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## REFORM OF GUERNSEY'S ZERO 10 CORPORATION TAX STRATEGY

### UPDATE

It has been well documented that the international community in the form of the EU Code of Conduct Group has objected to Guernsey's Zero 10 taxation strategy. This objection also applies to the other Crown Dependencies (i.e. Jersey and the Isle of Man) who have similar tax regimes.

The basis of the objection is that whilst the tax regimes comply with the terms of the EU Code of Conduct on harmful tax practices, they are not within the spirit of the Code. It is widely understood that a corporation tax rate of 10% is considered to be within the spirit of the Code of Conduct. The present tax regime was introduced on 1 January 2008 and applies a standard rate of corporation tax of 0% and intermediate and higher rates of 10% and 20% which apply to certain forms of income.

When Zero 10 was introduced, it was planned that there would be a review of the regime after three years. The new regime was not without its critics and it led to a great deal of complexity when compared to the regime in place before 2008. I for one have spent a great deal of time and effort in understanding the new tax structure and discussing various issues with the States Tax Department. However, no one could have foreseen the dramatic crisis that was to hit the global economy during 2008 and 2009.

The implication of Zero 10 was an expectation of a structural fiscal deficit arising during the first three years or so after its introduction. Thereafter, the competitive nature of the new regime, when combined with expected economic growth, would see the Island's annual budget move into surplus soon thereafter.

Unfortunately the economic downturn, when combined with the EU objection to our tax regime, has meant that an earlier review would be necessary. As such Guernsey has undertaken to carry out a review of its corporation tax strategy. In November last year, the Island's Government approved the review under the **initial presumption of a 10% rate of corporation tax**. Areas that are under review include inter alia:

1. Banks with significant fiduciary deposits and in receipt of other business income
2. Fund investment managers
3. Special purpose vehicles
4. Private equity funds
5. Insurance and captive insurance business

A sensitivity analysis of the impact of various tax strategies on the Island's industry sectors is being undertaken by GIBA (Guernsey International Business Association). This analysis will assist the States in establishing a framework that will maintain States revenues whilst ensuring the competitiveness of the Island's finance industry.

Indeed, Guernsey's Chief Minister went to great lengths in a statement to the Island's Government during its meeting on 24 February 2010 when he provided an update on the corporate tax review. In his statement the Chief Minister reported that the Government was in the very early stages of developing changes to the corporate tax regime. He noted that whilst the Government's thinking is guided by a presumptive 10% general rate of tax, "it is only a guide, nothing more, nothing less!" He further stated that the term "general rate" remains to be determined and that shall be done through discussion and consultation.

The Chief Minister also stated that he strongly believed that it was important to emphasise the five key principles that are underpinning the review process. They are that any new corporate tax regime for Guernsey must:

1. be "internationally acceptable";
2. be "competitive";
3. "promote a sustainable economy in Guernsey";
4. be based on a simple, solid rationale (and not over-complicated);
5. give rise to other benefits such as double taxation agreements.

He went on to state that **clearly fundamental to the continued competitiveness of Guernsey's financial**

**services industry is the safeguarding of the broadest range of tax neutrality of financial products.**

The Chief Minister was at pains to stress that the Government will not undermine the economic position of the Island during this process and that the purpose of the review was to maintain a vibrant economy whilst ensuring that the tax regime conforms to emerging international standards including compliance with the EU Code of Conduct on Business Taxation.

It is interesting to note that the recent “Foot Report” very usefully provides details of an international “best practice” corporation tax model. Most importantly this includes the following:

1. Tax to be imposed on active, domestic source business profits (here there may be scope for some exemptions for companies that carry on activities at the margin, for instance re-invoicing companies, commission collecting companies or possibly companies that do not carry out a manufacturing process or provide goods or services).
2. There is an assumption that dividends and capital gains from subsidiaries and substantial shareholdings would not be taxable.
3. Fund vehicles should be exempt on the basis that their income is considered to arise from passive (i.e. investment) income.
4. The profits of trust vehicles should be exempt from tax to the extent that they are in receipt of passive (i.e. investment) income.
5. The report also highlights the need for a wider tax base by the imposition of Value Added Tax or a Goods and Services Tax (Guernsey is the only jurisdiction not to have introduced such a tax and will look to resist bringing one in).
6. Encouragingly the report indicates the requirement for a “level playing field” between the Crown Dependencies and other overseas competitor jurisdictions.

The Chief Minister closed his statement by emphasising that the Government will ensure that Guernsey’s regime is as competitive as, or is more competitive than, any key competitor jurisdiction and that his message is important not just for local audiences but also to key industry influencers based in onshore financial centres.

One element of the review involves consideration of corporate tax regimes in other jurisdictions and Guernsey, in association with the other Crown

Dependencies has commissioned a professional review of corporate tax regimes throughout Europe.

It should also be noted that the States Treasurer has previously emphasised that the exempt fund regime will be protected.

Whilst no timeframe has been established at this stage, it is unlikely that any changes will be implemented before 2012, and certainly not before the other Crown Dependencies.

Further reports will be produced as the review develops.

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