Personal Tax, Pensions and Benefits Review

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STATES OF GUERNSEY

Thinking about our future

The way in which Guernsey and Alderney raise taxes to fund public services, social benefits and pensions is well established. The majority of our public money is raised through people paying income tax and social insurance on the money they earn.

However, our community is changing - the balance between the number of people who are of working age and the number of people who are not is shifting. The way that we fund and deliver public services needs to adapt if it is to be sustainable in the long-term. If it doesn't, the time is fast approaching when the States will struggle to provide essential public services and support those in greatest need.

The Personal Tax, Pensions and Benefits Review was set up by the Treasury & Resources Department and the Social Security Department in 2013, and consultation has taken place with the public, local charities and social groups and business.

Before the end of this year a report will be put to the States of Deliberation that sets out the challenges we face and how they might be overcome. No recommendations are being presented at this stage and none of the options have been ruled out.

The challenges we face

Tax and economy

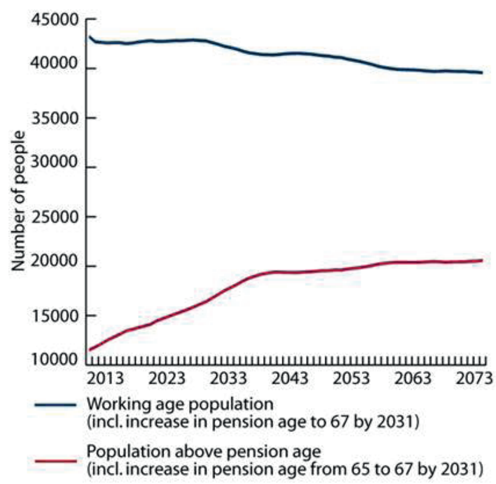
The decision to adopt the zero/10 tax system for companies in 2008, secured Guernsey's future as a competitive international finance centre, helping bring further jobs to Guernsey and making the economy more resilient in the face of the global downturn that began in 2008. However, it has also significantly reduced the States' income, and at the same time has narrowed the tax base, putting the onus on income tax paid by individuals rather than income tax paid by companies. Some of this has been mitigated by steps taken by the States: cutting £26 million a year from expenditure over the past four years; increasing the upper limit on social insurance contributions; and increasing indirect taxes such as TRP on commercial buildings. However, it has made planning States' revenue and public services for the future more difficult.

What is zero/10?

In a zero/10 tax regime for companies, the standard rate of tax on companies is 0%. Certain financial services activities, such as banking, are taxed at 10% and the profits from regulated utility companies and income from the ownership of lands and buildings are taxed at 20%. Zero/10 tax systems were introduced in Guernsey, Jersey and the Isle of Man in response to the EU Code of Conduct working group's review of harmful tax measures in the EU and dependent territories, which found that certain measures in the Crown Dependencies were harmful. The introduction of zero/10 enabled the islands to abolish tax measures perceived as harmful, without damaging their competitive position.

Population changes

The good news that we are living longer requires new approaches if we are to enjoy long lives free of financial and health care problems. However, the movement into retirement of the so called "baby-boom" generation (born in the period of high birth rates between 1946 and the mid to late 1960s) also means that over the next 50 years the number of people over the age of 65 will increase and the number of people of working age will decrease. This means that States' spending on old-age pensions and health and social care will need to increase to provide the same services to more people for a longer period of time. At the same time the working age population is projected to decrease, reducing States income.



"It is vital that we think strategically about our community and its well-being. That means looking far beyond the end of the current States' term. This review is about where we will be beyond 2025. The issues that the review is looking at are complicated, but boil down to making sure that the States raise money appropriately and then spends that money responsibly. Only by doing this can we ensure that our community and its public services are as protected as possible from threats that might be around the corner, economic or otherwise. This review covers lots of interlinked issues relating to taxes, benefits and pensions – and none of these issues can be looked at in isolation. For the same reason, the proposals that will be made should also be seen as a package – not as a set of individual measures."

Chief Minister, Deputy Jonathan Le Tocq

Overdependence on personal taxation

Almost three-quarters (73%) of Guernsey's taxes come from direct personal taxation (i.e. personal income tax and social insurance contributions). This figure is at least 10% higher than most other jurisdictions. This makes States' income particularly vulnerable to changes in the amount people are earning, either because there are fewer people in work (i.e. because there are fewer people of working age or more people unemployed) or because people are earning less. This also makes States' income less certain, which in turn makes it difficult to make the long-term investment in public services that Guernsey's community needs and expects.

Establishing the size of government

The upward pressure on old-age pensions, health and social care means that, unless changes are made, the States will need to spend more money to maintain the current level of services. In addition, many in the community would like to develop new public services such as maternity benefits. We also need to invest in maintaining our infrastructure, such as housing, schools, the hospital and coastal defences, and to develop new infrastructure which will help our Islands develop both economically and socially (e.g. purchasing new equipment for the hospital). To be sustainable in the long term, the States need to decide how much money it will take out of the economy as taxes to provide these services and capital investment.

The objectives of the review

This review has been put in place to answer a single, big question: "How can we create a more sustainable system?"

This review has not been focusing on how to raise more money. It has been focusing on how to ensure that money is raised and spent by the States in a way that is sustainable, efficient and fair.

Sustainable

A secure and stable tax, pensions and benefits system is crucial to the ongoing provision of public services. An unsustainable tax, pensions or benefits system is a threat to our community as well as our economy.

By sustainability we mean that in the long-term Guernsey's tax and social insurance systems need to generate sufficient revenues to meet States expenditure needs. Guernsey's Fiscal Framework already commits the States of Guernsey to a principle of permanent balance (i.e. in the long-term it should not spend more than it receives) and this principle should be upheld.

In practice, this means that services, in particular benefits, pensions, health and social care should be structured in such a way as to provide an appropriate level of care and support, without exerting unsustainable pressure on the public purse.

It also means that revenues need to be raised in a way which provides predictability and, where possible, resilience to economic conditions and demographic change. Both the population and the business community need confidence about the level of tax they are required to pay and the level of public services they can expect to receive in return in the long-term.

Efficient

An efficient tax, in economic terms, is a system that has little effect on the behaviour of taxpayers and, by implication, on the economy as a whole.

Taxing any activity is similar to the usual impact of a price increase in that it tends to discourage that activity. Taxes on income reduce the value of work, reducing the amount of money taken home. Taxes on wealth reduce the benefit from savings and investments. Taxes on consumption increase the cost of goods and services purchased.

Taxes that reduce the incentive to work, invest or save are generally considered less efficient than those that discourage consumption or leisure. The OECD rank taxes in the following order with the most efficient tax first:

- Property taxes (e.g. TRP in Guernsey or council tax in the UK)
- Consumption taxes (e.g. excise taxes, GST or VAT)
- Personal income taxes (including social insurance contributions)
- Corporate taxes

Administrative efficiency, i.e. the annual cost of collecting a tax verses the revenue gained from it, should also be considered.

Fair

The concept of fairness is subjective; each person's view of what is fair or unfair will differ. Three terms are commonly used when discussing the fairness of a tax regime, all of which describe the distribution of tax relative to income:

- Proportional: where each individual pays the same proportion of their income in tax
- Progressive: where higher earning individuals pay a larger proportion of their income in tax
- Regressive: where higher earning individuals pay a smaller proportion of their income in tax

Tax systems that are considered economically efficient often do not meet the criteria of what people would typically consider fair. The reverse is also true. For example, progressive taxes, such as higher rates of income tax for higher earners, are considered fair by some (and unfair by others) but, they can reduce the incentive to work and earn for those above the threshold, and are therefore not considered to be economically efficient.

Clearly, then, a compromise between fairness and efficiency is unavoidable, but there are measures that can be taken to mitigate aspects that might be considered unfair. That is why it is important that the proposals that will be put forward are looked at as an overall package.

During the public phase of the consultation, five recurring themes emerged which are now at the centre of the work that is being done. These are:

1. The tax and benefits system should incentivise people to work and support themselves
2. People should be encouraged to take responsibility for their financial well-being in later life
3. The tax and benefits system should be, as far as possible, simple and easy to understand
4. The personal tax system needs to be competitive in comparison with other jurisdictions
5. The States' have a duty to ensure that expenditure is controlled and public money is used efficiently

Potential options for change

The review has been exploring a number of options, and attempting to assess the impact of each option before finalising any recommendations. Part of this is also assessing how the different options would work together, as it is clear that a wide set of changes will be needed in order to ensure a balance between sustainability, efficiency and fairness.

Pensions

- How might the Guernsey Insurance Fund, from which old age pensions are paid, be increased to meet future needs?
- What impact would this have on social insurance contributions and the States' grant to the Fund?
- Should we continue increasing pensions each year by more than inflation?
- The age at which a pension can be claimed will increase to 67 by 2031, but should the pension age be increased further and people encouraged to work for longer?
- Should people be given the option of deferring their pension in return for a slight increase in the amount they will eventually receive?
- How could the States encourage and assist individuals to contribute to private pension schemes, which, together with the old age pension, will provide greater financial security in retirement?

Public services and benefits

- In what way could the delivery and funding of long-term care services, whether for people in residential care or in their own home, be reorganised to address future needs?
- What would be the effect of reducing or removing universal benefits such as: family allowance, subsidised medical subscriptions, GP and nurse consultations, and free TV licences for the over-75s?
- How should we support investment in our infrastructure to facilitate social development and economic growth?

Taxation

- Should the amount of money the States collects from income tax or social insurance contributions be increased? This could include increasing headline rates of tax or contributions, higher tax rates for higher earners, withdrawing tax allowances for higher earners, or cutting out specific allowances such as mortgage interest relief.
- Should we consider increasing personal tax allowances so that they compare more favourably with other similar jurisdictions?
- Guernsey's Tax on Real Property (TRP) as charged on residential buildings is low compared with other places, so what scope might there be for increasing it without adversely affecting individuals?
- Could the introduction of some sort of consumption tax (for example a Goods and Services Tax) provide a new source of income without incurring excessive costs or having a major impact on individuals or businesses?

Meeting other challenges

- Should the States set a limit on the total income they receive from the community as a means of controlling what they spend? Is this the most effective way to build on the financial discipline of the Financial Transformation Programme, which ends in 2014?
- How do we make sure that the changes made through the work of this review also support economic growth and prosperity in Guernsey; for example, through supporting the Economic Development Framework published in 2014? How might we use economic growth to increase tax revenue through both direct and indirect taxation?
- The size of the working age population in Guernsey in the future has a significant impact on the economy and States' income. Should the States review its policy on the total population level to help mitigate some of the pressures we face?

These options are set out in more detail in the June 2014 document Personal Tax, Pensions and Benefits: Principles and Issues which can be found at www.gov.gg/ptr

"All challenges present opportunities. Diversification of our tax base presents Guernsey with a number of opportunities. These opportunities include lowering both the direct and total tax burden for many hard-working households in middle income brackets by increasing their tax-free income tax allowances; providing a more stable and sustainable tax base to provide the services (for example, maternity benefits) which many in our community and many other jurisdictions now regard as standard, but which we will struggle to provide so long as we seek to fund everything from an increasingly narrow tax base; and increasing the contribution from that part of the corporate sector which consumes goods and services in our islands, but no longer pays corporate income tax."

Treasury and Resources Minister, Deputy Gavin St Pier

"The risk of upward pressure on spending is not unique to our islands, but our narrow tax base and comparatively small population can make the risk more acute in Guernsey and Alderney. Demographic changes mean that the proportion of people in employment in Guernsey continues to fall, and that a bigger elderly population is entitled, quite rightly, to their pensions it will also have increased health care and long-term care needs. At the same time, as an island we have chosen to make important commitments to put in place greater maternity benefits, free pre-school education, a Disability and Inclusion Strategy and a Mental Health and Wellbeing Strategy, among other things. In order to plan their long-term funding we need to ensure we have the resources to do so. If we don't face up to the challenges that we face now, our only alternative is to bury our heads in the sand at Cobo Bay, cross our fingers and hope for the best. Clearly that is not an option."

Deputy Chief Minister and Social Security Minister, Deputy Allister Langlois

What happens next?

- During the summer there will be an online question and answer session with politicians so you can ask any questions you might have.
- Further information will be at www.gov.gg/ptr, including short films and more detailed documents.
- You can send questions or requests for further information about the review to personaltaxreview@gov.gg.
- Detailed recommendations of the Review will be published and presented to the States for debate in late 2014.
- Where appropriate, changes to your personal tax, pensions or benefits arising from this review will be phased over a number of years.

Political membership

Treasury and Resources Department

Deputy Gavin St Pier (Minister)
Deputy Jan Kuttlewasher (Deputy Minister)
Deputy Hunter Adam
Deputy Roger Perrot
Deputy Tony Spruce

John Hollis (non-States Member)

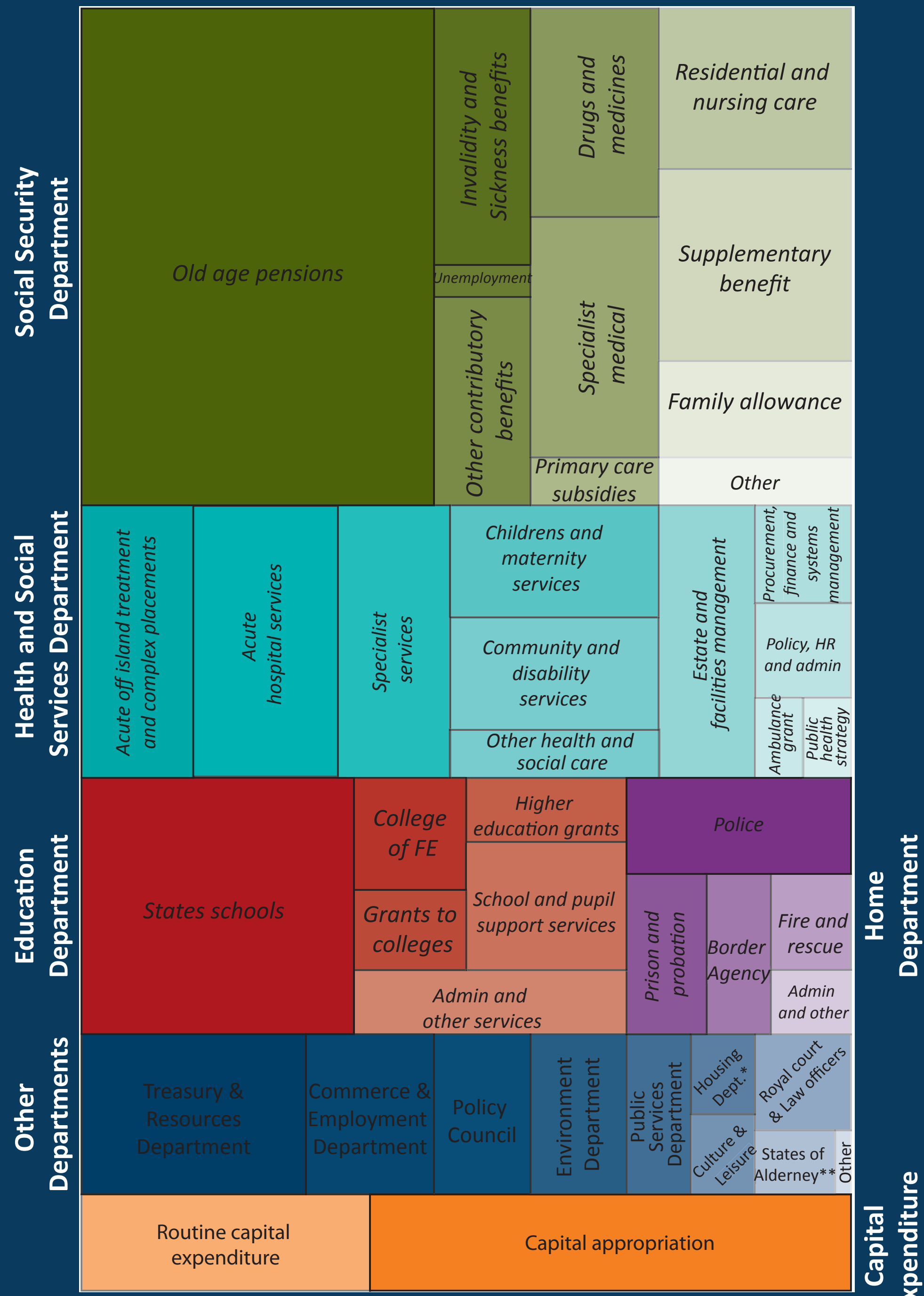
Social Security Department

Deputy Allister Langlois (Minister)
Deputy Sandra James MBE (Deputy Minister)
Deputy John Gollop
Deputy David Inglis
Deputy Michelle Le Clerc

Susie Andrade (non-States Member)
Michael Brown (non-States Member)

Where does your money go?

Presented to scale



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