities	0.4	(0.0)	0.4	-
Other service activities	-	-	-	-
Total	23.6	(5.2)	18.4	(34.3)

Given the above, the following should be noted:

► This tax reform option would generate an additional of £18.4m in post-behavioural tax receipts. This is based on a static increase of £26.7m due to the Corporate Income Tax rate change, adjusted for a decrease in the distributed profit tax (-£3.1m) and behavioural change (-£5.2m) due to potential company relocations and profits shifting.

- The greatest increase under Option 2 is generated by Domestic retail banking (£6.2m) and Captives (£4.7m), followed by Professional activities (£2.8m) and Regulated fiduciary (£1.9m).
- The behavioural response includes second order effects of -£0.2m, of which -£0.1m is the impact of reduced Finance sector activity on professional services and administrative and support activities, and -£0.1m is the impact of reduced income on consumer-facing sectors of Guernsey's economy.
- The behavioural response from the increase in Corporate Income Tax would lead to an estimated decline in GVA by £34.3m, or 1.1%. This is generally consistent with the available literature on GDP response to changes in tax burden which suggests the range between 1.2% and 1.8%.
- For £20m of tax revenue to be generated under the static impact, the new tax rate would have to be set at 13.9%. Accommodating for behavioural changes, this tax rate would need to be set at 15.6% to generate an additional £20m in tax revenue.

Figure 10: Summary of changes in tax under Option 2 (£m 2019 prices)



Source: EY analysis

5.3 Option 2a – a territorial regime including "red line" sectors

5.3.1 Background

This is a variation of Option 2 where no sector is "red line", and all sectors face Corporate Income Tax at a rate of 15% under the territorial regime. In practice, such a pure territorial regime (without, for example, relief for domestic income of collective investment schemes) is not seen in practice but this has been developed to test the rationale for the "red lines".

The territorial nature of the option is maintained and hence the following sectors are excluded, due to the lack of disaggregation between domestic and foreign income: Other fiduciary, Funds / investment - other, Holding companies, Stockbroker services, Investment advisors and Special purpose vehicles.

5.3.2 Results

Table 11 and Table 12 below summarise the impacts under Option 2a.

Table 11: Summary of impacts under Option 2a, by tax type (£m 2019 prices)
Source: EY analysis

Tax type	Static change	Behavioural change	Total tax change
Corporate Income Tax	50.9	(26.0)	24.9
Income tax – individuals		(7.4)	(7.4)
Income tax - distributed profits	(3.1)	-	(3.1)
Social security contributions		(4.7)	(4.7)
Company fees		(0.5)	(0.5)
Total tax revenue	47.8	(38.6)	9.1

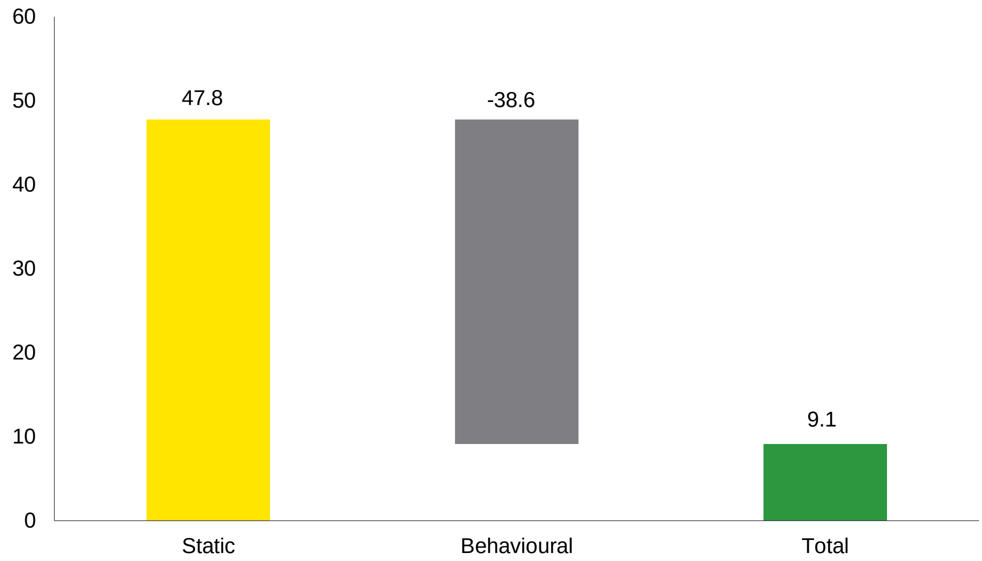
Table 12: Summary of impacts under Option 2a, by sector (£m 2019 prices)
Source: EY analysis

Sector	Static change	Behavioural change	Total tax change	Change in GVA
Agriculture	0.1	0.0	0.1	-
Manufacturing	0.0	(0.1)	(0.0)	(0.4)
Electricity	(0.0)	0.0	(0.0)	-
Water supply	(0.0)	0.0	(0.0)	-
Construction	0.9	(0.3)	0.6	(1.6)
Wholesale, retail and repairs	0.5	(0.5)	(0.0)	(6.2)
Hostelry	0.3	(0.1)	0.2	(0.6)
Transport and storage	0.1	(0.0)	0.0	(0.2)
Information and communication	0.0	(0.0)	0.0	(0.1)
Domestic retail banking	6.5	(0.3)	6.2	(1.2)
Private and other banking	15.1	(16.5)	(1.4)	(51.9)
Regulated fiduciary	2.5	(0.6)	1.9	(2.7)
Other fiduciary	-	-	-	-
Holding companies	-	-	-	-
Funds / Investment – other	-	(2.4)	(2.4)	(162.2)
Administrators of funds	1.4	(2.0)	(0.6)	(14.0)
Managers of funds	3.3	(2.2)	1.1	(13.1)
Stockbroker services	-	-	-	-
Investment advisors	-	-	-	-
Authorised managers	0.2	(0.4)	(0.2)	(2.5)
Insurance intermediaries	0.3	(0.2)	0.1	(1.1)
Domestic insurers	0.0	(0.0)	0.0	(0.0)
Captives	6.0	(1.3)	4.7	(7.3)
Commercial General Insurers	1.7	(2.4)	(0.6)	(13.6)
Commercial Reinsurers	0.9	(1.3)	(0.4)	(7.4)
Commercial life insurers	0.6	(0.8)	(0.2)	(4.7)
Special purpose vehicles	-	-	-	-
Other finance	2.4	(3.1)	(0.7)	(29.8)
Rental property	(0.4)	(0.1)	(0.5)	(0.2)
Professional activities	3.9	(2.5)	1.4	(22.5)
Administrative and support activities	0.7	(0.9)	(0.2)	(7.6)
Education	0.0	0.0	0.0	-
Human health activities	0.4	(0.0)	0.4	-
Gambling and betting activities	0.1	(0.6)	(0.5)	(1.7)
Other service activities	0.1	(0.1)	(0.0)	(0.2)
Total	47.8	(38.6)	9.1	(352.7)

Given the above, the following should be noted:

- ► This tax reform option would result in an increase of £9.1m in post-behavioural tax receipts. This is based on a static increase of £50.9m due to the Corporate Income Tax rate change, adjusted for a decrease in the distributed profit tax (-£3.1m) and behavioural change (-£38.6m) due to potential company relocations and profits shifting. As, under Option 2a, the worldwide income is not subject to tax rate increase, a number of "red line" sectors do not generate additional tax, resulting in a relatively small gain in tax receipts.
- ► The behavioural response includes second order effects of -£2.6m, of which -£2.0m is the impact of reduced Finance sector activity on professional services and administrative and support activities, and -£0.6m is the impact of reduced income on consumer-facing sectors of Guernsey's economy.
- ► The behavioural response from the increase in Corporate Income Tax would lead to an estimated decline in GVA by £352.7m, or 11.1%. The decline in GVA in Option 2a is significantly higher than in the available literature on GDP response to changes in tax burden. This is driven by significant non-linearities expected in the response of Guernsey companies, which are expected to be highly mobile, to changes in tax rates. This includes a significant loss in financial services activity and would be consistent with a significant loss of employment activity (with the potential for consequent declines in household incomes and standard to living) in Guernsey.
- ► For £20m of tax revenue to be generated under the static impact, the new tax rate would have to be set at 10.5%. Accommodating for behavioural changes, this tax rate would need to be set at 29.0% to generate an additional £20m in tax revenue.

Figure 11: Summary of changes in tax under Option 2a (£m 2019 prices)



Source: EY analysis

5.4 Option 4 – Flat fee model

5.4.1 Background

Option 4 has been designed to apply a flat levy, rather than a profits-related tax rate. The option broadens the "tax" base and brings within charge those economic operators which do not currently contribute through the tax system.

This would retain the "zero-tax" regime and, depending on how the levy is structured, could potentially be viewed as a cost of doing business in Guernsey rather than as a tax.

This option could be structured in several different ways, taking into account:

- ► The basis for the charge – i.e., which companies would be subject to the levy.
- ► The collection mechanism – i.e., how the levy would be collected / administered.
- ► The "tax" attributes of the levy – i.e., whether this is a simple fee or a tax (which could be potentially creditable against tax payable on distribution or corporate profits).

For the purposes of this report, the following three scenarios for a flat fee have been costed:

- ► Apply a levy to all companies that are Guernsey registered (incorporated in Guernsey).
- ► Apply a levy to all Guernsey tax resident companies, excluding those that are exempt from paying tax (as they already pay a levy of £1,200).
- ► Apply a levy to all Guernsey tax resident companies that do not currently pay tax at the intermediate (10%) or higher (20%) rate, excluding those that have exempt status.

To gauge the revenue raising capacity of this approach, an indicative levy has been modelled for each scenario and set at a rate of £1,000 per year in addition to current Registry fees (and regulatory fees where applicable). An estimate of the rate of levy required to raise £20m has also been provided.

A levy of £1,000 per year has been selected based on indicative feedback that a higher fee could result in Guernsey becoming uncompetitive. In particular, in the fiduciary sector, private wealth asset holding vehicles may be more susceptible to outward migration, and care would be needed in setting a levy at the appropriate rate. Additionally, there exists a risk of any increase making the recruitment of new business more difficult, which would have implications for future growth. Such a behavioural response would need to be further tested in consultation with Guernsey businesses.

5.4.2 Data

Table 13 contains the total number of companies by sector in Guernsey in 2019.[32] These data have been broken down by company status and headline corporate income tax rate. This table provides an indication of the size of the different groups that could be targeted under a flat fee model.

Table 13: The number of companies in Guernsey in 2019 by sector and status

Source: States of Guernsey

				Total Guernsey tax residents by type			***Certificate 1 companies by headline tax rate***		
	Guernsey registered	Foreign incorporated Guernsey residents[33]	Total Guernsey tax residents[34]	Cert 1[35]	Cert 3	Exempt	20%	10%	0%
Total	**17,141**	**3,826**	**20,967**	**4,447**	**16,520**	**525**	**320**	**296**	**3,831**
Agriculture	85	55	140	33	107	-	-	-	33
Manufacturing	104	-	104	52	52	-	-	-	52
Electricity and water supply	…[36]	…	31	16	15	-	16	-	-
Construction	…	…	362	314	48	-	-	-	314

[32] The following sectors have been omitted from Table 132: Public Administration; Activities of households as employers; Uncoded.
[33] This has been implied from the difference between total Guernsey tax residents and total Guernsey registered companies.
[34] The total number of Guernsey tax resident companies in 2019 has been implied from the number of companies that were expected to provide a tax return in 2020 (20,500 companies). This was provided via email by Director of the Revenue Service on 21/07/2022.
[35] Source document: '*Copy of Cert 1 data July 21.xlsx*'.
[36] Suppressed data.

	Guernsey registered	Foreign incorporated Guernsey residents[33]	Total Guernsey tax residents[34]	Total Guernsey tax residents by type Cert 1[35]	Cert 3	Exempt	Certificate 1 companies by headline tax rate 20%	10%	0%
Wholesale, retail & repairs	480	181	661	381	280	-	-	-	381
Hostelry	…	…	187	151	36	-	-	-	151
Transport and storage	…	…	136	80	56	-	-	-	80
Information & communication	220	-	220	133	87	-	-	-	133
Banking	10	10	20	20	-	-	-	20	-
Fiduciary	2,042	13	2,055	249	1,806	-	-	243	6
Holding companies	9,626	533	10,159	1,742	8,417	-	-	-	1,742
Funds / Investment	1,309	2,903	4,212	96	4,116	525	-	26	70
Insurance	…	…	110	45	65	-	-	6	39
Other finance	44	7	51	51	-	-	-	-	51
Rental property	832	61	893	304	589	-	304	-	-
Professional activities	581	2	583	363	220	-	-	-	363
Administrative & support	515	2	517	201	316	-	-	-	201
Education and health	242	6	248	90	158	-	-	-	90
Gambling and betting activities	158	43	201	66	135	-	-	-	66
Other service activities	…	…	76	60	16	-	-	-	60

Given the above, the following should be noted:

- Of the 20,967 companies that were tax resident in Guernsey in 2019, a substantial proportion consisted of Holding Companies and Funds / Investment. These two sectors accounted for 14,371 companies, or 69% of the total number of tax residents.

- The Finance sector accounted for 77% of Guernsey registered companies and 79% of Guernsey tax resident companies in 2019. A higher proportion of Guernsey tax resident companies reflects that the foreign companies which are managed and controlled (and therefore tax resident) in Guernsey are largely based in the Finance sector.

- Outside of Finance, the sectors with the largest number of companies in 2019 were Rental Property, Wholesale, Retail and Repairs and Professional Activities. These sectors accounted for 4%, 3% and 3% of total companies respectively.

- “Certificate 3” companies are companies that file a simplified tax return (which includes questions on economic substance) on the basis they are taxed at 0% and have no Guernsey shareholders or employees. The Finance sector accounts for 87% of Certificate 3 companies.

- “Certificate 1” companies are companies that file a full tax return on the basis they either have income subject to corporate income tax at 10% or 20% or they have Guernsey owners. As such, many Certificate 1 companies already contribute tax revenue either based on their sources of income, or via tax paid on distributions to Guernsey resident owners. A “simplified Certificate 1” tax return applies where a company would qualify for Certificate 3 except that it has Guernsey employees.

- Dormant companies may file a “Certificate 2” tax return. Based on available data, we have assumed that the number of dormant companies is not material and are included in the figures for “Certificate 3”.

5.4.3 Scenarios

Three distinct scenarios have been considered within this analysis; however, as noted above, multiple variants of these scenarios could be developed. The data provided in Table 13 can be used to estimate the revenue that could be generated under a more refined scenario, e.g.

a levy that varies across different sub-sectors of Certificate 3 companies (for example a lower fee for companies administered by the fiduciary sector).

A behavioural response of companies has not been modelled, as the initial costs of relocation are expected to exceed a £1,000 fixed fee. However, based on consultation with in-house tax specialists, care is needed not only in setting the amount, but also in the way such a levy is implemented. In particular, there is some concern that, if implemented as a "tax", some companies (especially in the funds sector) may view this as a precursor to future tax regime change, leading to nervousness about using Guernsey as a location for future structuring. Consultation with industry experts should be considered prior to the implementation of a levy to further understand potential behavioural responses and to help shape the design of this option.

Scenario 1 – All Guernsey registered companies

Under scenario 1, all companies that are Guernsey registered would be subject to a fixed annual levy.

In total, 17,141 companies fall into this group, meaning that an £1,000 levy would generate revenue of £17.1m. To generate an additional £20m in revenue, this levy would need to be fixed at a rate of £1,167.

This policy could be administered separately from the tax system, potentially with fees paid via the Guernsey Registry, rather than to the Revenue Service.

Scenario 2 – All Guernsey tax resident companies, excluding exempt companies

Under scenario 2, all companies that are Guernsey tax resident (other than those with exempt status) would be subject to an annual levy. Companies with exempt status are already subject to a fixed annual fee of £1,200, and it has been assumed that no additional revenue could be generated from this group using a further levy.

This scenario expands the "tax" base relative to scenario 1, bringing in a number of fund-related vehicles, holding companies and retail companies that are not incorporated in Guernsey, but are managed and controlled (and therefore tax resident) in Guernsey (for example there is a significant volume of British Virgin Islands incorporated companies that became tax resident in Guernsey from 2019 when the rules on tax residence were amended).

Given that 20,442 companies have Guernsey tax residency status and are not exempt, a £1,000 levy would generate £20.4m in revenue. To generate £20m in revenue, this levy would need to be fixed at a rate of £978.

It is possible for this scenario to be differentiated based on the headline corporate income tax rate of each sector. For example, if Certificate 1 companies subject to a headline rate of 20% (i.e. in rental property and utilities) were to pay a discounted levy of £500, then the total revenue generated from this scenario falls to £20.3m.

Another variation of this scenario could involve this levy being creditable against tax on distributions. A rough calculation based on total tax paid by sector reduced the revenue raised by a £1,000 levy from £20.4m to £13.5m. However, this may be an underestimate because some companies within each sector may not distribute profits. A similar effect (without the significant administrative complexity) can be achieved by targeting the levy at Certificate 3 companies that currently pay tax at 0% in Guernsey – see scenario 3 below.

Scenario 3 – All Guernsey tax resident companies which are currently taxable at 0%

Under scenario 3, Guernsey tax resident companies (which would exclude those with exempt status) that are taxable at 0% are subject to an annual levy.

It is possible to estimate the number of companies that do not currently pay tax on the basis of corporate income and tax on distributions receipts. However, given that Certificate 3 companies by definition pay tax at 0% rate, it is recommended that Certificate 3 status is instead used to gauge this number, and in practice this is likely to provide a more stable basis for calculating and estimating the potential revenues[37].

Given that 15,995 companies fit into this group (Certificate 3 companies excluding those with exempt status), an annual levy of £1,000 would generate £16.0m in revenue. To generate £20m in revenue, the levy would need to be fixed at a rate of £1,250.

As with Scenarios 1 and 2, variations of this option are possible. In particular, it may be desirable to set a lower levy in sectors administered by fiduciaries (especially private wealth asset holding companies) which are more likely to be susceptible to outward migration. Similarly, there are options for how the tax could be collected under this option – given that many Certificate 3 companies are administered by fiduciaries and fund administrators, these Corporate Service Providers could potentially collect the levy in bulk to simplify administration and cost of collection.

5.4.4 Collection mechanism

As noted in section 5.4.1, there are alternatives to how the levy could be collected. The design of the collection mechanism will be important in influencing:

- The cost of collection and administration for the Revenue Service or other appropriate authority;
- The cost of administration to business; and
- The likely behavioural response.

As discussed above, Scenario 1 lends itself to collection via the existing mechanism via the Guernsey Registry. This would be relatively straightforward to administer and consistent with a levy charged in Jersey.

From a behavioural response perspective, there is merit in considering a mechanism whereby the levy is viewed by the international business community (such as fund managers or private wealth advisors) as a cost of doing business in Guernsey rather than a tax. One way to achieve this would be for Guernsey Corporate Service Providers to administer the levy in bulk in a single return to the Guernsey Registry or Revenue Service on behalf of its administered entities

5.4.5 Summary

Table 14 contains a summary of the tax revenue generated under an £1,000 levy, and the rate of a levy required to generate £20m in tax revenue in scenarios 1 to 3.

Table 14: Summary of impacts of flat fee scenarios

Source: EY analysis

Scenario	Tax revenue generated	Levy required to generate £20m
Scenario 1 – All Guernsey registered companies	£17.1m	£1,167
Scenario 2 – All non-exempt Guernsey tax resident companies	£20.4m	£978
Scenario 3 – All non-exempt non-taxpaying Guernsey tax resident companies	£16.0m	£1,250

[37] Many Certificate 1 companies are also subject to tax at 0%, and hence might be included, which would increase the number of companies beyond that modelled here.

6. Assessing the options

6.1 Revenue raising capacity

The revenue which could be raised under each option is summarized in the table below.

Table 15: Summary of impacts

Source: EY analysis

Option	Tax impact	GVA impact	
Option 1	£19.2m	(£40.1m)	(1.3%)
Option 2	£18.4m	(£34.3m)	(1.1%)
Option 2a	£9.1m	(£352.7m)	(11.1%)
Option 4	£16 – 20m		

All four options have the capacity to raise additional revenues. However, this is off-set under the tax options by the inevitable reductions in GVA.

6.2 Compliance with the international norms

As noted above, it is important to consider the potential implications of any changes to the Corporate Income Tax regime on the status of Guernsey as a complaint regime under international norms. This section of the report considers the various bodies and how any changes might be perceived.

A key concern is to avoid Guernsey being categorised a non-cooperative under the EU's classification of third countries as non-cooperative tax jurisdictions (and hence added to Annex 1 (the so-called "Black List") or Annex 2 (the so-called "Grey List"). This involves the application of the EU's Code of Conduct on Business Taxation by the EU's Code of Conduct Group.

In practice, this also requires meeting the requirements of international standards, since the requirements of the CoC, which have broadened over time, now include obtaining a satisfactory assessment ("largely compliant") from the OECD's Global Forum on Tax Transparency and Exchange of Information for Tax Matters (the "Global Forum") and being a (compliant) member of Inclusive Framework on Base Erosion and Profit Shifting (the "Inclusive Framework"). This latter requirement (i.e. the Inclusive Framework) includes the requirement to satisfy Action 5 of the Base Erosion and Profit Shifting ("BEPS") Action Plan, which relates to the removal (and non-introduction) of harmful tax practices. Compliance with Action 5 is reviewed by the OECD's Forum on Harmful Tax Practices ("FHTP").

When considering the application to this project, the key concern will be whether the changes to the Corporate Income Tax regime results in preferential measures from the perspective of the CoC or a harmful tax practice from the perspective of the FHTP[38]. In practice, the CoCG and the FHTP works closely together, although with slightly different perspectives: as noted in Appendix B, the EU CoCG is more focused on tax being used as a tool to move investment, whilst the FHTP is more focused on how the tax regime applies to mobile activity, in particular intellectual property.

None of the options examined is likely be in clear breach of the relevant rules and this matter was discussed directly with the Policy and Resources Committee. In any event, should the options presented proceed to become policy proposals under the Strategic Review, such proposals would need to be assessed in detail against the relevant criteria.

[38] It is assumed that there would be no change in the transparency requirements and therefore the changes should not affect the rating under the Global Forum.

6.3 Impact on competitiveness

It has been argued that the ability to operate successfully as an international centre for financial services is based on the following key features:

1. A stable political system
2. An effective but non-burdensome regulatory framework operating under English Common Law
3. Ready access to markets in other key centres (including the City of London)
4. World class expertise in financial services (such as captive insurance)
5. A competitive tax system

Changes to the Corporate Income Tax regime should have no impact on features 1 and 3, as they are enduring characteristics of the Guernsey model. However, changes to tax do have the potential to negatively impact the remaining features and therefore each of the options under examination should be assessed in terms of the extent to which their introduction could reduce Guernsey's attractiveness as a place to do business.

6.3.1 Option 1

Option 1 has been designed to increase revenue without fundamentally changing the nature of the Guernsey tax system. In particular, it has been designed not to change the tax treatment of the highly mobile international services which provide the bedrock of the Guernsey economy. Therefore, these sectors can be expected to see no change in the amount of tax paid or in the levels of administrative burden borne.

While the direct impact of the option on key sectors would be negligible, the fact that related services (such as fund administration and domestic banking and insurance) will face a higher charge may have some indirect impact. At the level of sentiment, any increase in tax, unmatched by similar changes in competitor jurisdictions, is likely to generate some negative impact, even if this is merely to raise sensitivity to the risk of potential future increases. In a direct comparison with other jurisdictions, a key metric is whether Guernsey's actions are matched by direct competitor jurisdictions.

Overall, and judged against the other options, Option 1 might be expected to have the least impact on today's level of competitiveness. Primarily this is because it can be designed to not move away from the existing model (for the core industries) and hence should not directly impact on the sectors which are vital to Guernsey's competitiveness as an international financial centre.

6.3.2 Option 2

In principle, Option 2 represents significant change to the Guernsey model, moving towards a more standard territorial system. However, the exemption of the "red line" financial sectors from the scope of the tax means that, as with Option 1, the direct effect on those sectors should be negligible.

The move to a territorial regime can be expected to trigger a reassessment by the CoCG (and/or the FHTP), which will result in a period of uncertainty whilst the CoCG considers the regime. In practice, the CoCG has shown that it sees itself as a group which reviews legislation (whether proposed or in place) rather than one that provides advice over what it wishes a jurisdiction to adopt. As such, the period of review can extend over a considerable period, during which time potential investors may be more wary of investing in Guernsey.

Whilst a successful outcome, and treatment as a compliant 2.1 jurisdiction, may bring additional competitive advantages, the uncertainty during the period of review might contribute to further competitiveness pressures.

6.3.2.1 Option 2a (i.e. Option 2 without red lines)

As noted above, the "no red line" variant of Option 2 was designed to test the effect of applying a tax to the "red line" sectors. Its direct effect would be to increase the cost of operating on Guernsey, while also to increase administrative and compliance burdens.

Whilst this can be seen as an extreme example (given that there are no restrictions on the application of the territorial regime), the results show a reduction in the tax revenue generated (compared to Option 2) as well as a significant increase in the reduction in GVA. As such, this validates the concern that is addressed by maintaining the "red lines". Whilst various elements of the "red lines" could be considered in more detail, it is clear that the complete removal of the "red lines" would not achieve the desired objectives.

6.3.3 Option 4

Strictly defined, this Option leaves the Guernsey tax system unaltered, and simply raises the cost to business of operating on Guernsey by apply a flat rate charge. The impact of this option on competitiveness would crucially depend on:

- The level at which the charge was set
- The cost and burden entailed in paying the charge
- The certainty provided to companies over the longer term

Provided that the charge is set at a reasonable level, the added burden may be expected not to outweigh the benefits of Guernsey's other features. A key question is therefore the relevant costs in competitor jurisdictions. Table 16 below summarises the Jersey International Service Entities ("ISE") fees for 2021, which appear not to have driven significant flight from Jersey.

Table 16: Summary of Jersey ISE fees for 2021

Source: Government of Jersey[39]

Entity type	Fee (£)
Trust company business affiliation leader + per vehicle	£13,100 £300
Trust company business participating member + per vehicle	£300 £300
Trust company business participating member (fee not paid by affiliation leader) + per vehicle	£13,100 £300
Banking business	£78,300
Collective Investment Fund	£4,700
Managed manager	£4,700
Managed manager (other)	£950
AIF services business	£4,700
Fund services business (non-managed entity)	£4,700
Fund services business (managed entity)	£950
Fund services business and manager	£4,700
Body corporate	£750
Trustee	nil
AIF or Collective Investment Fund (not affiliated)	£300
Anstalt, Stiflung or Foundation	£750

[39] https://www.gov.je/TaxesMoney/GST/InternationalServiceEntities/Pages/Registration.aspx.

The following should be noted in comparing Jersey and Guernsey:

- Company registry – whilst the specifics of the fee vary by type of company, Jersey's base fees are generally lower than the annual validation fee applicable in Guernsey.
- However, Jersey charges an additional Government levy of £220 / £270.
- Regulated entities – the GFSC and JFSC charge regulated businesses specific fees based on the type of entity. The GFSC is proposing increases to these fees, so the levy option needs to take into account the overall cost of doing business for the regulated sector.
- GST – Jersey operates a GST regime, and ISEs pay a fee, which varies by type of company. The fee is applied to companies exporting services where the majority of their activity would be zero rated for GST (i.e. generating minimal net revenue). The fee is optional and allows them to reduce their administration associated with the GST. These fees can be substantial for certain businesses, with lower fees for administered entities (£300 per vehicle).
- Based on feedback from specialists, Jersey's ISE regime rarely features as an issue in jurisdiction comparisons, as this is often viewed as an immaterial cost of doing business. There is therefore an opportunity for Guernsey to collect some form of levy without being seen as non-competitive against Jersey – however, as discussed above, a flat £1,000 may not compare favourably in this regard, and may need to be more nuanced.

Whilst this area will need further evaluation, the experience in Jersey indicates that, prima facie, there may be scope for this option.

7. Conclusion

The foregoing analysis shows that the Corporate Income Tax system can be reformed in ways which would raise a considerable amount of additional tax revenue in the context of Guernsey's Strategic Tax Reform. All of the modelled options therefore successfully fulfil the first success criterion of having the capacity to raise revenues.

Similarly, judged against the criterion of maintaining compliance under the EU's Code of Conduct (and international requirements more widely), none of the options would necessarily or directly place Guernsey in a non-compliant category. The most significant difference between the options on this criterion is that the territorial regime is more likely to trigger a period of reassessment of the Guernsey regime by the Code of Conduct Group.

Only under the competitiveness criterion does a clear ranking of the options emerge. Option 1 offers a clear advantage in that it retains the current tax structure and does not impose a tax charge on the finance sector. For the sectors which contribute most to the economy, this would amount to a "no change" option.

A territorial regime with a "red line" carve out would deliver a similar outcome to Option 1, though with the optics of a reform. The same model but without any "red line" carve outs would have the most significant negative impact on GVA and is not considered to satisfy the requirements expressed by the Policy and Resources Committee.

Viewed in the round, the options can be grouped as those which place a greater tax burden on the finance sector (Option 4) and those which place a greater burden on the non-financial sector (Option 1 and 2). This opens up the possibility that an overall reform process could include elements of different options to balance the increased tax burden across different sectors.

Finally, it may be noted that both Option 1 and Option 2 impose greater tax on profits made within the domestic economy. Whilst this is delivered by means of an increase in direct tax (ie. Corporate Income Tax), the tax base (being the profits made in Guernsey) may not differ significantly from the "value added" by those businesses (directly and through their supply chains), once adjusted for imported added value. As such, in theory, the taxpayers under Options 1 and 2 may be similar to those under a Value Added Tax or GST. In practice, how the additional burden falls will depend critically, in the first instance, on the design of either tax (and in particular the use of exemptions and thresholds in GST).

Appendix A Methodology

This Appendix sets out the methodology used to estimate the impact of tax policy options presented in this study.

Key data inputs

To estimate the static and behavioural impact, economic analysis has been performed using Guernsey national accounts data and other statistics as well as additional parameters obtained from a review of existing literature.

Guernsey's statistics used in this study consist of data on gross domestic product (GDP) and its components, including: gross operating surplus (GOS), compensation of employees and mixed income; the number of companies; net assessable profits (NAP); tax revenue by tax type; share of companies in Guernsey with overseas headquarters; firm level data on Certificate 1 companies.

Additional data sourced from a literature review includes linear and non-linear elasticities, the proportion of companies located in low-tax jurisdictions by sector and the proportion of a reduction in profit in response to tax rate changes. Elasticities are used to model the response of companies to change in the rate of Corporate Income Tax, whilst the other data are used to inform assumptions regarding sectoral mobility.

A summary of client data sources used in this study is provided in Table 17 below.

Table 17: Summary of client data sources

Source: EY analysis

Source	Date received	Brief description of use
'Copy of Cert 1 data July 21.xlsx'	21/07/22	Used to calculate the number of Certificate 1 companies by sector, as well as the proportion of each sector that is incorporated in Guernsey in terms of turnover.
Budget reports – States of Guernsey	25/05/22	Contains data on total receipts by tax type. This has been used to estimate the behavioural impact of a change in tax rate.
'Annual self employed tax.xlsx'	19/05/22	Contains data on individual income tax contributions by self-employed individuals by sector. This has been used to model the flat rate option.
'for ey 20211014Guernsey GVA basic market and GDP 2020 COE and Biz Support OPTION A V1.0 .xlsx'	18/05/22	Provides sector level data on components of GVA and tax revenue. This has been used to model the behavioural impact of a tax reform.
'Summary table - Normal Status Companies by Economic Activity (2).xlsx'	19/05/22	This file contains sector level data on the number of companies. This has been used to model the flat rate option and disaggregate net assessable profit data for Funds.
Client email on non-ETI data	30/05/22	Contains data on individual income tax contributions by sector. This has been used to model the behavioural impact of a tax change.
Client email on distributed profits	30/05/22	Contains a breakdown of contributions to tax on distributions revenue by sector. This has been used to model the behavioural impact of a tax change.
Net assessable profits	13/06/22	Provides data on the size of the corporate income tax base by sector.
Client email on the split of banking profits by banking sub-sector	16/06/22	Used to split national account data for Banking between Domestic Retail Banking and Private and Other Banking.
'Economic Overview Jan 22 final.pdf'	14/06/22	Used to provide a breakdown of national account data by sub-sector for Insurance.

The detail of the approach to elasticities is provided in Section 3 of the study.

Approach – static impact

The static impact is equal to the change in corporation and tax on distributions receipts resulting from a change in the Corporate Income Tax rate while the tax base, in terms of net assessable profits, is assumed to remain unchanged:

- Change in Corporate Income Tax receipts is equal to the percentage point change in the Corporate Income Tax rate multiplied by net assessable profits.

- Change in tax on distributions is driven by the change in the ‘top-up’ percentage. This top up tax is designed such that any profits distributed to Guernsey residents are effectively taxed at 20%. For example, if the Corporate Income Tax rate increases from 10% to 15%, the top up percentage on any distributed profits will decline from 10% to 5%. The proportionate fall in this top up rate is applied to current tax on distributions receipts to estimate the new tax on distributions receipts.

Approach – behavioural impact

Drivers of behavioural impact

Economic modelling in this study uses two drivers of behavioural impact:

- Reduction in net assessable profits due to relocations. This impact assumes that companies which relocate stop employing people in Guernsey. This results in a decline in employment and the related employment taxes.

- Reduction in net assessable profits due to profit shifting. This impact assumes that the companies stay in Guernsey. While they retain their staff, their activities become relatively less profitable, leading to a reduction in net assessable profits and Corporate Income Tax payments.

In practice, both drivers are expected to co-exist and both feed into the behavioural tax calculation. The distinction between relocations and profits shifting enables a more accurate estimation of impacts on compensation of employees, employee taxes and social security contributions as well as impacts on consumer facing sectors and GVA.

The relative weights of these two drivers of impacts (28% driven by relocations and 72% by profit shifting) have been informed by the study by Heckemeyer and Overesch (2013) who synthesize the evidence from 25 studies on profit-shifting behaviour of multinational firms and consider different channels of the behavioural tax response.[40]

Corporation and tax on distributions impact

Under the behavioural impact, the Corporate Income Tax base, net assessable profits, is modelled to respond to the change in tax rate.

Net assessable profits following a change in Corporate Income Tax rate are estimated on a sectoral level, using the following formula:

$$Net\ assessible\ profits_{T_1} = Net\ assessible\ profits_{T_0} \times (1 + elasticity \times (T_1 - T_0) \times mobility)$$

T_1 – The rate of tax on distributions plus Corporate Income Tax over net assessable profits under the new scenario

T_0 – The current rate of tax on distributions plus Corporate Income Tax over net assessable profits

Net assessable profits - Total profits reported by a sector

Elasticity - Percentage change in pre-tax profits associated with one percentage point change in tax

Mobility - The propensity of a sector to leave Guernsey following an increase in tax rate.

[40] Heckemeyer and Overesch (2013) Multinationals' Profit Response to Tax Differentials: Effect Size and Shifting Channels, ZEW - Centre for European Economic Research Discussion Paper No. 13-045.

Change in Corporate Income Tax receipts is equal to the new Corporate Income Tax rate multiplied by new assessable profits less current Corporate Income Tax. Change in tax on distributions is driven in the same way as under the static impact.

Other tax impacts

Other taxes that are assumed to be affected by a change in the Corporate Income Tax rate include:

- Income tax
- Social security contributions
- Company fees

The tax base for both income tax and social security contributions is assumed to change less than proportionately with the change in net assessable profits. It is assumed that these taxes only decline where a reduction in net assessable profits is driven by complete migration, rather than entities shifting profits overseas. The change in these taxes is driven entirely by a change in the tax base, with tax rates remaining constant.

Company fees are assumed to fall proportionately with the change in net assessable profits.

GDP impact

When estimating the impact of a change in Corporate Income Tax rate on GDP, each component of GDP is treated separately. The five components of GDP are: gross operating surplus; compensation of employees; mixed income; rental income of households; taxes less subsidies on production. Of the five components, it is assumed that only compensation of employees and gross operating surplus change following a change in tax rates.

The percentage change in gross operating surplus is assumed to be directly equivalent to the percentage change in net assessable profits for each sector.

As with income tax and social security contributions, it is assumed that compensation of employees only declines for those companies that migrate and remains the same for those companies that shifts profits overseas. As a result, the change in compensation of employees is less than proportional to the movement in gross operating surplus.

A benchmarking exercise has been performed to ensure that the results in terms of change in GDP are in line with evidence provided in available literature.[41]

[41] See Mertens and Olea (2018) Marginal Tax Rates and Income: New Time Series Evidence, The Quarterly Journal of Economics, Volume 133, Issue 4, November 2018, Pages 1803–1884; and Romer and Romer (2007) The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks, NBER Working Paper 13264.

Appendix B EU Code of Conduct – history and background

This Appendix summarises the rules of the European Union Code of Conduct for Business Taxation. The EU operates an EU group Code of Conduct Group on Business Taxation (or "CoCG") that reviews countries that have not joined (and are unable to join) its group. This somewhat extra-territorial approach arises due to the extension of an internal agreement between the European Union Member States. The Code, its application and guidance are dynamic documents and regularly reviewed and updated by Member States. Changes to the Code are currently under discussion.

Development and focus of the EU CoCG

Whilst the original focus of the CoC was on tax systems of EU Member States, Member States also committed to promoting the adoption of its principles by third countries and in territories to which European Union ("EU") treaties do not apply, noting that:

> "*Member States commit themselves to promoting their adoption in third countries*"[42].

In extending the work to third countries, the Council agreed on 25 May 2016[43] to:

> *"the establishment by the Council of an EU list of third country non-cooperative jurisdictions and to explore coordinated defensive measures at EU level without prejudice to Member State competence*."

Under the process set out in the Council conclusions on 8 November 2016[44], third country tax systems are assessed under the same criteria applied to EU countries. The rationale for extending the CoC to third countries is:

> *"… that co-ordinated policy efforts in this area at EU and global level, such as determining the objective criteria to identify non-cooperative jurisdictions for tax purposes, are part of effective measures that will contribute to economic growth and tax certainty."*[45]

Guidelines in overview

The criteria used by the CoCG for screening jurisdictions are based on

1. tax transparency;
2. fair taxation and
3. the implementation of BEPS measures

as set out below[46]:

1. Tax transparency criteria

1.1. With respect to the OECD Automatic Exchange of Information (AEOI) standard (the Common Reporting Standard – CRS): The jurisdiction should possess at least a "Largely Compliant" rating by the Global Forum with respect to the AEOI CRS,

[42] 1 December 1997, "Resolution of the Council and the Representatives of the Governments of the Member states, meeting within the Council on a code of conduct for business taxation" Annex 1, tax measures covered"
[43] 25 May 2016, Council of the EU, "Council conclusions on an external tax strategy and measures against tax treaty abuse"
[44] 8 November 2016, Council of the European Union, "Council conclusions on the criteria for and process leading to the establishment of the EY list of non-co-operative jurisdictions for tax purposes, Annex"
[45] 8 November 2016, Council of the European Union, "Council conclusions on the criteria for and process leading to the establishment of the EY list of non-co-operative jurisdictions for tax purposes, Annex"
[46] 8 November 2016, Council of the European Union, "Council conclusions on the criteria for and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes, Annex"

1.2. The jurisdiction should possess at least a "Largely Compliant" rating by the Global Forum with respect to the OECD Exchange of Information on Request (EOIR) standard, with due regard to the fast track procedure, and

1.3. The jurisdiction should have either:

i. ratified, agreed to ratify, be in the process of ratifying, or committed to the entry into force, within a reasonable time frame, of the OECD Multilateral Convention on Mutual Administrative Assistance (MCMAA) in Tax Matters, as amended, or

ii. a network of exchange arrangements in force which is sufficiently broad to cover all Member States, effectively allowing both EOIR and AEOI;

1.4. Future criterion: in view of the initiative for future global exchange of beneficial ownership information, the aspect of beneficial ownership will be incorporated at a later stage as a fourth transparency criterion for screening.

2. Fair taxation criteria

2.1 The jurisdiction should have no preferential tax measures that could be regarded as harmful according to the criteria set out in the Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation, and

2.2 The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction.

3. Implementation of anti-BEPS measures criteria

3.1 Initial criterion that a jurisdiction should fulfil in order to be considered compliant as regards the implementation of anti-BEPS measures: the jurisdiction should receive a positive assessment for the effective implementation of the agreed OECD anti-BEPS minimum standards.

Preferential tax measures

In relation to the above, a key concern is whether a jurisdiction operates preferential tax measures (also known as "harmful tax measures"). The scope and criteria for tax measures to be considered harmful as set out in the CoC[47] are:

A. Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community.

Business activity in this respect also includes all activities carried out within a group of companies.

The tax measures covered by the code include both laws or regulations and administrative practices.

B. Tax measures which provide a significantly lower effective level of taxation including zero taxation, than those levels which generally apply in the Member State in question, are to be regarded as potentially harmful and therefore covered by this code.

[47] 1 December 1997, "Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council on a code of conduct for business taxation" Annex 1, tax measures covered. Also 27 February 2018 "Agreed guidance by the Code of Conduct Group (business taxation): 1998-2018."

- *Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.*
- *When assessing whether such measures are harmful, account should be taken of, inter alia:*

  1. *Whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or*
  2. *Whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or*
  3. *Whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or*
  4. *Whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD, or*
  5. *Whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.*

Applicability to nil or near-nil rate regimes

The CoC considers how this applies to regimes where the is a nil or near nil rate of corporation income tax. In relation to the application of criteria 2.1 and 2.2, the guidance sets out the following[48]:

1. *... absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero by a jurisdiction should be regarded as within the scope of Paragraph A…*
2. *where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero", then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2 has been met.*
3. *In the context of criterion 2.2, the fact of absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero cannot alone be a reason for concluding that a jurisdiction does not meet the requirements of criterion 2.2.*

Application to this project

The relevance of the CoCG rules to this project relates to whether the changes to the business tax regime would breach one of the above guidelines. Since many of the guidelines are unaffected by the changes, the key areas of focus would be whether Guernsey would fall into:

- criterion 2.1 (being a jurisdiction with a tax regime, in which case the concern relates to “preferential measures”) or
- criterion 2.2 (where the jurisdiction is considered to have a nil/almost nil tax rate and the focus is on ensuring that the jurisdiction does not seek to attract profits that do not reflect real economic activity in the jurisdiction).

[48] 27 February 2018 “Agreed guidance by the Code of Conduct Group (business taxation): 1998-2018.” P112

The impact of these categories is discussed in the context of each option.

Current state

Guernsey is currently considered to be a “2.2 jurisdiction”, such that there is a nil/near nil tax rate, and focus has been given to ensuring that activities in Guernsey reflect real economic activity in the jurisdiction.

Appendix C Evaluation of measures under the CoCG

In the guidance, the CoCG has noted that, *"while each measure should be assessed on its merits …, precedence has in the past and should in the future play a role in the Code of Conduct procedure"*.

In comparing tax measures, the CoCG has provided a table (see below) to specify the comparables. In doing so, it has noted[49] that:

- *"the elements in the table should not be used as a cumulative requirement list since requiring 100% comparability would undermine and erode the principle of precedence and equal treatment;*

- *the left column of the comparability table contains a full list of the elements derived from the Code of Conduct that are relevant in the comparison. The list of comparables, in the right column of the table, sets out factors which may be considered relevant for the Code of Conduct but is in principle non-exhaustive;*

- *'type of income' is a relevant comparable since the Code focuses on measures that affect the location of business activities. The Group could consider that if a measure targets a type of income which is relatively mobile, one could argue that the measure is more likely to affect the location of business activities than a measure that targets a less mobile type of income (determined on the basis of the actions needed and risks run by relocating the underlying asset or activity that generates the income or the possibilities to re-route a flow of income from the companies actually paying the income)."*

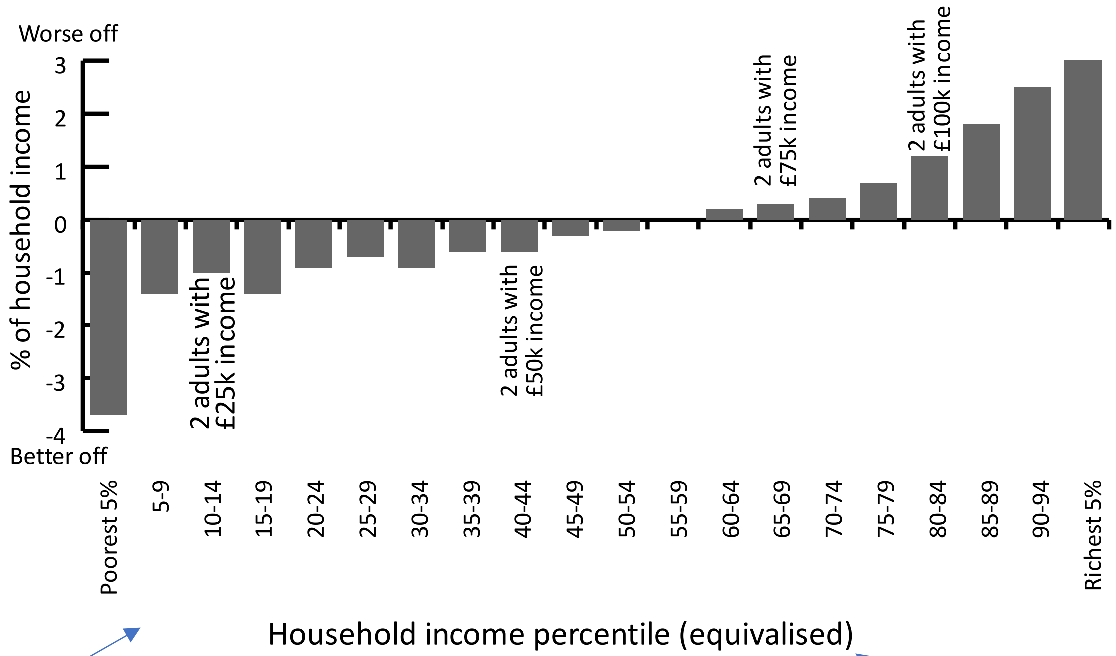
Code of Conduct elements		Comparables
A	Affects business location	• Which type of business or income is covered by the regime? • Does the measure attract genuine economic business or artificially shiftable mobile tax bases? • Attraction of tax bases of other MSs? Can the tax base easily be shifted (mobility)? • Is the measure targeted at MNEs (intra group)?
B	Lower level of taxation	Design of the reduction of the tax base or rate
1a	Benefits accorded to non-residents or transactions with non-residents	To what extent does the measure, de jure, benefit foreign-owned companies?
1b	De facto	To what extent does the measure, de facto, benefit foreign-owned companies? Impact assessment required, economic effects (e.g. number of foreign owned companies benefiting as a percentage of total companies benefiting). Without prejudice to the criteria in the Code, the Group will consider any economic factor and impact data that are brought to its attention. The Group will consider size and openness in order to ensure that there is no discrimination between Member States. Equally, it will not use these factors in a way which discriminates against larger or less open Member States. Together with size and openness the Group will consider other relevant factors, such as the transparency of the tax system and the significance of the economic effect on other Member States, in a similarly full and balanced way.
2a	Protection of the tax base	Does the measure affect the domestic tax base? Is the domestic tax base protected in any way? If yes, in which form? (e.g. no domestic companies allowed or limitation of deductibility of transactions with domestic companies).
2b	De facto	To what extent (budgetary) is the domestic tax base protected? Impact assessment needed, economic effects.

[49] 5 December 2019. General Secretariat of the Council. *Agreed guidance by the Code of Conduct Group (business taxation): 1998 - 2019.*

3	Substance	Which substance requirements are in place? Personnel, investments in fixed assets, other.
4	Profit determination (transfer pricing)	OECD Transfer Pricing Guidelines: • fixed margins vs case by case approach • periodical review of the transfer price • exchange of information
5	Transparency	Procedure for granting of the benefits (discretionary powers?)

Appendix 4. Guide to interpreting the analysis presented

This graph expresses the impact as an average percentage of a households gross income including pensions and benefits but before taxes

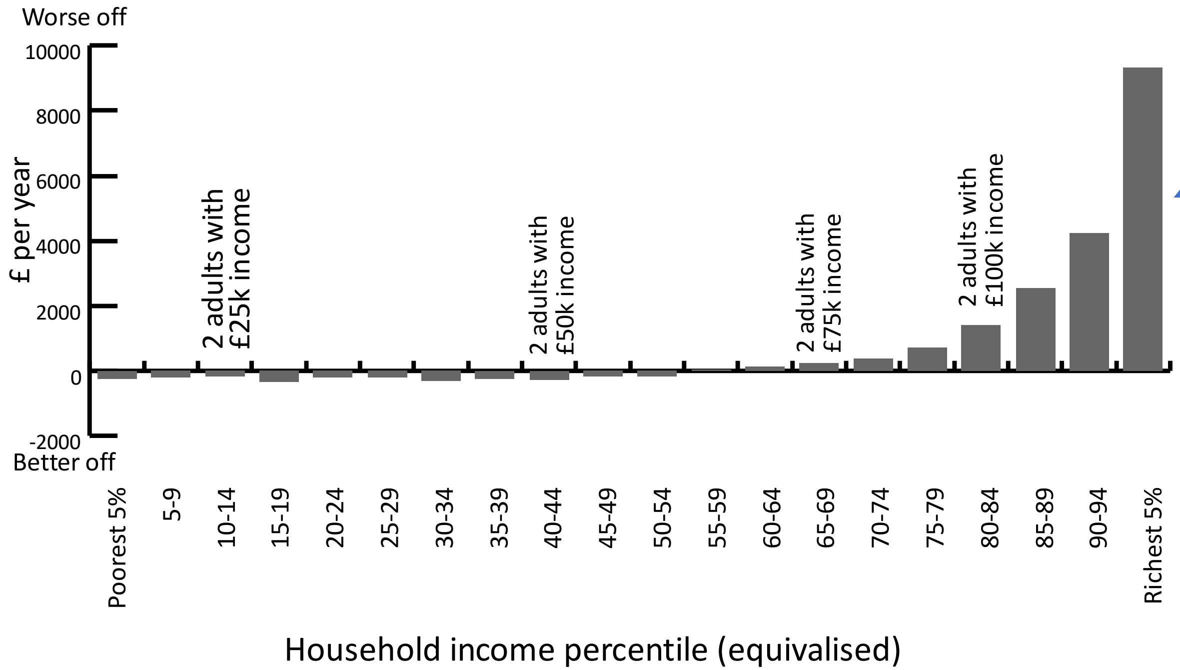


The analysis includes both the change in households tax liability, and any changes in their pension and benefit entitlement. Household groups where the outcome is negative are better off, where the outcome is positive they will pay more.

Households are grouped by equivalised income percentile. Each bar represents 5% of households grouped in order of income from the lowest (left) to highest (right). Figure 34 provides the average income of households in each band.

Equivalisation means that the income of the households undergoes a standard adjustment reflecting how many people live in the household. This is intended to account for the fact that it takes more money to support two people than one, but not twice as much. Figure 34 provides the average income of households in each band.

This graph expresses the impact as a monetary value in £ by which a household group will be better or worse off in £ per year



Higher income households pay much more because their larger income means that even a small percentage change is more in monetary terms than the same change for a household with a smaller income

Figure 34: Average gross household income (including pensions and benefits) of households by equivalized income percentile and household composition

Equivalised Household income percentile	One adult (16-64)	One adult (16-64) with child(ren))	One adult (65 and over)	Two adults (16-64 with child(ren))	Two adults (16-64)	Two adults (65 and over)
0-4	7,394	14,201	10,198	22,804	12,491	14,594
5-9	13,160	20,021	12,958	31,849	20,173	19,136
10-14	15,382	24,290	15,240	36,288	23,747	22,833
15-19	18,349	29,028	17,944	42,520	27,305	27,012
20-24	21,042	32,425	20,643	48,342	31,756	30,880
25-29	23,518	35,702	23,301	53,869	36,039	34,915
30-34	26,707	42,266	26,057	57,183	39,880	38,986
35-39	29,741	45,734	29,040	63,945	44,300	43,392
40-44	33,003	48,062	31,993	71,237	49,525	48,036
45-49	36,304	52,272	35,140	76,799	54,148	53,382
50-54	39,440	56,951	38,738	82,288	58,824	57,498
55-59	42,992	61,774	41,956	89,841	64,321	62,929
60-64	46,576	63,906	45,618	96,515	69,526	67,961
65-69	50,661	68,454	49,174	105,210	75,546	74,149
70-74	54,786	*	53,603	114,775	82,244	80,275
75-79	60,118	*	59,004	125,534	90,157	89,106
80-84	67,055	*	66,609	140,660	100,430	99,193
85-89	77,367	115,354	75,814	163,856	116,627	116,012
90-94	97,890	*	96,093	201,350	143,647	146,647
95-99	213,954	*	281,398	369,066	284,838	309,290
* Represents groups with less than 10 households in the data set						

Appendix 5. The Alternative Levers

Corporate Income Tax

A5.1 Corporate taxes make up approximately 10% of Guernsey's current revenues. Despite the headline 0% rate the proportion of government revenues they comprise is similar to the international average (although this varies considerably from country to country). Taxes on company profits tend to be volatile since they are very sensitive to economic conditions. This means few countries choose to rely on these as their primary source of revenue.

A5.2 Guernsey's current regime was introduced in 2008 because the previous regime was deemed non-compliant by the EU Code of Conduct Group, because it offered preferential tax rates to international business which was not available to domestic business.

A5.3 Zero-10 involves the application of three different tiers of tax rates.

A5.4 The Standard rate is 0% - This is the rate of tax applied to the majority of tax resident companies, including most domestic businesses. Any distributions made from a 0% company to a locally resident share holder are taxable under the 20% personal income tax rate.

A5.5 The company intermediate rate (10%) applies to income from:

- banking business,
- domestic insurance business,
- fiduciary business,
- insurance intermediary business,
- insurance manager business,
- administration of controlled investments,
- provision of custody services,
- provision of investment management individual client services,
- operation of an investment exchange,
- compliance and other related activities and,
- income from operating an aviation registry.

A5.6 The company higher rate (20%) applies to income from

- trading activities regulated by CICRA,
- the importation/supply of gas or hydrocarbon oil,

- large retail business carried on in Guernsey (with a taxable profit of more than £500,000), and
- the ownership of Guernsey land and buildings, i.e.
    - Property development and exploitation of land (including income from the sale of extracted materials)
    - Rental income
- income from the business of the cultivation or use of the cannabis plant, and from the prescribed production or prescribed use of controlled drugs

A5.7 Guernsey introduced economic substance requirements for businesses undertaking certain activities from 1 January 2019 to meet international and regional standards. On 12 March 2019, ECOFIN formally confirmed Guernsey's position as a cooperative jurisdiction, reaffirming this in 2020, 2021 and February 2022.

- ***International Tax Reform***

A5.8 The Organisation for Economic Co-operation and Development (OECD) continues to press forward with reforms to the international tax framework, developing proposals to address the challenges of increased globalisation and the digitalisation of the economy, targeted at the world's largest Multinational Enterprises (MNEs).

A5.9 On 8 October 2021, the OECD Inclusive Framework released a statement on a two-pillar solution, in which 136 jurisdictions (including Guernsey) joined the political consensus on the new tax framework. This was an important political stepping-stone and established the building blocks for the tax reform process. Significant further technical work is ongoing, with implementation plans being developed. Guernsey remains actively involved in these discussions through our seat in OECD fora.

A5.10 The proposed elements of these pillars are:

- Pillar One - a minimum standard that creates new profit allocation rules for MNEs with global turnover in excess of €20bn and profitability in excess of 10%. The Pillar One rules will exclude Regulated Financial Services. For the very small number of MNEs globally that are impacted by Pillar One, a proportion of their profits would be re-allocated to market jurisdictions.

- Pillar Two – a common approach that seeks to ensure those MNEs with global revenues of at least €750m would pay a minimum effective tax rate of 15% on their profits. There is an important carveout for investment entities (such as funds). This Minimum Effective Rate would be calculated in a specific way based on financial statements and on a country-by-country basis.

A5.11 Pillar One is a minimum standard that Guernsey will be required to introduce in legislation, notwithstanding the minimal practical impact. However, Pillar Two is a common approach, giving Guernsey options regarding how to respond.

A5.12 Technical discussions on both pillars continue at an international level in which Guernsey actively participates. Extensive stakeholder engagement and data analysis is being undertaken to understand potential impacts of the various policy options. Whilst it is expected that the proposals will bring in some additional revenues, the level and timing are still uncertain, as these are impacted by MNE behavioural responses and how other jurisdictions implement the proposals.

- ***Corporate Income Tax Analysis***

A5.13 Since the previous debate on the tax review, an exercise has been undertaken to examine what further options might be available to Guernsey to modify its corporate tax regime in a way that contributes to the sustainability of Guernsey's overall tax receipts, whilst remaining internationally acceptable and competitive.

A5.14 EY modelled 4 different options (full report at Appendix 3) which were:

- Expansion of the categories of income taxable at 10 and 20% in the existing corporate tax regime
- A territorial regime with a headline rate of 15%, considering the impact of preferential rates for certain sectors
- A worldwide regime with a headline rate at 9%, which was discounted fairly early, given in the context of the Guernsey economy it would be practically indistinguishable from a territorial regime
- A flat-rate levy

A5.15 The review suggests that there are opportunities in the region of £10-20m, which individually are not sufficient to meet the funding gap. They are also likely to overlap with any additional revenues that may arise from responding to Pillar 2.

A5.16 The Committee are engaging with stakeholders to consider the competitiveness impact and fit of the options with Guernsey's wider tax strategy, which is not something that can be achieved quickly.

A5.17 The Committee therefore intends to in parallel continue engagement with industry and with the other Crown Dependencies with the objective of exploring ways in which the corporate income tax system may be amended or extended to raise additional revenues without unduly negatively impacting Guernsey's competitive position or compliance with international standards.

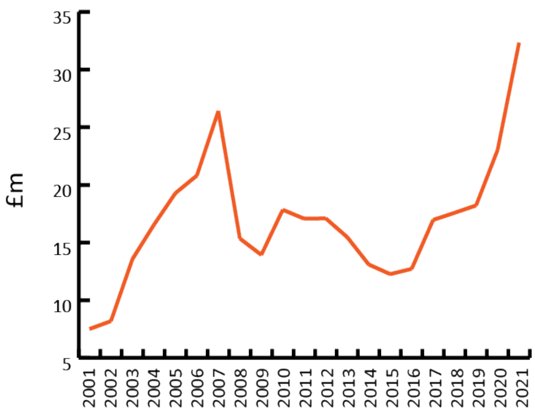
Property taxes

- ***Document duty***

A5.18 Guernsey applies two forms of taxes on property. Document duty, which is an ad velorum tax charged as a percentage of the purchase price of a property; and Tax on Real Property, which is an annual charge based on the size of domestic and commercial properties.

A5.19 Document duty is one of the most volatile taxes in Guernsey's tax base because it is dependent on both the volume and the value of transactions taking place. Revenues over the last 20 years have ranged from £12m to £32m. It is common for the revenues generated to shift by more than 10% in either direction, and this has happened in 11 years out of the last 20. On four occasions receipts have moved by more than 30% from year to year.

Figure 35: Document Duty Receipts



A5.20 While this means that the States can receive a boost to revenues when the housing market is strong it also means that they are very difficult to forecast reliably (in both 2020 and 2021 document duties were a significant source of forecasting error). This makes them a poor choice for long term sustainable revenue raising. **It is, therefore, not recommended document duty be used as a mechanism to raise significant revenues.**

A5.21 However, changes to document duties may be a mechanism which might be considered for behavioural reasons. The 2023 Budget received endorsement for the amendments to document duties to:

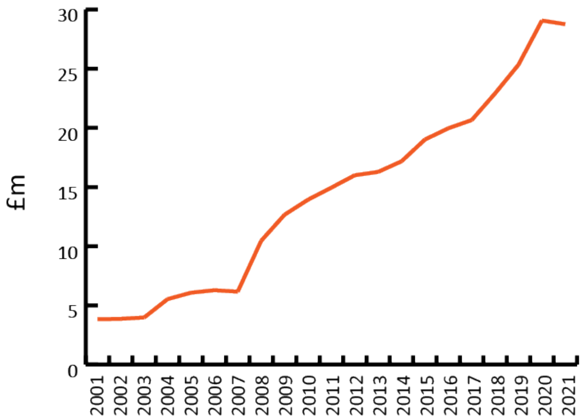
- Introduce a time limited scheme reducing document duty for those downsizing
- Add a supplementary rate of 2% on residential properties which are not to be the purchaser's principle private residence.

A5.22 Such moves are unlikely to be significant revenue raising measures but may influence purchasing decisions.

- ***Domestic TRP***

A5.23 Tax on Real Property, the annual charge levied on the ownership of property is far less volatile, and an area of taxation that (in relative terms) has been increased significantly in the last fifteen years.

Figure 36: TRP Receipts (TRV prior to 2008)



A5.24 Unlike Jersey and the UK, who assess their equivalent charges based on property value, in Guernsey this was restructured in 2008 to be charged based on property size. This significantly simplified the administration of the tax and relieved much of the challenge around assessments. However, it does make comparison between rates charged in Guernsey and other jurisdictions difficult.

A5.25 For the majority of domestic properties TRP rates are still low relative to council tax rates in the UK. The average council tax payable for a band D property (considered of average size) in 2021-22 is about £1,900[23]. An average size property in Guernsey (TRP of 150) would carry a charge of £291 in 2023, with approximately £100 of parish and refuse rates charged in addition to this by the parish. It was for this reason that the 2015 Personal Tax, Pensions and Benefits Review recommended doubling domestic TRP rates over 10 years – a policy that was continued until the 2021 budget. To complete the previous policy of doubling the basic TRP rate in real terms over ten years, would require an increase of a further 40% and would raise about £3m. As this demonstrates, the revenue raising potential of even quite substantial increase in TRP is limited.

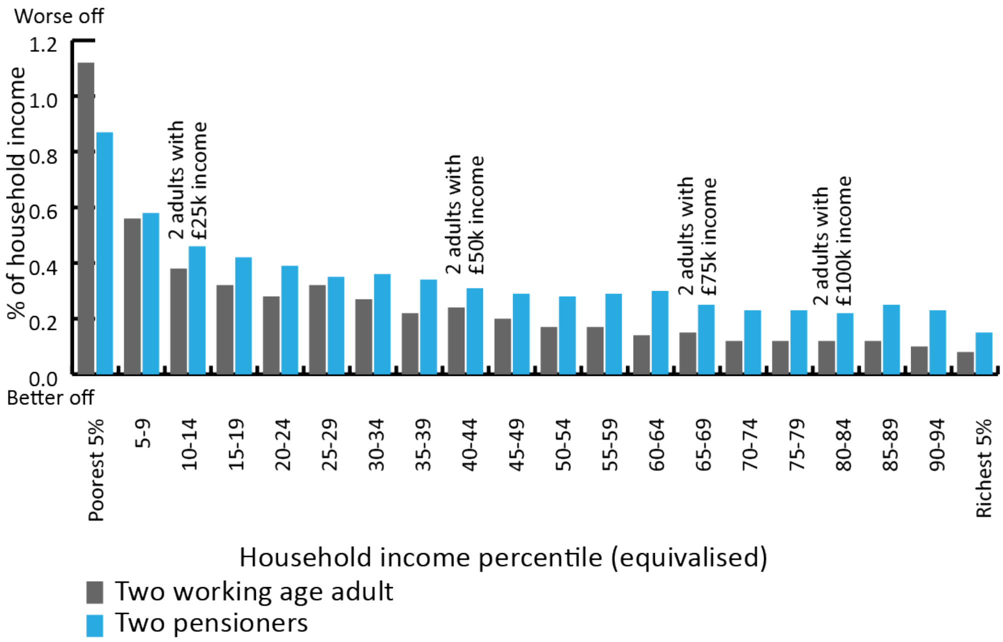
A5.26 The multiplier introduced across the 2019 and 2020 budget means the tax charged on the largest properties (the top 25%) is charged at progressively higher rates with properties with a TRP value of between 200 and 299, 300 and 399, 400 and 499, and 500 or more are now subject to rates significantly higher than the baseline rate. The TRP charged for properties in the highest band (approx. the largest 2.5%) begins at £1,860 a year. The very largest properties (top 0.2%) may carry TRP bills of more than £3,000 which is similar to the council tax charged on band H properties by most UK councils. This means that the TRP

[23] Discounts are available for various household types including single adults and students.

charged for the most prestigious properties is closer to the rates you might expect to face in the UK.

A5.27 Generally (but not universally) TRP values increase with income, but the increase in TRP values is slower than the increase in income. This means that, presented as a percentage of gross household income, increases in TRP tend not to be progressive. Because the distribution of property ownership across the community is uneven the application of significant increases in TRP affects some groups significantly more than others. In particular, because in Guernsey pensioners are more likely to own a home that is large relative to their income than working age households, increases in TRP can be challenging for pensioner households. Figure 37 below compares the impact of a 40% increase in TRP rates (raising just £3m) on working age couples and pensioner couples.

Figure 37: Comparison of the impact of a 40% increase in TRP on working age and pensioner couples (raises £3m)



A5.28 Combined these factors mean that raising very substantial revenue from increases in domestic TRP is not a good option. However, it will continue to form part of the budget considerations each year and may make marginal contributions to revenue raising.

A5.29 Like document duty consideration has been given to using TRP as a means to influence behaviour and the 2023 budget proposed the application of enhanced TRP rates on derelict property and property where development has been approved but not completed.

- ***Commercial TRP***

A5.30 Like domestic TRP, commercial TRP was also restructured in 2008 and it was significantly increased as part of the restructure, with rates in most classes increasing by 100% and Regulated financial services increasing by 400%. In the intervening years the trend has been to increase these rates by at least inflation and in some years considerably more. Since 2007, TRP rates for all financial services, legal and accountancy office space has increased by more than 900% in real terms (see Figure 38). The current policy is to transition the rate for all other office accommodation to the same level raising approximately £2m additional revenues.

A5.31 Office accommodation makes up more than half of commercial TRP revenues. The TRP on a modest size office of approximately 1000sqft would cost approximately £4,200 a year at this rate. Comparison with UK and Jersey is difficult because both jurisdiction base rates on values, not floor areas and the UK apply a range of "multipliers" based on business sectors. Business rate estimates in central London are generally considerably higher than this, but very broadly this is similar to the amount you might expect to pay in business rates for office space outside of London.

A5.32 The rates for most other sectors (excluding utilities) are lower, and in general this reflects the lower level of profit you might expect to generate for these uses from different business types. The largest of the non-office-based categories, are the Retail sector and Hostelry and TRP is a significant fixed cost. A moderate sized retail unit of 3500 sq ft (a typical size for units in Le Pollet) would have a TRP bill of around £4,000 a year. Some real increase may be tolerated, but the high turnover of smaller retail outlets suggests that many of these smaller businesses operate on quite marginal profits and could be very sensitive to significant increases in rates.

A5.33 In 2023 commercial TRP is expected to raise £23m. To raise £10m it would therefore be necessary to increase rates across the board by almost 50%. For office accommodation this would come on top of very considerable increases since 2007 potentially pushing rates to a level where they are uncompetitive. Of the other classes only Utility providers, Hostelry, Retail and Warehousing (which is usually related to retail activity) raise more than £1m a year each. **Overall, this suggests that the capacity for additional revenue raising from commercial TRP is limited.**

Figure 38: Real increases in commercial TRP

	2023 rate	*Real increase since 2007*	*Forecast revenue £m*
Hostelry and food outlets	£7.45	183%	£1.4
Self-catering accommodation	£4.70	189%	£0.2
Motor and Marine Trade	£6.45	189%	£0.4
Retail	£13.05	169%	£2.4
Warehousing	£6.95	190%	£1.3
Industrial and Workshop	£5.55	189%	£0.5
Recreational and Sporting premises	£3.15	183%	£0.1
Garaging & Parking	£6.95	na	£0.6
Utilities providers	£54.30	189%	£3.2
Office and ancillary accommodation (regulated finance industries)	£50.65	926%	£6.0
Office and ancillary accommodation (legal services)	£50.65	926%	£0.8
Office and ancillary accommodation (accountancy services)	£50.65	926%	£0.6
Office and ancillary accommodation (NRFSB)	£50.65	926%	£0.0
Office and ancillary accommodation	£43.90	789%	£5.5
Horticulture (building other than a glasshouse)	5p	-38%	£0.0
Horticulture (glasshouse)	5p	-61%	£0.0
Agriculture	5p	-38%	£0.0
			£23.3

Motoring and environmental taxes

A5.34 Environmental taxes, and motoring taxes in particular were raised multiple times in debate. They have therefore been flagged for further consideration as part of a mosaic approach to revenue raising.

A5.35 Generally, whiles such taxes can be effective in helping meet environmental objectives, such taxes are not ideal mechanisms for raising revenues, for several reasons:

- They change behaviours

A5.36 Quite often such taxes are often specifically designed to drive behavioural change – for example by reducing fuel or energy usage. As a result, they are prone, almost by intent, to be unsustainable as revenue streams. The decline in tax revenues from excise duty on motor fuels is a good example of this. Because the tax is levied on very specific activity or consumption, as consumption patterns change the revenues are eroded. To maintain revenues, the taxes need to be increased in real terms or their scope expanded.

-

- They can be regressive

A5.37 Unless designed carefully environmental taxes are the among the most regressive taxes within the tax base (tobacco duty is the most regressive, followed by excise duties on fuel and alcohol). This is because they tend to fall on items over which people may have limited short term discretion on their spend and their consumption of goods and services subject to such taxes may have limited relationship to their income. For example, a lower income household will have a minimum requirement for things like hot water and heating and are also likely to be living in poorer quality accommodation which are inefficient to heat. As a result, there is little variation in the monetary spend on domestic energy as income rises (Figure 39 and Figure 40). Proportionate to income therefore such taxes tend to rest more heavily on poorer households.

Figure 39: Estimated excise liability for fuel purchases

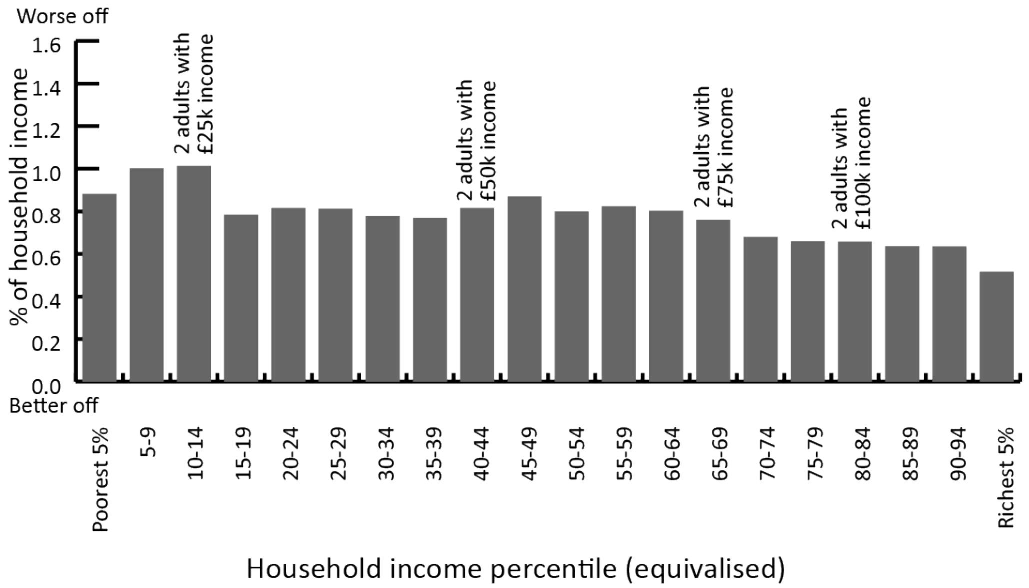


Figure 40: Average expenditure on household energy by income quintile

	Quintile 1 (poorest 20%)	Quintile 2	Quintile 3	Quintile 4	Quintile 5 (richest 20%)
	£s per year	£s per year	£s per year	£s per year	£s per year
Electricity	1,078	980	979	1,094	1,438
Gas	212	237	289	367	276
Other fuels	449	458	548	482	799

A5.38 The cost of these taxes can be mitigated in the medium to long term, but typically this requires a capital investment – for example to insulate a home – which may still be beyond the means of lower income households. Further, for those in rental accommodation the action required may be the responsibility of a landlord with little incentive to invest the money for the benefit of their tenants.

These could be mitigated with means tested grants for lower income households towards capital purchases and legal requirements on landlords, but that implies a mitigation cost which is likely to be high relative to the revenues raised.

- They may apply unevenly across generations

A5.39 Because the taxes may be levied on very specific activities there is a risk that their distribution across the community would be uneven. Motor taxes for example are likely to rest more heavily on working families with children who have the highest need for transport. Environmental taxes which might impact the cost of heating for example, may rest more heavily on older people, who spend more time at home and are more likely to be living in older, poorly insulated homes. Table 2 shows that on average a single pensioner spends £183 a year more of domestic energy than a single working age adult and a pensioner couple will spend £246 more on average than a working age couple.

Figure 41: Average expenditure on household energy by household type

	One Adult (16-64) £s per year	One Adult (65+) £s per year	Two adults (16-64) £s per year	Two Adults (65+) £s per year
Electricity	834	785	1,103	1,047
Gas	230	267	294	261
Other fuels	213	408	443	778
Total	1,277	1,461	1,840	2,086

A5.40 However, while they are not suitable to make up the bulk of the required revenue raising, given the current focus on climate change there is clearly an appetite to look at expanding the amount of revenue Guernsey raises from such taxes. Such measures require careful design if they are to meet environmental objectives without significant negative social impacts. This requires specialist expertise and is not something that can be achieved in full within the timescale of this project.

A5.41 To give an indication of an appropriate scale:

- Duty on fuels (which incorporates revenue previously raised via annual charges) raises approximately £20m in a normal year (less in 2020 because of COVID-19 restrictions) but this has been eroded by falling volumes because of increased fuel efficiency of cars and more recently an increase uptake of EVs and this trend appears to be accelerating. This is subject to on ongoing workstream to look at the future of motor taxes in Guernsey and there is now direction to consider increased revenues through this workstream.

- Revenues for Guernsey Waste from domestic charges total £3.9m (not including parish charges). A further £4m is gained from commercial operations, gate fees at various sites and other operational revenues. When discussed in the assembly Members voted against increases in waste charges sufficient to cover the full cost of disposal (Billet d'État XXIII, 2022).

- Paid parking in Jersey raises approximately £8m a year. Pro-rata this suggests a limit of around £5m for Guernsey.

A5.42 This suggests that the scope of what is realistically achievable in terms of revenue raising is highly unlikely to be a very significant proportion of the existing funding gap. Previous experience also suggests they are likely to meet significant public resistance prior to implementation. A £5m envelope may be achievable, £10m may be ambitious particularly if this is in addition to further revenue raising from taxes on motoring.

Capital taxes and inheritance taxes

A5.43 **Capital gains taxes** are paid when an asset is sold or transferred. Many jurisdictions have them but how they are applied varies widely. However, they are relatively unusual in offshore finance centres – neither of the other Crown Dependencies apply these, nor does Singapore or Gibraltar. This is because these jurisdictions typically wish to attract high net worth individuals who tend to specifically seek jurisdictions where such taxes are not applied. They can also impact elements of wealth management industries that are detrimental to their economies.

A5.44 In Luxembourg they are only charged for investments held for less than 6 months (2 years for real estate) for individuals. For companies gains are treated as ordinary income but certain shareholdings are exempt and there is a complex “recapture” system to neutralise the impact of deductible expenses in relation to exempt gains.

A5.45 The only tax of this nature Guernsey has ever applied was a specific tax on the rapid resale of property to prevent speculation. This was applied following a period where this became a specific issue at a time when property prices were rising quickly. The tax applied was set at 100% of gains for a primary residence sold within a year or a rental property sold within 5 years. The tax was specifically designed to discourage speculation and raised little or no money in most years, costing more than it raised to administer. It was suspended in 2009 because:

- it caused some odd behaviour, for example people notionally moving into rental or investment properties they wished to sell; and

- caused issues for people who had genuine reasons for a quick resale – for example following a relationship breakdown, or for contractors genuinely seeking to refurbish and resell properties in need of renovation.

A5.46 There is little evidence that this type of speculation has become a significant issue again and tackling such a problem would be better considered as a budget matter.

A5.47 UK capital gains tax is charged at 28% on residential property gains (with a private residence relief effectively exempting capital gains on sale of your home) and 20% on other assets (or 18% and 10% for basic rate taxpayers). It raised £10bn in 2019-2020 financial year which (adjusted pro rata for the size of the population) suggests an outer limit of revenue from a capital gains tax in Guernsey of £10m. Given that an upper rate of 28% would be out of step with Guernsey's income tax rates, in reality the scope is significantly smaller. **An estimate of £5m may be more realistic for a capital gains tax at a more modest 10%.** Revenues are likely to be volatile and the more restrictions are placed on the application (for example if applied only to the sale of residential property which is not a primary residence) the smaller this will become.

A5.48 **Inheritance tax** is similar to capital gains in that it relates to the value of assets when they transfer ownership, but it is applied specifically to the estate of the deceased before ownership is passed to the heirs. Like capital gains taxes they are relatively unusual in offshore finance centres – neither of the other Crown Dependencies apply these, nor does Singapore or Gibraltar. Inheritance tax is charged in Luxembourg, but their rules around inheritance are complex.

A5.49 In the UK inheritance tax is charged at 40% for the value of the estate above the threshold value (£325,000) and it raised £5bn in 2019/2020. This high rate of inheritance tax is well beyond what Guernsey is likely to consider, using the same pro-rata approach, **estimates for what might be raised in Guernsey at a more moderate rate would be no more than £1-2m.**

A5.50 As described above the potential revenue generation from capital gains or inheritance taxes are likely to be far smaller than some might suppose.

A5.51 They also pose a very high level of risk to the Guernsey economy. Feedback from Locate Guernsey suggests that, while there are many reasons for HNWI selecting Guernsey as a place to live, the absence of capital gains and/or inheritance taxes is usually a pre-cursor to considering a jurisdiction as an appropriate location. The application of such taxes in Guernsey would not only pose a significant barrier to attracting such people to Guernsey but would risk losing many of those already living here. Given the extent of the contribution such households make to the economy and to the tax system this risk alone may place such taxes beyond consideration.

A5.52 There is also potential risk that some elements of the financial service sector might be impinged, most notably fiduciaries and family trust activities, unless steps were taken to protect these. This is because typically a capital gains tax charge arises when assets are put into a trust or transferred out. Similarly, a charge to corporate tax arises when capital assets are disposed of by a company, noting that any discrimination between resident and non-resident owned companies would likely breach international tax principles.

A5.53 Further, the collection of taxes on capital gains for individuals or inheritance tends to be administratively intense relative to the amount collected when compared to other taxes, involving the valuation of assets and a high rate of appeal and significant measures to prevent avoidance (such as rules on divestment of assets).

A5.54 The overall conclusion of the steering group is that such taxes may ultimately risk more revenue than they gain and should not be considered further.

- ***Online Taxes and packaging taxes***

A5.55 While superficially attractive the application of a tax which applied specifically and solely to online purchases by Guernsey consumers would have very significant implications for Guernsey's domestic and international relations.

A5.56 Guernsey entered into a Customs agreement with the UK in November 2018. Paragraph 4 of this agreement specifically prohibits Guernsey from imposing import duties (or charges or levies of equivalent effect) on the movement of goods from the UK to Guernsey[24]. The Customs arrangement achieves the effect of ensuring that Guernsey, along with the Isle of Man and Jersey are in effect one Customs territory for the purposes of the movement of goods and applying a unified UK tariff. Without being in a Customs Territory or Customs Union, the Island would not be able to participate easily either within other International trade organisations or agreements, which rely on the firm basis of being within a Customs Union.

A5.57 To lose this agreement would be of significant detriment to Guernsey and is not a position in which Guernsey would wish to place itself. The consequences of doing so, could be significant and wide reaching.

A5.58 Further Guernsey participates in the UK's membership of the World Trade Organisation (WTO) and UK-Rest of World Free Trade agreements (FTA). Membership of the World Trade Organisation ensures that in a post-Brexit world, the Islands are afforded international trade protection from unfair and

[24]A GST, which is applied equally to both imported and domestic goods is permissible under this arrangement and in place in Jersey who hold a similar agreement with the UK

discriminatory trade practices on a reciprocal basis, which can be applied to non-Members.

A5.59 Being part of the WTO also means that Guernsey in return must adhere to globally recognised international trade rules and equally not apply unfair or discriminatory trade rules. It is important to note also that the scrutiny we are under is continual - the WTO, and other countries require routine and regular demonstration that Guernsey is adhering to the trade rules such as those in relation to the movement of goods. The key principles of WTO Membership which are referred to as Most-Favoured-Nation (MFN) specify that countries cannot apply regulations that discriminate between trading partners and National Treatment (NT) which means that Guernsey must treat foreign and imported goods equally. For example, applying a duty only on small packet freight, such as those ordered online, and not larger consignments or items shipped in bulk destined for domestic retail would be considered as discriminatory and not compliant with the core WTO principles as it has the effect and aim of offering favourable treatment to local suppliers over those who import small packet goods into the Islands.

A5.60 These considerations essentially preclude an “online” or packaging tax (which would risk being considered as having “equivalent effect”) applied to personal import. This is even before consideration that this would require a significant proportion of the administration by the Guernsey Border Agency that would be required to administer a GST but would raise only a small fraction of the revenues. For these reasons an online tax has been ruled out from further consideration.

A5.61 The UK conducted a consultation around the possibility of introducing an Online Sales Tax as part of their review of business rates. The outcome of that exercise was that the UK has decided not to introduce one. Their decision reflects concerns raised around the complexity and risk of creating unintended distortion or unfair outcomes between different business models.

Appendix 6. Alternative packages

A6.1 Through the course of this project the Steering Group and the Committee have examined large numbers of possible structures. This includes structures with both higher and lower rates of GST and models which apply no GST but raise revenue from income-based taxes only.

A6.2 It would be unfeasible to present all these options in full detail, however, the Committee have opted to present high level analysis of a small number of alternative structures so that members can see the impact of different approaches.

A6.3 Each of the models presented raises approximately the same amount of revenues and includes a restructure of the social security contributions system. Each is designed to be generally progressive, with the largest additional burden falling on those households with the largest income. However, they do vary with regards their impact on households, business and the economy.

A6.4 The four alternative models presented are:

- Adaptations of the lead model with a 5% GST with approximately £19m of revenue raising via the Social Security system but which:

    a) Reduce the headline rate of income tax to 19% and apply an increase in tax allowances by £1,100

    b) Retain the 20% headline rate and increase the tax allowance by £2,400

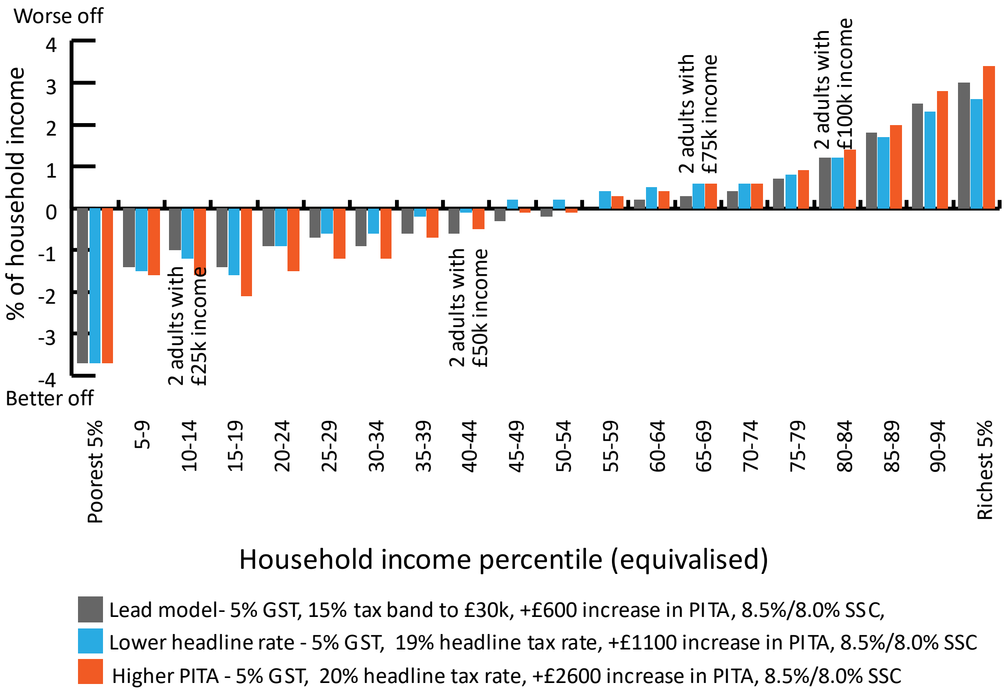
- Income based approaches with approximately £19m of revenue raising via the Social Security system but which:

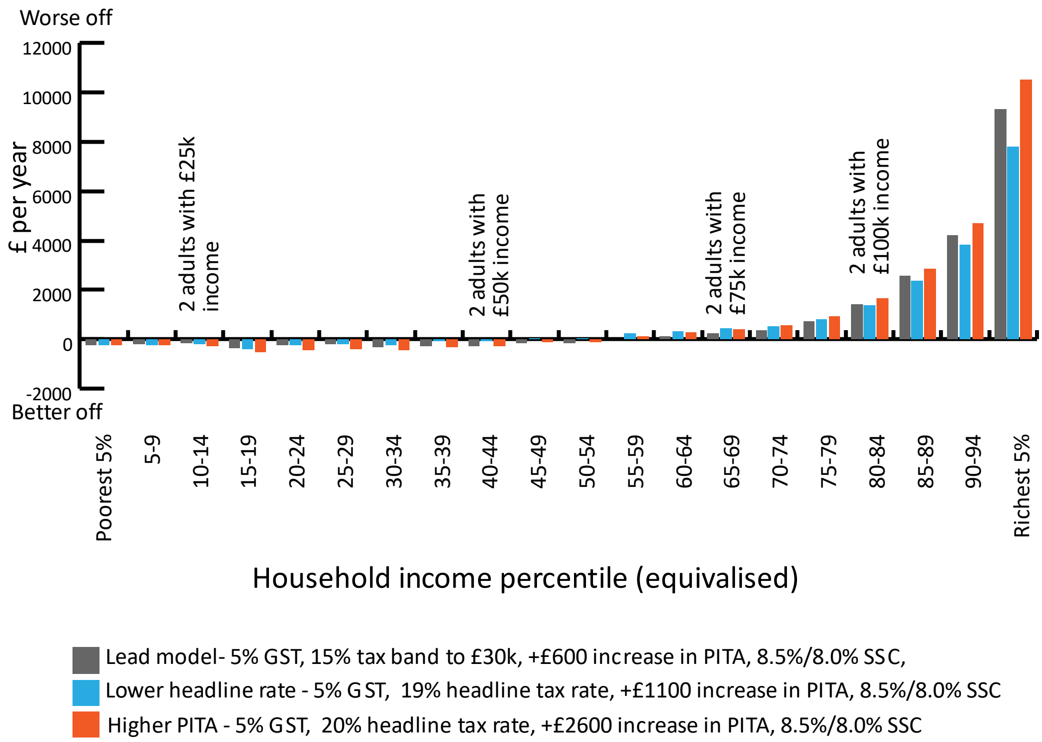
    a) Apply a 3% increase in the headline rate of income tax (or a health tax)

    b) Apply banded rates of income tax with a 15% rate on income between the personal and other tax allowances (including pension contributions) an individual is entitled to and £30,000 and a 25% headline rate beyond that

GST Based options

A6.5 The two options below look at different mechanisms for redistributing the tax burden through the income tax system, in models where the bulk of the revenue raising is applied via a GST (with c£19m raised via the contributions system).





- ***GST with a 19% headline rate***

A6.6 This model combines a slight reduction in the headline rate with a further increase in the personal income tax allowance. This model is still progressive, and low-income households would still be expected to pay less. However, it is less beneficial to low- and middle-income households than either the lead model with the 15% tax band or the alternative presented which retains the headline rate at 20% but applies a larger increase in the personal allowance.

A6.7 This model does provide a lower increase in the overall tax increase incurred by the highest income households than the other alternatives presented and arguably has a competitive advantage in attracting high income individuals.

- ***GST with a flat 20% rate and larger personal income tax allowance***

A6.8 The lead model already includes a £600 increase in the personal income tax allowance alongside the 15% lower rate tax band, but this model retains the 20% headline rate and pushes this further, increasing the personal income tax allowance by £2,600.

A6.9 This approach is of most benefit to low-income households, particularly since the assumption is that the allowance to be applied to Social Security Contributions will be aligned with that applied to income tax. Higher tax allowances have little benefit for high income households because the tax allowance is withdrawn above £90,000. As a result, higher income households would be expected to pay more under this approach than the lead model, low-income households would pay less. Middle income households would pay a similar amount.

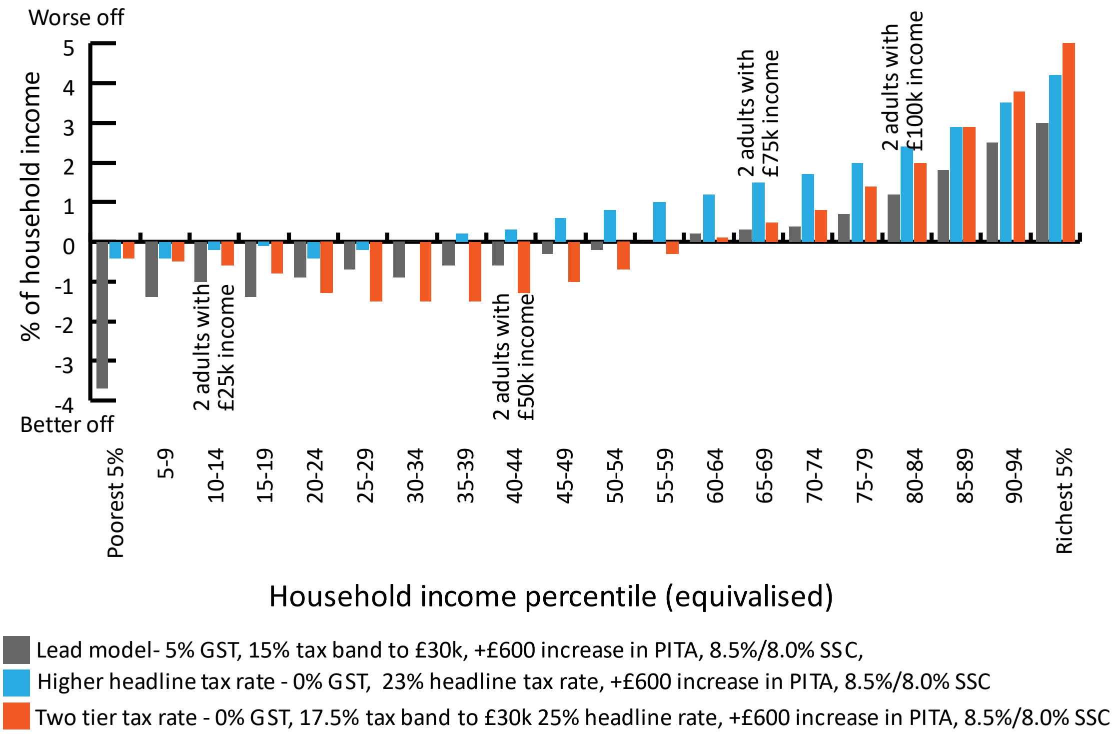
Income based options

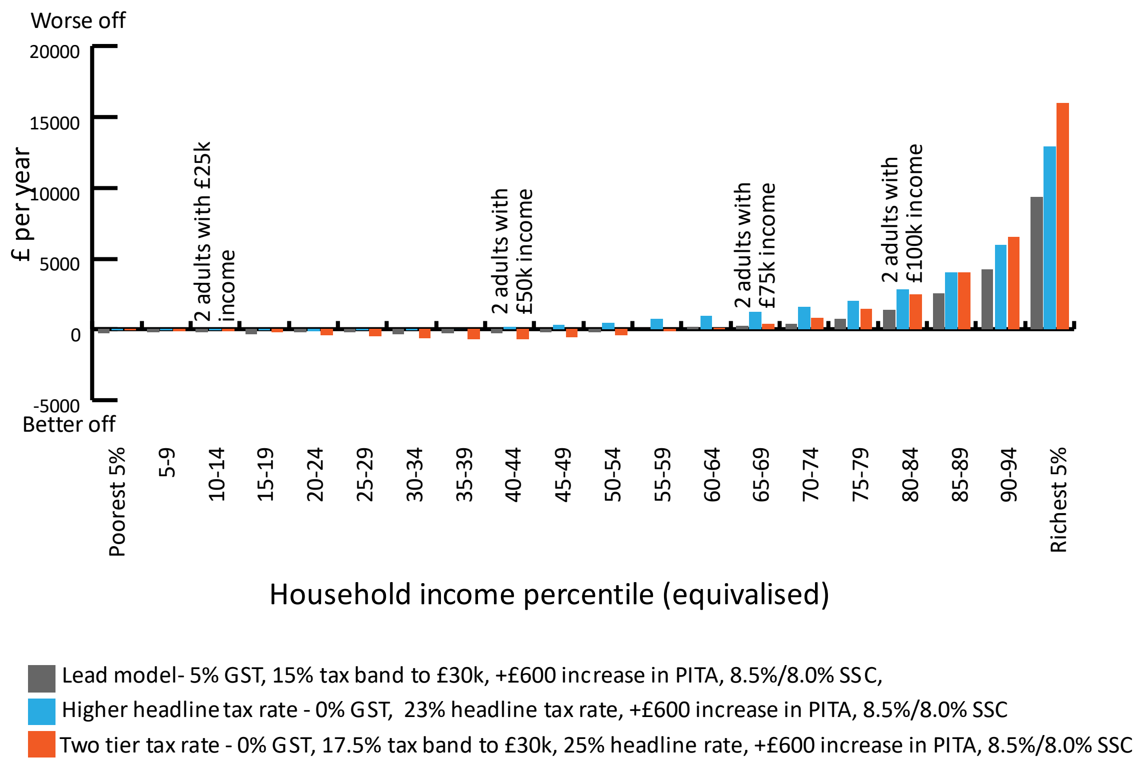
A6.10 With the loss of the revenue from ISE and non-residents incorporated within the GST, the options based on direct taxes only must derive a much higher proportion of revenues from households. These models raise around £38m from households compared to around £26m in the lead model.

A6.11 These models also do not address the issues of Guernsey's very narrow tax base – in fact they increase the focus on direct taxes and the level of exposure to labour market shocks and the ageing of the population.

A6.12 Economically this focus on income-based taxes for revenue raising is not ideal. As demonstrated in the analysis conducted for the first phase of this project, while income-based taxes may have less impact on inflation they are more likely than consumption taxes to result in a fall in GDP.

Figure 42: Comparison of alternative structures based on income tax increases





- ***An increase in the headline rate of personal income tax to 23%***

A6.13 An increase in the headline personal tax rate is perhaps the simplest solution to raising revenues. However, it is less progressive than the models presented with a GST included. These models include a restructure of the Social Security contributions, including the application of an allowance, as well as the same modest increase in the personal tax allowance included in the lead model. That does allow a small reduction in the overall liability of low-income households, but it is far less beneficial than the lead model.

A6.14 Middle income households could expect to pay more overall under this model than under the lead model, and high-income households would expect to pay significantly more. Households in the top 5% could expect an increase in their liability averaging £1,000 a month.

- ***With a 17.5% lower tier rate to £30k and a 25% headline rate***

A6.15 This model is provided as an illustration of how a more progressive tax-based structure might be applied without a GST. In this case a lower tier tax rate of 17.5% is applied on all income up to £30,000, but in order to balance the revenues, it is necessary to increase the headline rate to 25%.

A6.16 Like the GST structure with a lower tier rate this is most beneficial for middle income households, but the benefit for lower income households is limited because they may not have sufficient income to benefit from the lower tax band in full. The increase in the headline rate places further pressure on the highest income households, pushing the average additional liability for the top 5% over £1,250 a month or £15,000 a year.