STATES OF GUERNSEY

Planning a Sustainable Future

Treasury and Resources Department
&
Social Security Department

Personal Tax, Pensions and Benefits Review

Appendices to States Report
Billet d'État IV, March 2015

List of Appendices

Appendix 1: Principles and Issues Document

Personal Tax, Pensions and Benefits Review

Principles and Issues

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STATES OF GUERNSEY

This document is important because...

It outlines the key principles and issues identified as part of the Personal Tax, Pensions and Benefits Review process, together with some of the options available to mitigate some of the risks and challenges faced by Guernsey and Alderney in the long-term. Its intention is to promote informed debate on these issues in the wider community.

This report does not contain any formal recommendations.

The Treasury and Resources and Social Security Departments will submit specific recommendations to the States for debate later in 2014.

If you have any queries or if you would like a large print version please contact us.

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1 Executive Summary

Unless major changes are made to the way in which Guernsey and Alderney raise taxes and fund old age pensions and social insurance, universal and welfare benefits, the time is fast approaching when the States will be unable to fulfil its commitments to provide a wide range of public services, to invest in essential Island infrastructure and to support those in greatest need.

As explained in this paper, while Guernsey's system of raising the majority of public funds through direct taxation and social insurance contributions has served the Island well for the past fifty years, it is no longer sustainable in the face of a number of critical changes and increasing fiscal pressures.

Recognising the need for change in response to these growing pressures on income and expenditure, the States have embarked on a Review of Personal Taxation, Pensions and Benefits. Over the past 18 months, the Treasury and Resources and Social Security Departments (working together as the "Joint Boards") have examined the issues in detail, carried out public consultation, and identified the key challenges and potential options for addressing the issues identified, the results of which are contained in this paper.

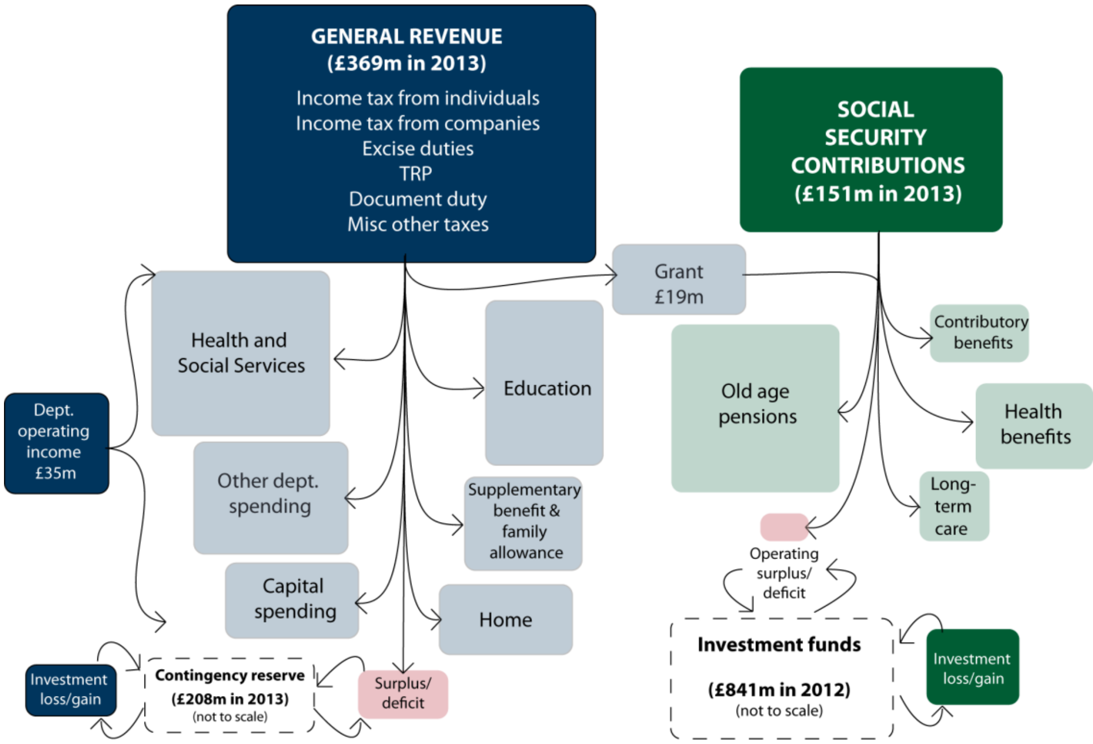
2 Background

Guernsey funds its public services from two separate, but connected, systems as demonstrated in the diagram below.

The General Revenue budget receives money from general taxes such as income tax, tax on real property (TRP) and excise duties. The budget is administered by the Treasury and Resources Department and money is allocated to the operational departments which provide services such as education, law enforcement and the majority of health and social care services. Overall expenditure and appropriations[1] from the General Revenue budget totalled £394m in 2013 and net income totalled £369m[2], leaving a deficit of £25m.

The Social Insurance system receives income from social insurance contributions. It also receives a grant from General Revenue to supplement its income, which totalled £19m in 2013. This money is divided between three funds[3], which act as buffers for the provision of insurance-based benefits such as old age pensions, unemployment, long-term care and some healthcare services (such as prescription and primary medical care subsidies). Net expenditure from the Social Insurance system (including the grant from General Revenue) totalled £178m in 2013 and income totalled £170m, leaving an operating deficit (excluding investment income) of £8m.

Figure 2.1: Illustration of General Revenue and Social Insurance systems



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[1] Including the transfer of funds to the Capital Reserve for the investment in major infrastructure projects.
[2] A further £35m is raised at departmental level through fees and charges and other operating income. This income is netted off revenue expenditure for each department.
[3] The Guernsey Insurance Fund, The Guernsey Health Service Fund and The Long-Term Care Fund. For investment purposes, the reserves held in these funds are combined to form a single consolidated fund.

The basic structure of Guernsey's income tax system (including the standard rate of 20%) had been largely unchanged for more than fifty years until, in 2006, in response to growing pressure from Europe to remove perceived harmful aspects of Guernsey's tax system, Guernsey, alongside Jersey and the Isle of Man, approved the introduction of the Zero/10 tax regime (Billet D'Etat XI, June 2006). The Zero/10 system introduced a standard rate of tax on company profits at 0% with effect from 2008. There is also an intermediate rate of 10% which initially applied to income from banking activities. This has subsequently been extended to income from fiduciary, domestic insurance and insurance management activities in 2013. A higher rate of 20% applies to income from land and buildings in Guernsey and activities regulated by the Office of Utility Regulation.

The introduction of Zero/10 led to a significant reduction in income tax receipts from companies, resulting in a deficit in the General Revenue budget. Various measures have been employed to reduce the deficit which, if successful, will have reduced the potential deficit by an estimated £70m in total (see page 34). These have included:

- Increasing Tax on Real Property (TRP) (primarily those applicable to commercial premises, although some increases were made to domestic rates of TRP) and other indirect taxes;
- Reducing the revenue subsidy paid to Social Security and, to compensate, increasing the social insurance contributions paid by employers and increasing the upper earnings limit on contributions, increasing the liability for mid- to high-earning individuals;
- Reducing States' expenditure through the Financial Transformation Programme [FTP] - the FTP's objective is to achieve a minimum of £31m per annum of recurrent savings by the end of 2014[4].

In respect of the second of these measures, in contrast to personal income tax, the rates and application of social insurance contributions have been changed several times over the last forty years, as new benefits have been added to the social insurance scheme. Nonetheless, 2007 represented a milestone in the evolution of the social insurance scheme as, prior to that year, the limit on the total amount an individual could contribute was set with reference to the total expenditure of the Social Security funds and the number of contributors. In addition, it had been the practice that a grant was paid from General Revenue as a top-up for those whose contributions were below the maximum (see figure 2.1).

In 2007, the grant paid from General Revenue to the Social Security funds was lowered to reduce General Revenue expenditure ahead of the changes to the corporate tax system explained above. This reduced the income to the Social Security funds. To compensate for this, the upper earnings limit (or non-earned income for those not employed) on which social insurance contributions are paid was increased progressively, rising from £36,000 in 2006 to £132,444 in 2014. The rate of contributions paid by employers was also increased from 5.5% to 6.5% in 2008.

However, it was always intended that there would be a second stage to the realignment of public finances following the introduction of Zero/10; specifically the report at the time stated:

[4] The programme had achieved annual savings of £26m by April 2014, with a further £5m of savings to be achieved by December 2014 to meet its target.

"In stage two, the States, having run a deficit budget for three to five years (i.e. until 2011/2013), and then after taking into account international events, GST* history in Jersey and economic performance, will evaluate and produce an overall package which sustains the economic position and delivers a balanced States Revenue budget."

**Goods and Services Tax*

While the States did not approve the introduction of a consumption tax at the time zero/10 was agreed, enabling legislation, which sets the ground work for a GST, was approved by the States in 2009.

The system of taxing companies was further reviewed in 2011, as a result of further questions raised by the European Union's Code of Conduct Group regarding the compliance of Zero/10 with the EU Code of Conduct for Business Taxation. As a result, Guernsey's deemed distribution provisions were removed in order to make the tax system compliant with the Code of Conduct for Business Taxation, but further review of the Economic and Taxation Strategy was delayed until the closure of the Corporate Tax Review in December 2012.

In the 2013 Budget (published in October 2012), the Treasury and Resources Department stated its intention to complete a review of taxation in Guernsey by launching a review of personal tax. It was decided that any review should provide a wholesale review of taxation against personal income and, for completeness, should also include social insurance contributions and indirect taxation measures. As a result, it was decided that this Review should be conducted jointly by the Treasury and Resources and Social Security Departments.

In undertaking the review it was clear that a critical factor determining the income and expenditure of the States in future was the fact that the age distribution of Guernsey's population was changing. The number of people above retirement age relative to the number of people in the working age population is projected to increase significantly over the next few decades, and this will present challenges in the provision of those publicly funded services which older people typically make the most use of. The effects of this will be particularly felt in relation to pensions and health and social care provision. Given that these issues may have considerable bearing on the need for revenue in the future they have been incorporated within the scope of the Review.

The Review began in January 2013 and a public consultation was launched to gauge the feeling of the public on the issues involved. The public consultation took place over an eight week period between April and June 2013. Approximately 250 responses were received from both private individuals and organisations. A report summarising responses to the consultation was released in August 2013, the summary of which is included as Appendix A.

Towards the end of 2014, a formal States Report will lay out a vision of how the Tax, Pensions and Benefits systems should look in 2025. Clear recommendations for change will be presented with the intention that, if approved, changes will be phased in over a ten year period. In the meantime, as a prelude to that debate, the Joint Boards are issuing this report and supporting materials in order that the communities in both islands are well-informed and have sufficient time to reflect on the issues, the options and their implications, before the States is asked to agree the way forward.

However, it is important to understand that there will be no single solution. The recommendations presented will almost certainly contain a broad package of measures to mitigate the risks to both expenditure and income.

3 Setting the Context

Fiscal pressures

Growing pressure from the European Union, which considered Guernsey's former corporate tax practices harmful, and the need to remain competitive on an international stage, made it necessary for Guernsey to adopt the Zero/10 tax regime in 2008, as part of a co-ordinated approach with Jersey and the Isle of Man. Whilst this strategic policy change addressed these external pressures, it resulted in a significant reduction in the amount of income tax paid by corporations and led to a structural deficit in the Island's public finances.

Although the States have made good progress in reducing this resulting deficit through the Financial Transformation Programme (FTP) and other measures (such as increasing commercial property tax rates and increasing the upper limit on social insurance contributions), in the short-term the States' budget has been running a deficit equivalent to 4% of general revenues.

There are several work-streams that are intended to reduce this deficit further. These include work to continue to drive internal efficiency beyond the end of the FTP in Dec 2014; a further review of the extent of the application of the intermediate (10%) tax rate on companies (in particular, to capture fund administration businesses); and efforts to develop and diversify Guernsey's economy through the Island's Economic Development Framework. However, whilst these measures may successfully address the deficit in the short-term, on their own, none of these measures will address the fundamental issues outlined in this paper.

Whilst the focus of this paper is on the impact of increasing health, pensions and social costs largely as a result of demographic change, it would be foolish to overlook other financial challenges, such as capital investment required in public infrastructure, such as a new school, a new computer system or an extension to the airport runway.

The States have set themselves a target of capital spending of 3% of GDP per annum. This is not designed to encourage unnecessary spending, but as a guide to ensure that an adequate amount of money is being invested in the Island's infrastructure on an ongoing and planned basis.

Since the 3% target was established, the pressure on the General Revenue budget has meant that the States have been unable to generate the surpluses required to enable sufficient allocations to the Capital Reserve to meet the target. The States have allocated an average of 2.2% GDP to capital spending over the past 10 years; a shortfall of approximately £16m per annum.

Long-term, if the States are to maintain and develop the public infrastructure, a sustainable way to support the investment is needed.

Population size

Many of the long-term issues facing Guernsey are as a result of the changing age profile of the population, rather than its size. Currently, States' policy is to aim to keep population size to 2007 levels, albeit that to date it has not been possible to achieve this. Looking forward, if no growth in population is to be achieved, the changes in demographic make-up mean that this could only be through **net emigration**; and if, as seems more likely, this emigration was to be of people of working age, it would amplify many of the issues outlined in this paper. Reviewing the States' policy on population growth is, therefore, part of the package of options under consideration.

Demographic Change

Demographic change is not a new issue, but one that has been on the horizon for many years. Neither is it one unique to Guernsey, but a challenge faced by most western economies; a consequence of changes in birth rates and life expectancies over the last century, and a normal part of the evolution of an economically advanced community. Indeed, increased life expectancy reflects improvements in social conditions and medical care, and is something that all nations aspire to achieve. However, the negative consequence is that the changing age composition of our population will alter the level of income received by the States and increase the demand for public expenditure. The States must plan **now** to adapt to this changing environment.

To explain in more detail, the average number of people in Guernsey turning 65 each year between 2012 and 2015 is expected to be about 28% higher than it was between 2004 and 2008 - an increase of approximately 330 new pensioners each year. Furthermore, the annual number of new pensioners is expected to continue at this level for at least another twenty years. As a result, in the future there will be more people above retirement age and fewer people of working age than there are today.

Although there are steps that can be taken to mitigate the effects of this change in demographic profile, the fact remains that the increase in the **number** of older people in our society will increase the overall level of demand for services and it is essential this is planned for. In particular, to avoid expenditure on health and social care growing to unsustainable levels, our current models of delivery of housing, health and social care must change because these are based on a presumption of dependence, not independence. The work being undertaken to prepare a Supported Living and Ageing Well Strategy (SLAWS) is thus fundamental to achieving the necessary shift in our community mind-set to address conventional notions of what it means to be old and to plan the services required to meet the challenges of a vastly different Island population. It will also help to set in context improvements in medical technology and the costs associated with providing more sophisticated services, which, as they have always done, will exert a continuous upward pressure on medical care costs.

A shift in our demographic profile also presents challenges for States' income. As people who are working typically pay more income tax and social insurance than those who are retired, it follows that, unless changes are made, as the percentage of pensioners increases and the percentage of people of working age falls, the value of receipts from income tax and social insurance contributions will also fall.

Overdependence on personal income tax

Notwithstanding some of the positive benefits of an ageing population outlined later in this paper, there is a real risk that our current system, which is so heavily dependent on personal income tax and social insurance contributions, will become increasingly vulnerable as the age distribution of our population changes, or if there is a downturn in the economy and unemployment rises. Unusually, personal income tax and social insurance contributions account for some 73% of the States' total income (see section 6). This is at least 10% more than any comparable island jurisdiction or OECD country. Without diversifying the tax base this vulnerability will remain.

Review assumptions

Population policy, and the success or otherwise of achieving economic diversification and/or growth, will each impact on the scale of the issues outlined in this paper.

While there is a need for an informed debate on what size Guernsey's population should be, for the purpose of this report, levels of future migration are assumed to be consistent with Guernsey's recent history, i.e. **net immigration of about 200 people per year**[5].

With regard to the economy, the Economic Development Framework has outlined how the States aim to promote long-term economic growth and, clearly, enhanced growth would benefit Guernsey financially. However, whilst promoting the conditions for growth and removing barriers to business should be very high priorities for the States, basing long-term fiscal planning on over-optimistic levels of growth would be imprudent. Therefore the projections presented in this paper incorporate modest levels of GDP growth, based on an assumption of **1.5% annual growth in real earnings**[6]. The final recommendations of this review will need to be flexible enough to allow Guernsey's finances to adapt to an outcome better or worse than these projections.

[5] Figures published in April 2014 showed that, counter to recent trends, Guernsey experienced **net emigration** in the year ending 31 March 2013. It is, at present, too early to establish whether or not this is an isolated event or the beginning of a new trend.
[6] Using this type of modelling, levels of GDP growth vary with the changing size of the workforce.

4 Review Objectives

At the outset of the review process, the Joint Boards agreed that their prime objective was to present to the States a series of measures that would deliver long-term sustainability of public finances, pensions and benefits, and ensure a greater degree of efficiency and fairness.

There is some inevitable conflict between these objectives. Those taxes considered "economically efficient" are often not considered "fair" by the wider population, although the judgement of "fairness" is inherently subjective. The Joint Boards therefore established a priority of objectives.

4.1 Sustainability

The Joint Boards agreed that **sustainability** should be the key objective. 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 social and economic success.

By 'sustainability', the Joint Boards mean that:

- In the long-term, Guernsey's tax system needs to generate sufficient revenues to meet its expenditure needs, and that a balance between tax and expenditure pressures is needed to achieve this. The 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) within General Revenue and this principle should be upheld.
- The total value of money extracted from the economy to fund public services should remain at a level consistent with Guernsey's status as a relatively low tax jurisdiction. Expenditure should remain at a level at which permanent balance is achievable without increase in taxation beyond this.
- Benefits, pensions and services, in particular 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.
- Revenues need to be generated 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.

4.2 Efficiency

An efficient tax, in economic terms, is a tax which has little effect on the behaviour of a taxpayer 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 in exchange for work. Taxes on wealth reduce the benefit from savings and investments. Taxes on consumption increase the cost of goods and services purchased. A more detailed explanation of economic efficiency is provided in Appendix B.

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

a) Property taxes (recurrent on immovable property) (e.g. TRP or council tax)
b) Consumption taxes (e.g. excise taxes, General Sales Tax [GST] or Value Added Tax [VAT])
c) Personal income taxes (including social insurance contributions)
d) Corporate taxes

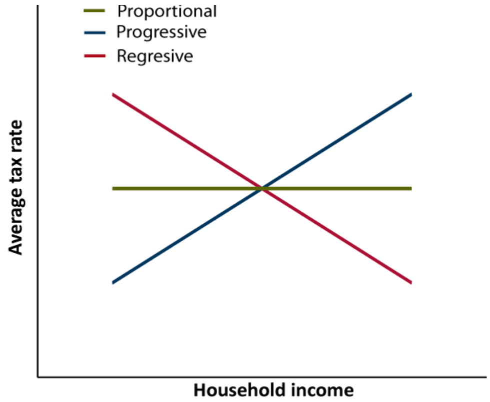
Administrative efficiency, i.e. the annual cost of collecting a tax versus the revenue gained from it, should also be considered.

4.3 Fairness

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 (see Figure 3.3.1):

- **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

Figure 3.3.1: Illustration of progressive, proportional and regressive taxation



The concept of horizontal equity (i.e. that people with the same income should pay the same tax) is also important. Arrangements which mean that two households with a similar income, but different circumstances, pay different amounts of tax are often considered unfair, e.g. a household with a mortgage is entitled to tax relief on the interest while another household renting a similar property is not entitled to any tax relief on their housing costs.

Similarly, tax systems which 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 reduce the incentive to work and earn for those above the threshold, and are not considered to be economically efficient.

The Joint Boards accept that a compromise between fairness and efficiency is unavoidable, but believe that there are measures which can be taken to mitigate aspects of any final proposal that might be considered unfair.

5 Guiding Principles

Using the recurring themes that emerged from the public consultation as a starting point, the Joint Boards developed the following set of principles to guide the design of the future Tax, Pensions and Benefits system.

5.1 The tax and benefits systems should incentivise people to work and support themselves

There are benefits to the individual, the community and the States in encouraging people to support themselves and become independent of States' support where ever possible.

For individuals, self-support is healthy, often resulting in employment and greater engagement with the community. By contrast, long-term over-dependence on government to provide for all social and financial needs is not healthy. Long-term dependence on benefits can have a tendency not to incentivise work, leaving some households trapped in relative poverty. Indeed, there are well-recognised links between long-term dependence on financial support and low self-esteem and poorer physical and mental health.

From the perspective of the States, a person in work is contributing towards the shared cost of providing services to the population. A person not in work is often a person needing financial and social support. There will always be people who, for a wide variety of reasons, may not be able to support themselves without help. However, it is in the interests of all to encourage people to make as much contribution to their own support as they are able.

5.2 People should be encouraged to take responsibility for their financial wellbeing in later life

As a community, we encourage those of working age to support themselves. However, most people are not currently setting aside enough (or in many cases, any) resources for their retirement. A survey conducted by the Policy Council in 2012 revealed that less than half of the working population is contributing to a private or workplace pension, and many of those that are may not be contributing enough to provide them with a sufficient return to provide for a comfortable retirement.

The promotion of positive outcomes, such as economic and social independence and the taking of personal responsibility, were set as objectives in the 2013 Social Policy Plan. If the States is to meet these objectives and avoid those who have not made sufficient pension provision becoming dependent on the welfare system for their financial support in retirement, it will need to ensure that people make more provision for themselves. In this regard, that tomorrow's older people may be fitter and healthier than their counterparts today means that, in general, they should be able to remain economically active for longer.

5.3 The tax and benefits systems should be, as far as is possible, simple and easy to understand

A simple tax system has many benefits. Most people are more comfortable paying a tax they understand; and the number of people who do not comply with its requirements (for example by not submitting a tax return) is typically much lower if the reporting requirements are straightforward. A high level of compliance means fewer resources required to enforce it, making the system less expensive to run.

Simple tax systems are also more transparent. In an era where tax transparency is the subject of international scrutiny, this is an important consideration for Guernsey.

5.4 The personal tax system needs to be competitive on an international stage

Guernsey's economy is founded on its reputation as a well-regulated, transparent and relatively low tax jurisdiction, of which an internationally competitive personal tax system is an important element.

In the international environment, the taxing of corporate bodies is rapidly evolving. The emphasis on tax transparency and information exchange has increased; corporate tax rates are being reduced in many jurisdictions; and there are initiatives, such as the OECD Action Plan on Base Erosion and Profit Sharing which could ultimately lead to a more territorial basis of taxation for corporates[7]. Guernsey needs to be constantly monitoring and reviewing its options to ensure that it's corporate tax strategy remains competitive. While any resulting changes could create beneficial opportunities, it would be unwise to assume that these will emerge during the period envisaged for this review.

Of more immediate relevance is that the highly mobile businesses which form the basis of Guernsey's finance industry - and which make up 40% of our economy - need to be able to attract staff to work for them from outside the Island, in areas where the skills and expertise needed may not be available locally. Particularly at a senior level, such staff can be as internationally mobile as the firms for whom they work. In order to be able to attract the right expertise to help our economy grow, Guernsey needs to be able to offer a personal tax package that will compare favourably with other territories competing for the same staff.

Guernsey also needs to import skilled staff to fill key positions in its social infrastructure, including teachers and nurses. The personal tax system must be competitive for lower and middle income earners to help attract the high quality staff needed to support the Island's health and education systems.

In this regard, it is relevant to note that indirect taxes paid by Guernsey residents remain low: the average domestic property tax is about one-tenth of the average Council tax bill in the UK and consumption taxes are currently limited to fuel and excise duties. Nonetheless, Guernsey's direct personal taxation has become less competitive in recent years. From April 2014, personal tax allowances in the UK are higher than those in Guernsey and, whilst the rate of employee social insurance contributions remains relatively low, the upper earnings limit on contributions is now significantly higher than it is in Jersey, the UK or the Isle of Man.

[7] A territorial tax system taxes only domestic income (E.g. profits earned in Guernsey) but not foreign income (e.g. profits earned outside Guernsey).

Combined, these factors mean that, in some cases, the direct tax burden of lower and middle income households in Guernsey may not compare favourably with the UK or Jersey.

5.5 The States have a duty to ensure that expenditure is controlled and public money is used efficiently

One of the primary roles of the States is to decide how public money is spent in the best long-term interest of the community. States' Members have a responsibility to ensure that funds are used wisely and that the population is receiving value for money for the taxes they pay.

In this respect, whilst the FTP may end in December 2014, longer-term there are projects underway which will deliver savings beyond the Programme's timescale. An example of this would be property savings from the delivery of the Strategic Asset Management Plan. In addition, the ongoing transformation of services provided by the Health and Social Services, Education and Home Departments each have the potential to release further efficiency savings beyond the Programme's timescale.

6 Issue 1: Spending public money

6.1 Short- and long-term issues

The States face two major challenges in relation to its spending:

- its short-term budget deficit, predicted to be approximately £14m in 2014; and
- a long-term increase in demand for services as a result of the changing demographics.

The two issues are independent of one another. Measures to reduce the current deficit and solve the immediate fiscal problem will not prevent the increase in expenditure on pensions, health and social care needed by a greater number of people over retirement age over the next few decades. Conversely, measures to mitigate expenditure in the long-term may not remove the current deficit.

Whilst closing the deficit is important; the focus of this review is to look at the more significant, long-term pressures on public spending and service provision.

6.2 More retired people and fewer workers

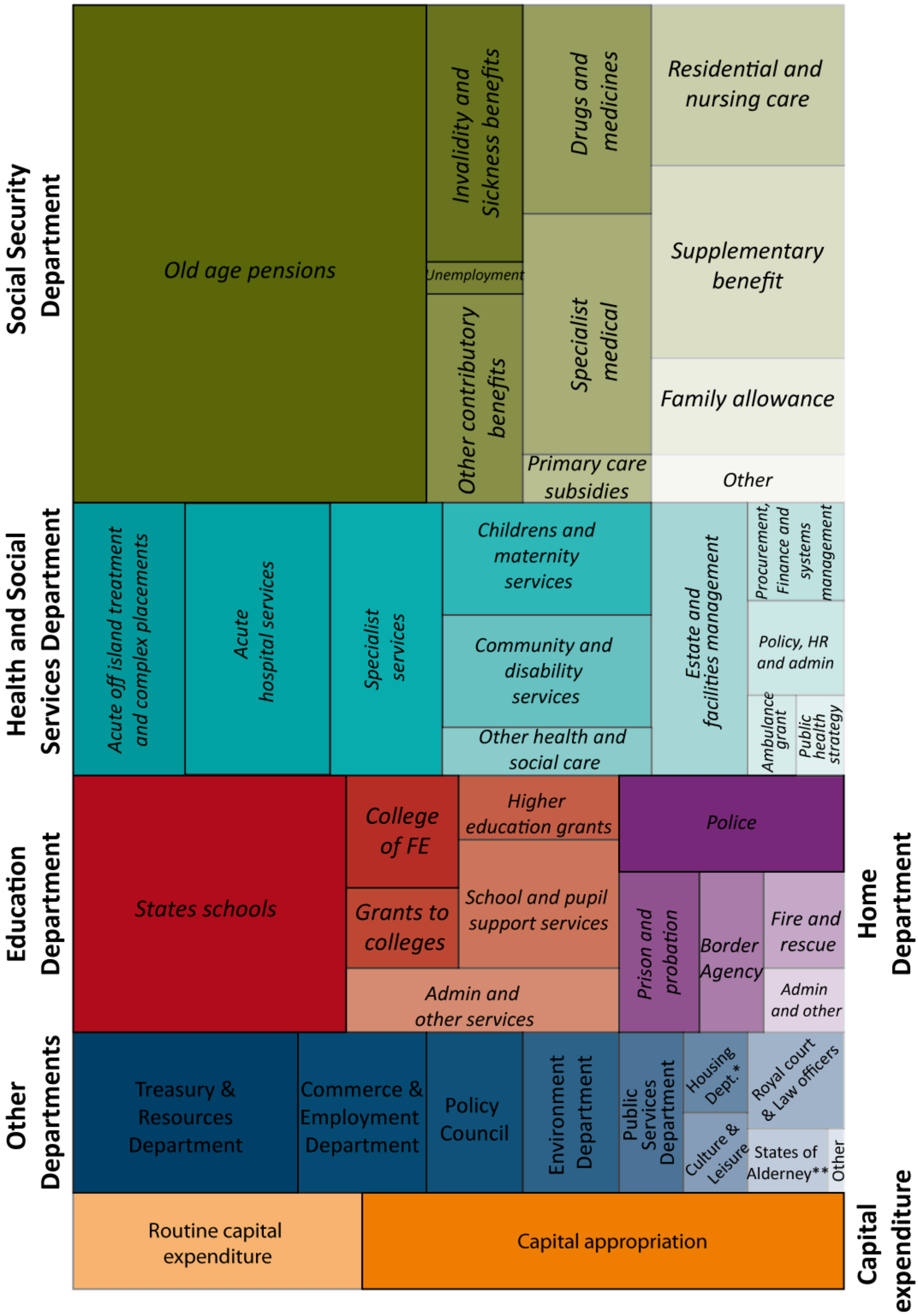
Simply put, the predicted demographic change means that in future a larger proportion of our population will be above retirement age and a smaller proportion will be of working age. The difficulty posed by this is that typically a working age person pays more in tax than a retired person; a retired person typically makes more use of services such as:

- old-age pensions;
- health and social care;
- welfare benefits.

As a consequence, the States will face the prospect of increased spending at the very time income from taxes is being eroded. As Figure 6.2.1 shows, these services already make up a large proportion of States' spending and the proportion of States' expenditure in these areas will increase over time.

Figure 6.2.1: Overview of total government spending

Presented to scale, net of operating income

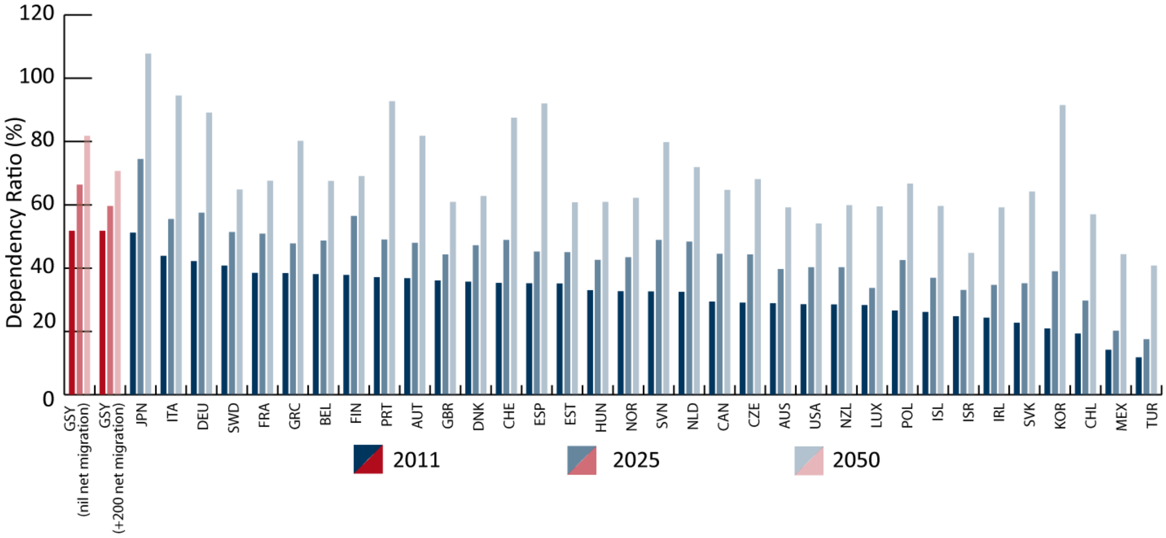


*Housing Department expenditure does not include £11m expenditure from the Corporate Housing Fund. £6m of this is captured as a transfer of rent rebates to the Corporate Housing Fund from routine capital expenditure.

**Central administration cost only. The cost of service provision in Alderney is incorporated within the budget of the operational departments.

Figure 6.2.2: Comparison of Dependency ratio with OECD countries[8]

Source: Policy Council; OECD Stats database



Demographic change is not a new issue, nor unique to Guernsey, but it has been on the horizon for many years. However, whilst the general issue is widespread, the situation in Guernsey is more pronounced than in many countries. Combined, Guernsey and Alderney have one of the highest dependency ratios in the world (see Figure 6.2.2). In 2011[9], for every 100 people of working age in the Bailiwick there were almost 52 people either of, or below, compulsory school age or above pensionable age. The only OECD jurisdiction with a comparable dependency ratio is Japan.

Demographic change is, of course, inherently positive: people are living longer, healthier lives and shifts in the make-up of the population are a normal part of the evolution of an advanced economy. However, because it will change the pattern of both the States' income and the demand for public expenditure, the States will need to adapt to the changing environment.

In the past, the States have been able to maintain balance between the money it takes in taxes - the majority of which is taken from the working age population - and the amount it pays for providing services, much of which is provided to those not of working age. The States need to consider how best to maintain the balance between income and expenditure as the age distribution of the population changes.

This pressure from an ageing population is a result of two factors: (i) the greater than anticipated improvement in life expectancy since the introduction of the pension scheme in Guernsey; and (ii) the increase in the birth rate between the end of World War II and the mid-1960s (generally referred to as the 'baby boom' generation). These two factors exert subtly different pressures on expenditure.

As stated above, the increase in life expectancy is a good thing. It demonstrates improvements in social conditions and the effectiveness of medical care. However, the current pension age of 65 is lower than it was when pensions were first introduced in the 1920s (when the pension age was 70), and the pension age has

[8] The data presented represents the combined dependency ratios of Guernsey and Alderney. Considered separately the dependency ratio in Alderney is significantly higher than for the Bailiwick as a whole. In March 2011 the dependency ratio for Alderney was 63%, the dependency ratio for Guernsey was 48%.

[9] 2011 figures are used to allow comparison to international data sources. 2013 data are available at www.gov.gg/population

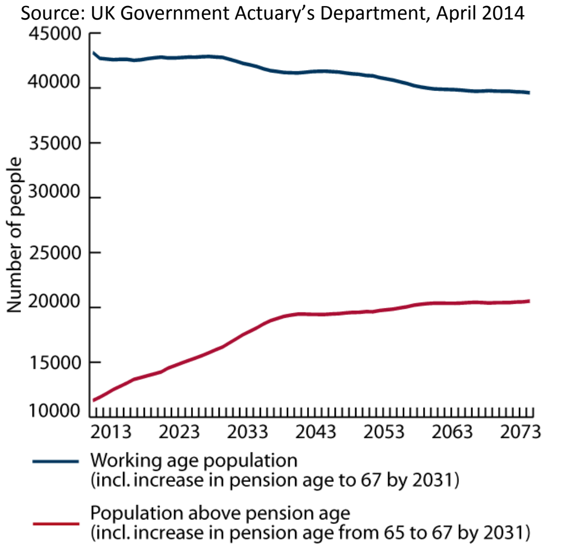
not been increased since the current pension law was established in 1965 (although an increase to 67 by 2031 has already been approved). Consequently, people are living longer in retirement and receiving more pension payments, but the period during which they pay into the pension fund remains unchanged. Indeed, the period over which pension contributions are paid may be reducing for many, given that people tend to stay in education longer than they may have in the 1960s. Any pension system where people are paying in the same number of contributions but getting out, on average, more payments, is not sustainable.

As the 'baby boom' generation (currently aged between 51 and 67) reach the age at which they can claim an old age pension, so there is an increase in the number of people drawing funds from the Guernsey Insurance Fund, from which pension payments are paid. The increase in the number of new old age pension claims each year is significant. For example, between March 2004 and March 2008 the annual average number of Bailiwick residents turning 65 was 521; between March 2012 and March 2015, the annual average is estimated to be around 850[10], an increase of about 28%.

Figure 6.2.3: Projected population: Working age and those above pension age

Assuming net immigration of 200 people per annum, incl. increase in pension age to 67 by 2031

Source: UK Government Actuary's Department, April 2014



By 2025 the number of people aged 65 or over is expected to be 44% higher than in 2012; indeed, by 2050 it is expected to have doubled. The States' decision in 2009 to increase the pension age to 67 by 2031 will lessen the issue but, even if this change is included, the change in the number of people of pensionable age relative to those of working age is significant (see Figure 6.2.3). As the large group of people in the 'Baby Boom' generation move beyond working age, they are being replaced by a smaller group of people moving into employment at the other end of the age scale. As a result, the working age population (at present those aged 16 to 64) is expected to decline.

This has consequences for States' income streams as, on average, a working age person pays about 60% more tax than someone of pension age and six times as much in social insurance (those over 65 being no longer required to contribute to their pension). However, as more people move into retirement, at which point their income is likely to be smaller and typically increases at a slower rate than earnings[11] in the working age population, the direct tax base will be eroded.

To make matters worse, in addition to an increasing number of claims for old age pension, as more people live for longer so the overall need for health and social care services will increase; and this will increase the total cost of providing these services. Combined, these issues could present a significant funding problem.

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[10] This follows a spike between March 2011 and March 2012 when more than 1,000 people turned 65 over a twelve month period. This age group represents Guernsey's largest age cohort, those born in the year immediately following the end of World War II.

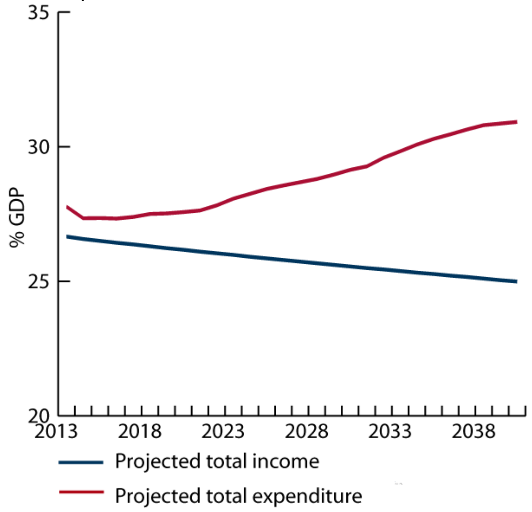
[11] The majority of private pension annuities are linked to inflation.

Without changes to the way in which income is raised, or restructuring in the provision of pensions, health and social care, revenue growth will lag progressively further behind expenditure growth. For example, if the States is to continue current income and expenditure patterns, between 2015 and 2025, government income is projected to fall relative to GDP by 0.6%, whilst expenditure is projected to grow by 1% of GDP. As the change in the population profile progresses, this gap is projected to get wider, so that by 2035, income relative to GDP is projected to be 1.2% lower than in 2015 and expenditure is projected to have increased by 3% of GDP.

The Social Security funds will be able to absorb some of the additional expenditure on pensions and long-term care; however, the reserves are not sufficient to absorb the whole of the projected cost if we continue to provide the same level of services and apply the same level of annual uprating (halfway between the increase in retail price inflation and the increase in median earnings) as are currently assumed.

Figure 6.2.4: Projected income and expenditure

Assuming net immigration of 200 people per year, annual earnings growth of 1.5% p.a., increase in healthcare costs of 1.5%pa, pension uprating of 0.75% p.a.



6.3 Demographic impact: Pension provision

Please note that the projections presented in this section are under review by the UK Government Actuary's Department and those presented in the final States report may differ from those presented here.

6.3.1 The States' Old Age Pension

Pensions are the most obvious area of expenditure impacted by the increased proportion of people of retirement age; more pensioners means more money is needed to pay their pensions.

Some action has already been taken to mitigate this issue; in 2009 the States approved a resolution to increase the pension age from 65 to 67 by 2031, **but this alone is not sufficient to resolve the problem**.

The Social Security Department currently spends around £100m per year on the payment of old age pensions. This is the largest single item of expenditure in the States' portfolio of services and expenditure on pensions is rising at an accelerating rate. By 2025, annual expenditure on pensions could be as high as £150m (at 2014 prices).

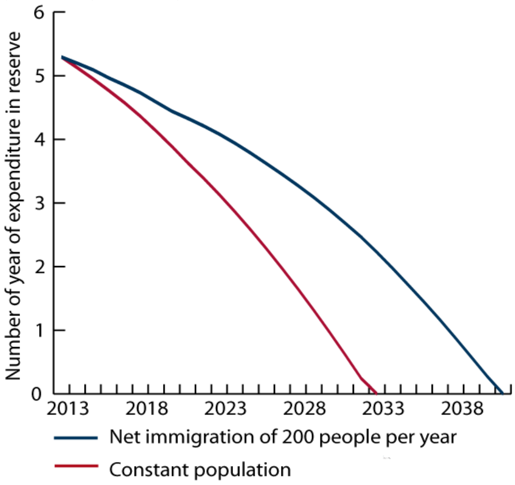
By contrast, even allowing for a real increase in earnings and net immigration of 200 people per year, the total income of the Guernsey Insurance Fund over the same period is projected to be less than half of this.

As a consequence, if no action is taken, the Guernsey Insurance Fund is projected to be exhausted by the early 2040s (see Figure 6.3.1); and if the States' policy of 'no growth' in population is achieved, the point of exhaustion could be as early as 2032.

However, unlike the UK, Guernsey is fortunate enough to have a significant amount of money held in reserve for the payment of pensions; enough to fund more than 5 years of expenditure, but not sufficient to fund all the projected growth in demand. Nonetheless, the income generated from the investment of these reserves supplements the contributions needed to fund expenditure year by year, and means that the mitigating actions needed are less severe than would be required to fund the pension system solely out of annual contribution receipts (as they are in the UK).

Figure 6.3.1: Projected reserves held by the Guernsey Insurance Fund

Assuming: 1.5% real annual increase in earnings; annual uprating of pensions by 0.75%; an increase in the pension age to 67 by 2031; current contribution rates



Previously, options presented for tackling this problem have assumed that reserves should not be reduced to less than two years of expenditure. **The Joint Boards have considered this assumption and consider that it would be imprudent to make long-term plans which would reduce the level of reserves to any less than this.**

In addition to using reserves, there are a number of other options available for resolving the old age pension issue. The options presented below outline the ways in which the Guernsey Insurance Fund could be stabilised, either by increasing the Fund's income or by reducing its projected expenditure. The options are not mutually exclusive; the solution could be to combine elements of two or more to achieve the desired result.

Option 1: Increasing the income of the Guernsey Insurance Fund

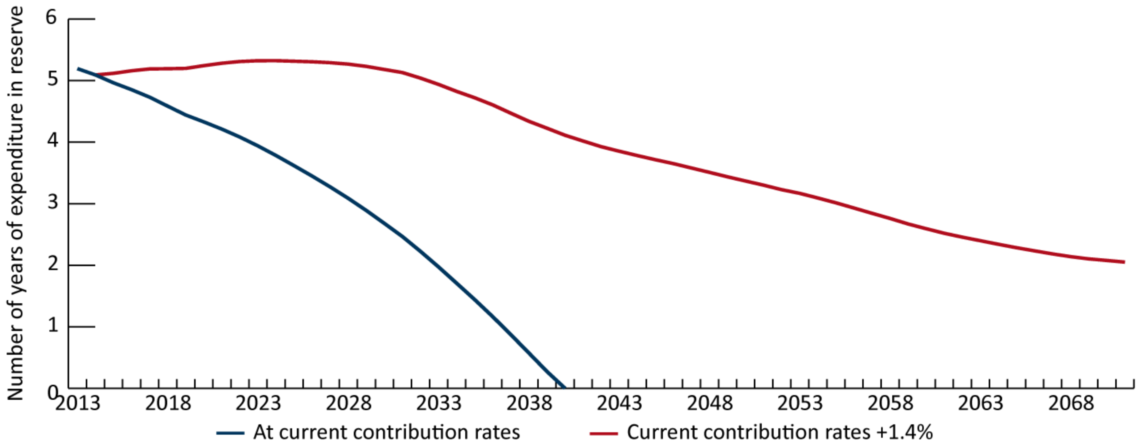
One solution to this problem would be either to increase social insurance contributions, or the grant paid from General Revenue, to provide for the extra demand for expenditure. If this was to be proposed as the entire solution, an increase in the contribution rate of approximately 1.4% (which could potentially be divided between the rates paid by employers and employees) would be needed (assuming net immigration of 200 people per year over the entire 60 year period projected). This would increase the combined percentage of earnings paid into the Fund by employers and employees from 8.3%[12] to 9.7%.

For individuals, this would mean an increase in social insurance contributions paid by working age people. For someone on median earnings (£29,640 a year) this would mean an increase in their contributions of £7.98 per week.

At 2014 prices, the effect of such a measure would be equivalent to an increase of approximately £19m in the Fund's annual income. Figure 6.3.2 below demonstrates the impact this could have on the Fund reserves.

Figure 6.3.2: Projected reserves held by the Guernsey Insurance Fund

Assuming: 1.5% real annual increase in earnings; annual uprating of pensions by 0.75%; an increase in the pension age to 67 by 2031; net immigration of 200 people per annum.



[12] Employees pay 6.0% of their earnings in Social Security contribution up to the upper limit; employers pay an additional 6.5%. The total contribution for each employed person of 12.5% is divided between Social Security's three funds as follows: 8.3% paid into the Guernsey Insurance fund; 2.9% paid into the Guernsey Health Service Fund; 1.3% paid into the Long-Term Care Insurance Fund.

Option 2: Reduce the assumed level of annual uprating of pensions

The central assumption used in the 2011 actuarial review was that pensions would be increased each year at a rate half way between the increase in retail price inflation (RPIX) and the increase in median earnings (which is typically slightly higher). Increasing pension payments by more than inflation each year has a very significant impact on the Fund's reserves. The actuarial review published in 2011 showed that if the annual increase in pension payments was reduced to inflation only, the Fund could be maintained without any other mitigating actions (see Figure 6.3.3).

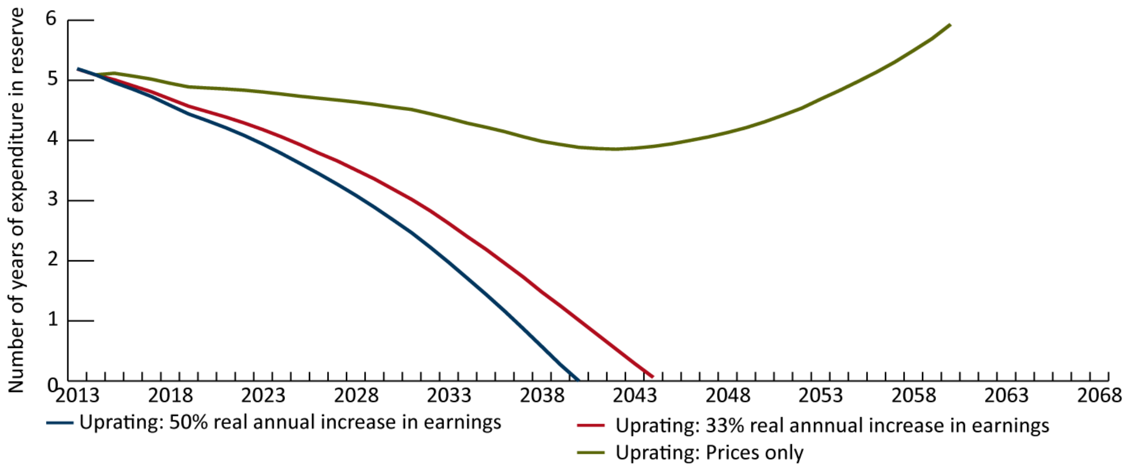
Increasing the old age pension by inflation means that a pensioner should be able to buy about the same amount of goods and services with their pension as they do today. (NB This is not exact because the actual change in the cost of living experienced by an individual or household depends on how they spend their money and can vary significantly from person to person.)

However, keeping the annual increase in pensions below the increase in median earnings means that, over time, the value of the old age pension relative to what people in the workforce are earning will reduce.

For example, in 2014 the Guernsey old age pension is equivalent to approximately 40% of median earnings (after the payment of income tax and social insurance contributions). If the rate of pension uprating is maintained at the same rate as the increase in earnings, this will not change; but if it is reduced to half the rate of increase in real earnings by 2025, this could reduce to 38% and if it is reduced to inflation only this could reduce to 33% by 2025.

Figure 6.3.3: Projected reserves held by the Guernsey Insurance Fund

Assuming: 1.5% real annual increase in earnings; an increase in the pension age to 67 by 2031; net immigration of 200 people per annum; current contribution rates.



Option 3: Increase the pension age

Increasing the pension age has the effect of increasing the number of contributions an individual might make over their lifetime and decreasing the number of pension payments they will receive. Many countries have already begun to increase their pension ages. The UK has approved increases to 68 and are indicating their intention to link pension age to life expectancy, which is expected to result in an eventual increase in pension age to 70.

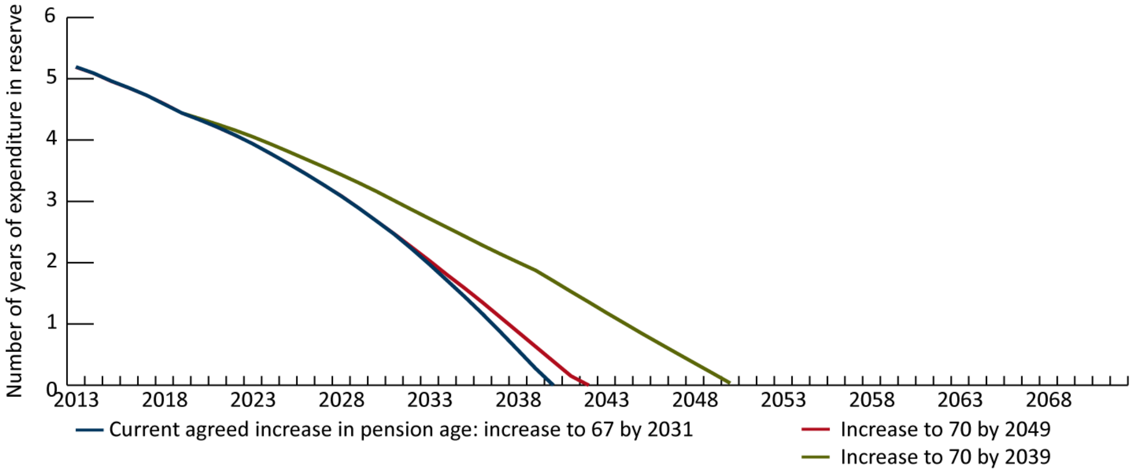
The States have already approved an increase in the pension age to 67 by 2031: the first increase in the pension age approved since the current scheme was established in the 1960s. However, whilst the pension age will have increased by 2 years, between 1965 and 2031 life expectancy beyond 65 is projected to have increased by 11 years for men and 10 years for women.

The implication of this is that, even allowing for the agreed increase, the average person will be paying up to two years' more contributions (possibly less, given the increase in post-16 and higher education[13]) and claiming their pension for eight or nine years longer.

A further increase in the pension age may form part of the solution; however, if the increase is continued at two months a year and from the end of the current policy to increase the pension age to 67 by 2031, the Fund's reserves will have been depleted to such an extent that, on its own, this measure will have little impact (see Figure 6.3.4). If implementation of the increase to age 67 already agreed is accelerated, or this measure is applied in combination with other mitigating measures, it will be more effective. **However, unless the States are willing to extend the pension age beyond 70 and to increase the pension age at a faster rate, extension of the pension age, on its own, is not a complete solution to this problem.**

Figure 6.3.4: Projected reserves held by the Guernsey Insurance Fund

Assuming: 1.5% real annual increase in earnings; annual uprating of pensions by 0.75%; current contribution rates; net immigration of 200 people per annum.



[13] Over this period the percentage of younger people who stay in education beyond the age of 16 has increased significantly. An increase in the number of people undertaking full-time undergraduate and post-graduate qualification means that it is increasingly common for people not to enter full-time employment until well into their twenties.

Increasing the pension age may not mean that everyone will work longer. As is currently the case, those who wish to retire before the State pension age (as many people choose to) will need to make their own financial provisions between their retirement and the States pension age.

Of course, many people will need to work for longer and this has its difficulties. If an individual's fitness declines as they approach retirement, the likelihood of experiencing difficulty in carrying out particular areas of a job increases. In addition, the 'baby boom' generation will hold a large proportion of senior executive positions and the progression of this group into retirement may strip valuable skills and expertise from the workforce. If people are to continue in work – and contribute economically - for longer, working practices will need to become more flexible to accommodate the needs of an older workforce.

Option 4: Means testing the old-age pension

The option of means testing the old age pension, and restricting access to lower income households only, was raised in the initial consultation paper. Australia introduced a scheme like this in 1992 making government-paid old age pension a means-tested safety net and placing the majority of the burden for providing for pensions in retirement on compulsory workplace pensions, with a compulsory employer's contribution of 9%.

The suggestion was highly unpopular with those who responded to the consultation paper. The current scheme is recognised and generally supported as a contributory system. People have paid into the Social Security system with the expectation that they will receive a pension and, as they approach retirement, plan their finances on the assumption that they will receive one. If an alternative means-tested scheme was to be pursued, the lead-in time required to make the transition to such a system would need to be very long – and well in excess of the 10-year transition period outlined for this review process - to give people enough time to adjust their savings' plans and expectations.

The fairest way to make the transition to a means-tested scheme may be a "closed to new members" approach; however, this would entail a transition period of 40 years or more. If this were followed it could be a long time before any significant impact on expenditure was apparent. The majority of the 'baby boom' generation are already contributors to the pension scheme and most are well over half way through their working lives. Unless the States are willing to change the package these people have expected throughout their working lives, they would continue to be entitled to a pension.

In short, although in the very long-term this option could very significantly reduce expenditure on old age pensions, it is not a viable solution within the period of this review.

Option 5: Allowing voluntary deferral of the old age pension

Many countries, including the UK and Canada, offer the option to delay the age at which a pension can be claimed in return for a slight enhancement of the amount received. Typically the benefit of deferral is shared between the individual deferring their claim and the government, which receives additional contributions from the person deferring their claim and makes fewer payments. The benefit the individual would receive from deferral varies by country, but pension payments might be expected to be increased by approximately 5% for each year a pension claim is deferred. At the current level of payments that is equivalent to just under £10 a week.

In most places, only a small proportion of people opt to defer their pension and the administration is more complicated than Guernsey's current system. **Financially, the benefits of a voluntary deferred pension scheme are unlikely to be large enough to make a significant improvement in the issue of financing pension provision. It could, however, be a useful way of encouraging people to stay in work longer.**

6.3.2 Private pension provision

The provision of private pensions has changed significantly over the last decades. In the private sector, *defined benefit pension schemes* (where you know at the outset how much pension income you will receive relative to your salary and the amount of contributions you make) have been almost entirely replaced with *defined contribution schemes* (where what you receive is based on how much you have paid in and the performance of the funds your money was invested in). The pensions received by those contributing to defined contributions schemes are less certain and, if the investments have fared poorly, may be significantly lower in value than those received by contributors to defined benefit schemes.

This is important because the States' old age pension is not intended to be sufficient to provide individuals with a full financial safety net in retirement, but as a supplement to personal income.

However, a survey conducted on behalf of the Policy Council in 2012 revealed that only 45% of people in Guernsey currently contribute to a private or workplace pension and that non-provision was commonest in the young and those on low salaries (see Figure 6.3.5). Of those that do contribute, many will be enrolled in defined contribution schemes which may well not pay out as much as might have been expected. This research suggests that a significant number of people do not make any private provision for themselves at all or they do not start their contributions early enough or make a large enough contribution to gain a significant income from it. This indicates that many of the next two generations of retirees are not making enough personal provision to support the lifestyle they have enjoyed during their working lives. As a result, they may need to work into later life to continue the lifestyles they have come to expect.

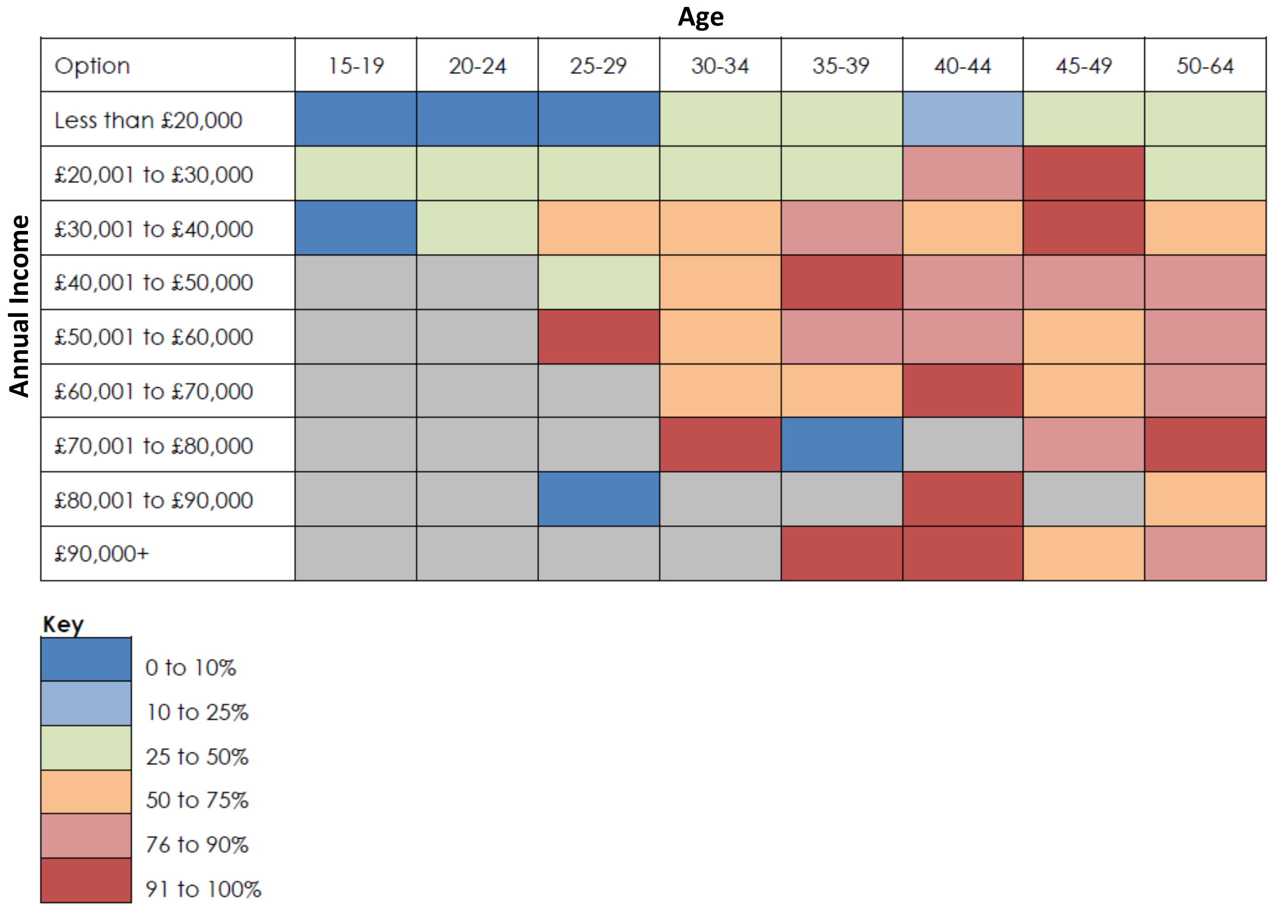
For those whose personal income in retirement is not sufficient to meet their basic needs, the supplementary benefit system is available to provide extra support. However, the increasing number of pensioners who do not have sufficient income on which to support themselves and who are likely to claim supplementary benefit as a result, is itself a significant funding issue.

Given that one of the principles of this review is that people should be encouraged to be more responsible for their own financial wellbeing, promoting private or workplace pension provision, particularly among those not currently making any provision, is important if these people are to be able to support themselves in retirement.

The provision of private pensions is outside the mandate of this review, but the Joint Departments recognise that it is a key area of work and acknowledges that is one which the Social Security Department is currently progressing.

Figure 6.3.5: Proportion of people contributing to private or workplace pension schemes

Source: States of Guernsey, Pensions Survey 2012



6.4 Demographic impact: Health and social care

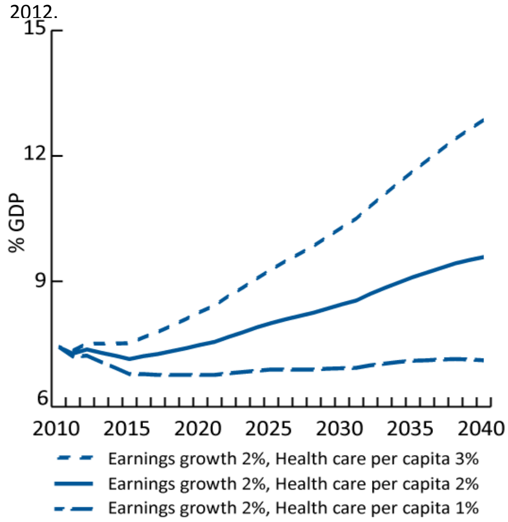
As people age they tend to suffer from more medical conditions for which they need treatment and their medical needs become more complex. As a result, the cost of providing healthcare to an individual typically increases as they age. Healthcare costs also increase dramatically at the end of someone's life. It is estimated that, in the UK, 29% of healthcare expenditure is spent on people in the last year of their lives. Older people also often require more social care services, such as assistance with daily tasks like cooking and cleaning, in order to support them in their daily lives.

The cost of providing healthcare also tends to increase at a rate above inflation. The development of new and more sophisticated drugs and medical techniques means that people's expectations of the treatments to which they should have access are always increasing. The experience of many countries, including the UK, shows that government healthcare spending can increase very rapidly if not tightly controlled.

Figure 6.4.1: Total public expenditure on health and social care: The effect of varying real annual growth in expenditure per capita

Assuming net immigration of 200 people per annum

Source: Potential long-term implications of demographic change on the demand for public services, Policy Council, 2012.



About 75% of health and social care in Guernsey is funded directly from General Revenue. This includes the running of the hospital, as well as treatment for patients sent off-Island, mental health, children's and community care services. Increased pressure on spending in this area would need to be met from general revenue on a year-by-year basis.

The remaining 25% of health and social care expenditure, including the subsidy on prescriptions and GP appointments and the secondary care provided by the Medical Specialist Group, is funded on an insurance basis. As with the provision of old–age pensions and long-term care services (see below), a portion of each person's contributions are paid into the Guernsey Health Service Fund. In 2012, this Fund contained the equivalent of just over 2 years of expenditure. These reserves could be used to mitigate some of the cost pressures in this area.

Modelling health and social care costs is very difficult. The relationship between age and health and social care needs is complex, and technological developments and the impact these might have on cost are almost impossible to forecast accurately in the long-term. Nonetheless, some modelling of this has been attempted in Guernsey, leading to the prediction that additional costs could amount to as much as 4% of GDP by 2040. To put this in perspective, at 2014 prices, this could mean an additional cost of anywhere up to £125m per year.

6.5 Demographic impact: Long-term care

Bailiwick residents are entitled to substantial assistance with the cost of privately-provided long-term residential and nursing home care. The States pay £413.90 per week towards the cost of each person in private residential care and £772.87 towards the cost of private nursing care. Each person is required to make a minimum co-payment of £186.83 per week towards the cost of their care. (NB The co-payment is also payable by those accommodated in States-provided care homes, which are otherwise funded from General Revenue.)

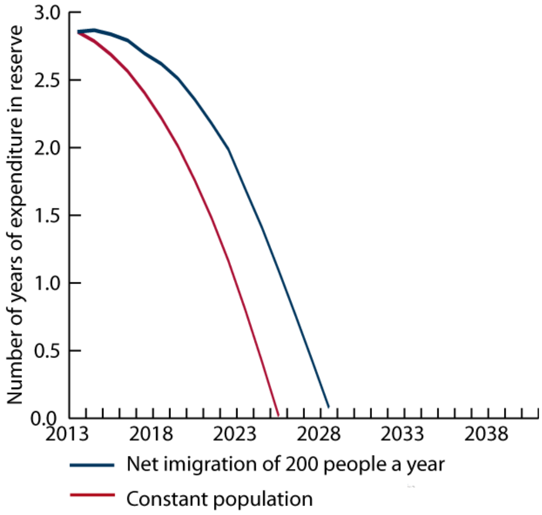
Those persons whose income is not enough to cover the co-payment can claim supplementary benefit to assist with this cost. The value of any property assets are fully protected both in providing long-term care benefit and in any assessment for assistance with paying the co-payment, although any income from property (such as rental income) may be included in the assessment of the latter.

Long-term care benefit is paid from the Long-Term Care Insurance Fund and a portion of each person's social insurance contributions (1.3% for an employed person) is allocated to this fund for the provision of this benefit. In reality, not every Islander will claim a benefit from this Fund, particularly as coverage is limited to care in private residential or nursing homes. It is estimated that approximately one in three people require care in a residential or nursing facility in later life.

Like the Guernsey Insurance Fund, the Long-Term Care Fund holds money in reserve. However, the reserves are much smaller: less than 3 years of expenditure. The projections for the Fund are also significantly worse. Assuming net migration of 200 people per year, this Fund is expected to be exhausted by about 2028; and as early as 2024 if a constant total population is assumed (see Figure 6.5.1).

Figure 6.5.1: Projected reserves held by the Long-Term Care Fund

Assuming: 1.5% real annual increase in earnings; annual increase in care cost per person of 1%; an increase in the pension age to 67 by 2031;



To make the current system sustainable would need an increase in contribution rates of 1.3% (raising a total of about £18m per year); almost as much as would be required to stabilise the old age pension system.

However, as noted already, the benefits provided from this Fund cover only those long-term care services provided in private residential and nursing care homes. They do not cover care provided in a person's own home, or in extra care or sheltered housing. Provision of community-based services for the elderly is divided between the Health and Social Services and Housing Departments, charitable organisations and private sector firms. The costs relating to the provision of all these services are in addition to the £18m quoted above.

The States has established a working party to develop recommendations for the Supported Living and Ageing Well Strategy (SLAWS), partly in acknowledgement that the financing of long-term care is unbalanced in its coverage and unsustainable in its funding. The working party is in the process of undertaking a comprehensive review of the provision of housing, health and social care services for older people and other adults in the community who require long-term care services. This will consider the unsustainable nature of the current system, which is based on models of dependency, and will bring forward recommendations for restructuring provision into a more sustainable system before the end of this States' term.

6.6 Provision of benefits

6.6.1 *Means tested benefits*

In 2012, Guernsey spent £20m on providing households with supplementary benefit. In addition, it provided a further £10m of rent rebates through the social housing system.

Both the supplementary benefit and rent rebate systems are means tested, i.e. they are only available to people whose income is below a set threshold. The two systems apply different requirements for assessing whether a household is eligible to claim the benefits they offer and how much they receive. The two systems overlap; there are households that claim only a rent rebate or only supplementary benefit, but there are also households which claim both.

In 2013, the States set up the Social Welfare Benefits Investigation Committee (SWBIC) to devise a single system of means-tested benefits where there would be only one set of rules, one assessment process and one claim to be made by each household.

However, reconciling the two systems has a cost implication. Because the two systems assess a household's need in different ways, moving to a single system would change the amount of benefit people receive. Two previous reports have been presented to the States outlining proposals for combining the two systems and the most recent proposals, presented in October 2013, estimated the annual additional cost of a new system to be between £4m and £7m. The 2013 report proposed that the Personal Tax, Pensions and Benefits Review considers how this money could be found, with particular reference to reducing the money spent on providing the universal benefits administered by the Social Security Department such as family allowance (see further below).

Although a final decision on the future of means-tested benefits was deferred to allow further review and analysis by the Social Welfare Benefits Review Committee (SWIBC), the Personal Tax, Pensions and Benefits Review will consider the possible reduction in spending on the universal benefits administered by the Social Security Department. At various times it has been suggested that this money could be reallocated to fund other welfare or social projects.

6.6.2 Universal benefits

The Social Security Department provides a number of so-called "universal" benefits. These benefits can be claimed by anyone living on the Island, who is registered with the Social Security Department and fits the claim criteria; there is no requirement to have paid any social insurance contributions and they are not restricted to those on low incomes.

These benefits include:

- Family allowance
  - Families in Guernsey can claim £15.90 per week from the Social Security Department for each child that they have.
  - Family allowance was paid to households at a total cost of £10m in 2012.
- The subsidy on medical prescriptions
  - The total amount a Guernsey resident has to pay for each item they are prescribed is limited to £3.30. The remaining cost of any prescription is paid for by the States.
  - Households on supplementary benefit, or people who are over 65, or those in receipt of severe disability benefit are exempt from any charge on prescriptions, i.e. they are free.
  - In 2012, paying for prescriptions cost the States £15m.
- The subsidy on GP and nurses' appointments
  - Most people in Guernsey have to pay to visit their GP. However, the States provides a £12 subsidy towards the cost of a doctor's visit and £6 for a visit to the nurse.
  - In 2012, this cost the States £4m.
- Free TV licences for all people aged over 75 (or aged over 65 for those receiving supplementary benefit)
  - As they do in the UK, in Guernsey, people over 75 receive a free TV licence, the cost of which is met by Social Security.
  - In 2012 this cost the States £600,000.

The continued provision of these types of benefits is under review in many countries. In the UK, child benefit – the equivalent of family allowance in Guernsey - was withdrawn for those liable for tax at the higher rate, and questions have been raised about the mounting cost of continuing the practice of providing free TV licences to those over 75.

6.7 General expenditure: financial discipline and justified spending

If the States continues on its current path with its current system of tax, pensions and benefits, then to meet all the expenditure areas outlined above under the current funding model (excluding the largely unknown pressure on healthcare) **the States would need to find an estimated £60m to £70m[14] per annum to support it.**

[14] This estimate includes a "do nothing" cost of supporting the Long-term Care Fund in its current form and an assumed cost of the SWIBC proposals. The recommendations of both SWIBC and SLAWS will impact on these estimates.

As highlighted, there are some realistic options for reducing the amount spent on providing old age pensions and there are a number of projects currently underway examining (among other things) how money is spent in particular areas. Measures to reduce expenditure on pensions and a withdrawal of universal benefits could reduce the above estimate to the £30m to £40m range. The outcome of projects such as SWIBC and SLAWS will also impact these costs.

The FTP, which commenced in 2008, aimed to achieve savings from the States' budgets through a series of efficiency measures. If it meets its targets, when it ends in December 2014 it will have reduced States spending by £31m a year, or about 10% of the General Revenue budget. However, the need to continue scrutinising the way in which the States provide services and whether these are being managed in the most effective way should not end with the FTP. The States should continue their commitment to financial discipline and be able to justify the way in which it spends public money.

Whilst the FTP may end in December 2014, longer-term there are projects underway which will deliver savings beyond the Programme's timescale. For example, the Strategic Asset Management Plan aims to accrue savings by making better use of the States' property portfolio. In addition, the ongoing transformation of services provided by the Health and Social Services, Education and Home Departments each have the potential to release further efficiency savings beyond the Programme's timescale. A review of longer-term savings is an integral part of this process.

On the other hand, as the community's standards and expectations change there are frequently demands on government expenditure to increase public service provision; for example, the recent States' decision to provide universal pre-school provision.

It is impossible to predict accurately all the expenditure pressures we may face in the future. We can plan for and mitigate pressures which we know and can predict but there are areas, such as health and social care, where predicting expenditure demand accurately is difficult, if not impossible. **If the States is to control expenditure effectively it needs to tackle a difficult question: how big should our government be?** It does not follow that, just because the States has traditionally provided a public service, it should be duty bound to do so in the future.

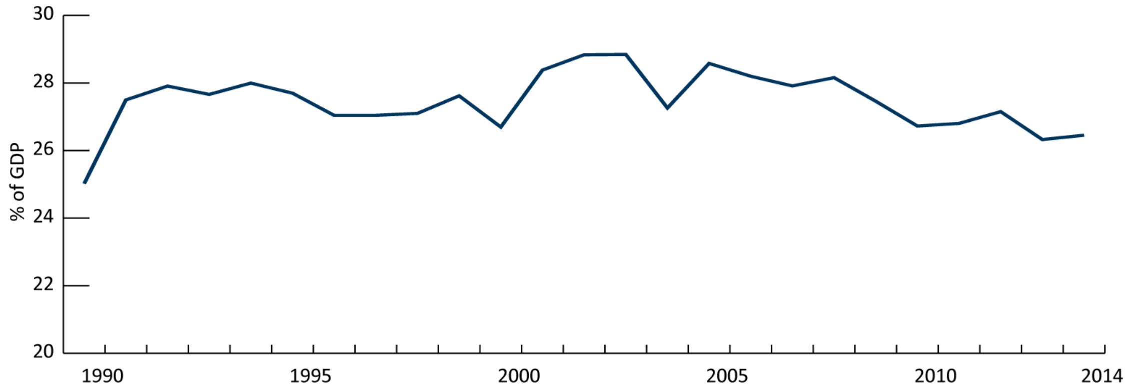
The States has already committed to a limit on General Revenue income and expenditure of 21% of GDP in the Fiscal Framework, agreed by the States in 2009. However, to some degree this limit is misleading, in that it did not cover social insurance contributions and the services funded by them.

At first glance it might seem appealing to place a limit on **total spending**, including that spent from the Social Security funds. However, because of the funding mechanisms for the Social Security funds, setting a limit on expenditure for these is not practicable. If enough money is held in reserve, it will be possible to draw down the reserves to cover a period of high expenditure needs without this being unsustainable in the long-term, but only if the reserves can be rebuilt at a later date.

Placing a limit on **aggregate income** is more practicable. This would limit the amount of money the States could take in total in the form of taxes and social insurance contributions. To continue its commitment to permanent balance, the States would need to manage expenditure to maintain the sustainable position of the Social Security funds in the face of a limit on the amount of additional money the States can ask the community to pay in.

Prior to 2010 (i.e. the completion of the transition arrangements for Zero/10), total government income had been consistently between 27% and 29% of GDP. In the 1990s, income was typically at the lower end of this bracket (between 27% and 28%). In the 2000s, this increased to between 28% and 29% of GDP. Since 2010, revenues have averaged just less than 27% of GDP, with total revenues in 2014 expected to total approximately 26.5% of GDP with a deficit of approximately 1% of GDP.

Figure 6.7.1: Guernsey estimated total public income as a percentage of GDP



Nevertheless, as outlined above, we know that, in the long-term, we may need to raise more money from the tax system to pay for public services generally; and for old age pensions, health and social care in particular. As such, the limit on total income will need to be higher than current revenues, which are, in any case, well below their historic average.

However, if the limit is to deliver real financial discipline, it must be set at a level which will require serious restraint to maintain. To pay for all the known pressures outlined in this paper without any form of mitigation would require an increase in income to approximately 30% of GDP. This does not include the unknown expenditure pressure on health and social care.

The Joint Boards believe that it is possible to reduce this to 28% of GDP by mitigating some of the pressures outlined. This could be further aided by continuing the work begun by the Financial Transformation Programme in improving the efficiency of States' services and by making better use of our physical and financial assets. However, we could still face a mounting annual bill for health and social care services.

The Joint Boards believe that the States should be recommended to set a limit on aggregate income in order to ensure ongoing expenditure discipline and control. This limit should not be viewed as a target. The temptation to relax fiscal discipline, and increase taxes and States' revenues to meet short-term objectives, simply because there is currently scope within a limit, should be avoided. If such short-sightedness is favoured, it could make it increasingly difficult to stay within the limit as pressures increase over the longer-term.

Decisions to meet short-term objectives should not undermine long-term stability.

Box 1: How much tax do we pay and how is it spent?

The tables below present a range of examples of how much income tax and social insurance households may pay in a year and illustrates how much various services cost the States. For reference, median average earnings for an employed adult in Guernsey in 2013 was £29,250.

Table B1.1: Annual amount of tax and social insurance paid by example households

SI = Social Insurance contributions; IT = Income tax; assumes income for couples evenly distributed between spouses

Household description	Household income				
	£25,000	£50,000	£50,000 (self-employed)	£75,000	£100,000
Single adult	IT: £3,065 SI: £1,500	IT: £8,065 SI: £3,000	IT: £8,065 SI: £5,250	IT: £13,065 SI:£4,500	IT:£18,065 SI:£6,000
Single adult with a mortgage (paying £5,000 interest per year)	IT £2,065 SI: £1,500	IT: £7,065 SI: £3,000	IT: £7,065 SI: £5,250	IT: £12,065 SI: £4,500	IT: 17,065 SI: £6,000
Married couple	IT: £1,130 SI: £1,500	IT: £6,130 SI: £3,000	IT: £6,130 SI: £5,250	IT: £10,130 SI: £4,500	IT: £16,130 SI: £6,000
Married couple with mortgage (Paying £5,000 interest per year)	IT: £130 SI: £1,500	IT: £5,130 SI:£3,000	IT: £5,130 SI: £5,250	IT: £9,130 SI: £4,500	IT: £15,130 SI: £6,000
Single parent	IT: £1,755 SI: £1,500	IT: £6,755 SI: £3,000	IT: £6,755 SI: £5,250	IT: £11,755 SI: £4,500	IT: £16,755 SI:£6,000
Single pensioner	IT: £2,710 SI: £520	IT: £7,710 SI: £1,245	N/A	IT: £12,710 SI: £1,970	IT: £17,710 SI:£2,695
Pensioner couple	IT: £420 SI: £316	IT: £5,420 SI: £1,041	N/A	IT: £9,420 SI: £1,765	IT:£15,420 SI:£2,490

Table B1.2: Estimated average costs of various services

Funding source	Service	Typical cost
General Revenue	1 year of education: primary	£4,536
	1 year of education: secondary	£6,692
	Hip replacement	£9,740
	Delivery of a baby: natural birth, in hospital, no complications	£1,174
	Delivery of a baby: by Caesarean section	£3,785
	Family allowance – per child, per year	£827
Social Insurance	Insulin and other prescription items for type I diabetes for 1 year	£2,028
	One year of old age pensions at full rate	£10,239
	One year of long term residential care for an older person (States subsidy only)	£21,523
	One year of long term nursing care for an older person (States subsidy only)	£40,189

7 Issues 2: Raising government income

In order to provide public services, the States raises money from the community by charging taxes. However, as stated earlier, the challenges arising from the way the States raises revenues are distinct from the issues of pressures on spending. The two are not mutually exclusive. If it were possible to eliminate the upward pressure on expenditure, we could still face an erosion of revenues if the working age population falls as projected. The reverse is also true: if the risk to income were successfully mitigated the mounting pressure on pensions, health and social care costs would remain.

The States' first priority should be to seek to grow the tax base by growing the economy and, in particular, high value employment in the Island. This requires delivery against the Economic Development Framework and the creation of conditions conducive to growth and the removal of barriers. However, it would be imprudent to seek to design a sustainable fiscal system on the presumption that we can consistently achieve high growth rates.

The sections below outline the problems faced and some of the options available for mitigating them.

7.1 The distribution of the tax base

Broadly speaking there are four areas of the economy which can be taxed:

- Wealth *(e.g. inheritance taxes, capital gains tax)*
- Corporations *(e.g. corporate profit taxes)*
- Income *(e.g. income tax, social insurance contributions)*
- Consumption *(e.g. excise duties, GST)*

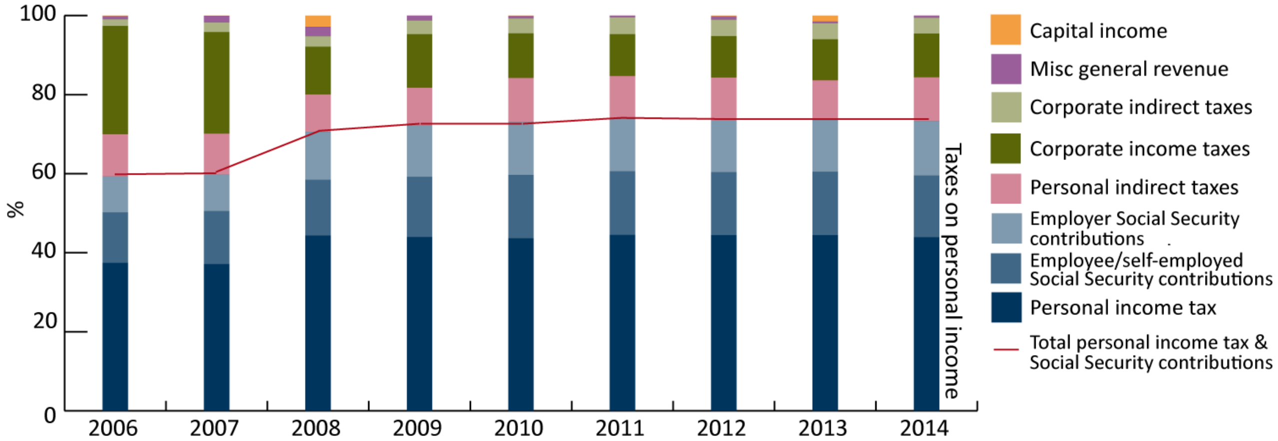
Guernsey does not impose any direct wealth taxes, such as capital gains or inheritance taxes. Such taxes are collected in response to specific events in the life of individuals and, therefore, the revenues generated are very volatile and difficult to predict with any accuracy. Introducing a capital gains or inheritance tax would undermine Guernsey's attractiveness to high net worth individuals to relocate and its 'tax neutral' offer for international financial services, particularly in funds and pensions administration. Furthermore, such taxes are rarely a significant revenue raiser, and they are very expensive to collect relative to the comparatively small amount of revenue they would generate. Such taxes would be damaging to Guernsey's competitive position, raise very little revenue and as such are not under consideration in this review.

Taxes paid by companies are also outside the scope of this review, although the Treasury and Resources Department is elsewhere considering whether there is further scope to extend the intermediate (10%) rate of income tax on company profits to fund administration businesses. However, the recent history of tax paid by companies in Guernsey must be taken into account when considering our current position.

In 2006, Guernsey sourced more than a quarter of its total government income from taxes on corporate income and 59% from personal income tax and social insurance contributions. In response to pressure from the European Union, Guernsey introduced the Zero/10 tax system in 2008. This reduced the proportion of income received from taxes on corporate income to 11% by 2010. This is equivalent to a reduction in tax receipts of approximately £80m at 2014 prices.

Figure 7.1.1: Distribution of total government income in Guernsey

Excluding departmental operating income



Unlike Jersey, Guernsey did not immediately move to introduce a consumption tax to replace the lost income, although the States did approve enabling legislation in 2009 to facilitate the introduction of a consumption tax, should it be necessary in the future.

Instead, Guernsey took an alternative approach:

- £31m of the lost revenue was to be reclaimed by making a reduction in annual General Revenue expenditure through the FTP between 2008 and 2014. £26m of these savings had been confirmed by the end of April 2014.
- Approximately £22m (at 2014 prices) was reclaimed by increasing employers' contributions to Social Insurance by 1% and increasing the upper limit on the earnings liable for social insurance contributions to £132,444.
- Approximately £17m was reclaimed by increases in indirect taxes, primarily those charged against companies. Specifically these included increased company registration fees and Tax on Real Property (TRP) rates charged on commercial properties.

In total, these measures have reduced the potential deficit by £65m, with a further £5m of savings to be made by the FTP by the end of 2014.

The intention had been to "wait and see" until 2012/13, and carry an intentional deficit on the Revenue budget for 5 years to allow the natural growth of the economy to erode the deficit. Five years have now elapsed and the hoped-for economic growth has not materialised: Guernsey's economy at the end of 2013 was, in real terms, about the same size as it was in 2008. Whilst this is not surprising given the global economic climate and its ongoing effect, particularly on international finance business, despite all the efforts referred to above, the General Revenue budget still showed a £25m deficit at the end of 2013.

The result of the changes to date has been to shift the burden of taxation towards that charged directly against personal income; namely: personal income tax and social insurance contributions.

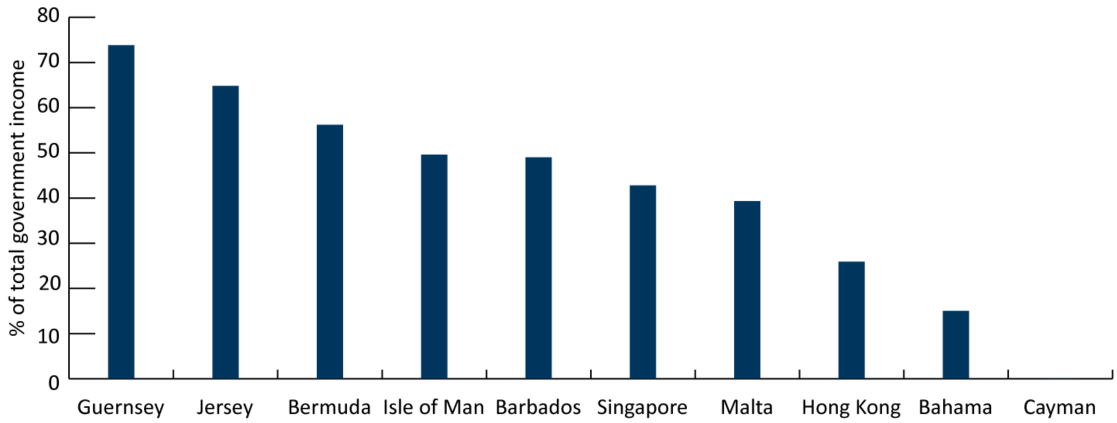
Figure 7.1.2: Proportion of tax gained from principal taxation sources in Guernsey (2013)

In 2014, Guernsey is expected to gain 74%[15] of its revenues from personal income taxes and social insurance contributions. Although conceptually theses taxes are charged on different principles, they are charged, for the most part, against the same income. The impact on income is also very similar; if the rate increases the amount of money people take home in exchange for their work is less.

This is very noticeably higher than in other jurisdictions. **Guernsey's dependence on these taxes is more than 10 percentage points higher than any OECD jurisdiction and any comparable island jurisdiction for which information is available.**

Figure 7.1.3: Comparison of reliance of direct taxes on income in Island Jurisdictions as a percentage of total funding

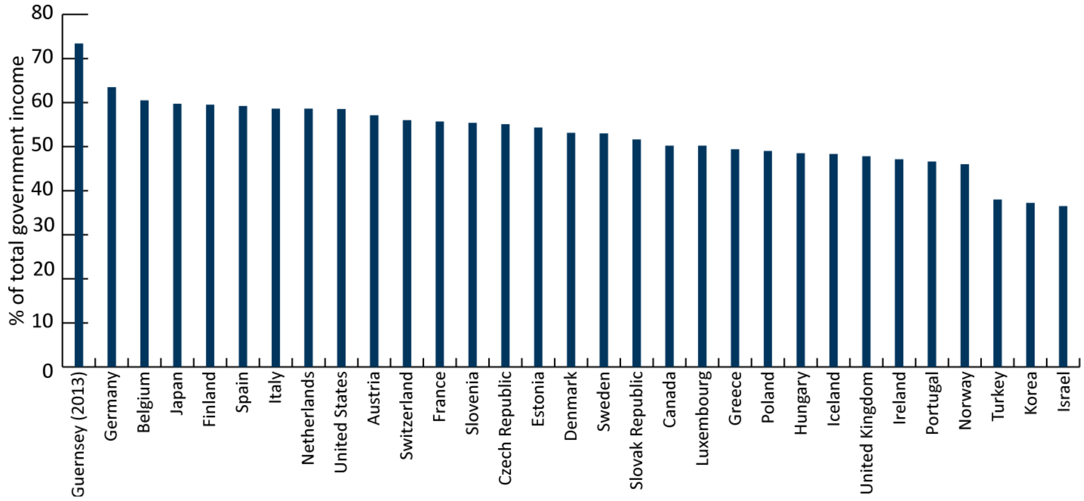
Includes: Personal income taxes, payroll taxes and social or national insurance contributions; excludes operational income
Source: Policy Council



[15] For ease of comparison with other jurisdictions this figure excludes revenue from departmental operating income (primarily fees and charges) as the services these cover can vary considerably between jurisdictions (for example if the provision of utilities is incorporated as a government service).

Figure 7.1.4: Comparison of the percentage of Government income from income taxes and social insurance contributions; Guernsey, Jersey and OECD countries (2010 unless otherwise stated)

Source: OECD Stats data base



Although Guernsey does not apply a broad-based consumption tax, it does apply more specific consumption taxes, namely excise taxes and fuel duties. Combined, these contribute about 6% to government income.

There are a number of reasons why an unusually high dependence on one type of tax might pose a risk to States' revenues and these are explored below.

7.2 The shrinking tax base: taxation and the changing population

If we return to the issue of the demographic change, in 10 years' time there will be a greater proportion of people in our population who are above pension age and a smaller proportion of people of working age.

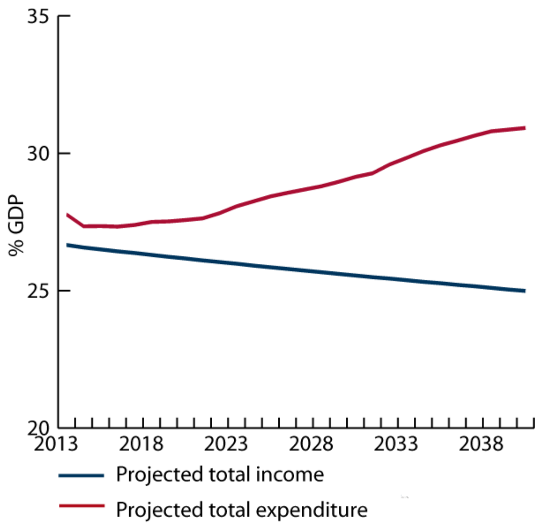
As more people move into retirement, when their income is likely to be smaller and typically increases at a slower rate than earnings[16] in the working age population, the direct tax base will be eroded. On average, a person of working age pays approximately 60% more in income tax then a person above the pension age.

This is more noticeable when social insurance contributions are considered; a person above retirement age is no longer required to contribute to the pension scheme, whilst a person of working age pays on average six times as much in social insurance contributions as the average pensioner.

Assuming that this pattern will continue, the logical

Figure 7.2.1: Projected income and expenditure

Assuming net immigration of 200 people per year, annual earnings growth of 1.5% pa, increase in healthcare costs of 1.5% pa, pension uprating of 0.75%pa.



[16] The majority of private pension annuities are linked to inflation.

progression of this argument is that over a period of time, the average amount of tax and social insurance paid per person will increase at a slower rate than the increase in earnings, reducing the value of direct tax receipts relative to the size of the economy.

Other taxes are more evenly distributed across the population:

- **Taxes on immovable property** (e.g. TRP) are not affected by the age profile of our population to any great extent. Property charges are the same regardless of the age of the person who lives in or owns the property.
- **Consumption** does vary with age, but less so than income. Estimates show that, excluding expenditure on housing and financial services, a person of working age spends on average 37%[17] more than a pensioner. As a result, although revenue from a consumption tax would be affected by the ageing population, the impact would be less than the impact on both Income Tax and social insurance.

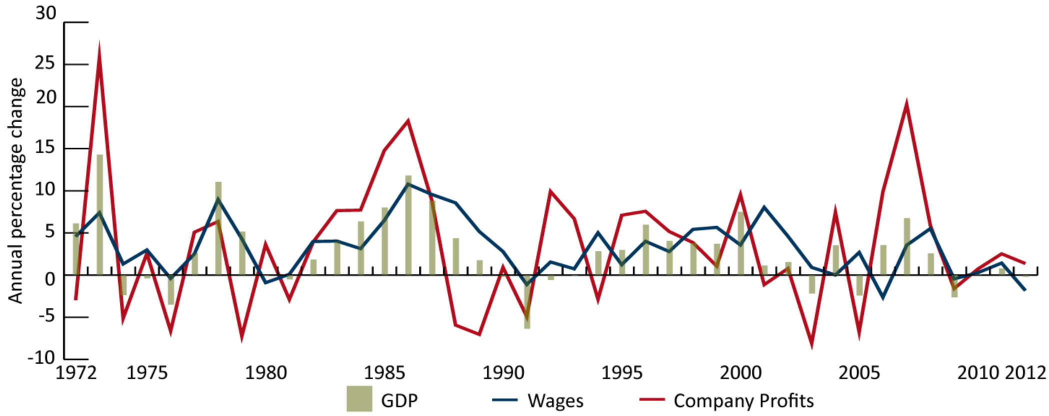
7.3 Volatility of revenues

Different taxes are affected by economic conditions in different ways. For example, taxes on corporate profits are typically the most volatile income stream. In times of economic boom, company profits (and the taxes charged on them) can show high levels of growth; conversely, they can show a rapid decrease in times of recession.

Personal income (and income tax) is less volatile than corporate profits; the reaction to changes in economic conditions tends to be smaller and to occur slightly later. A business taking less money is likely to absorb the drop in its takings for a period of time before it reduces staff numbers or wages. It is also likely to wait to be sure that business is picking up before hiring more staff or increasing wages (see Figure 7.3.1).

This "lag and smoothing" effect means that, comparing year on year, it is not uncommon for company profits to be down whilst aggregate wages increase or vice versa.

Figure 7.3.1: Movements in company profit and wages in Guernsey



[17] Household expenditure survey 2005/6

There is a similar relationship between income and consumption, although the relationship is a complex one[18]. Income is generally considered to be the principal driver of consumption, but the relationship is not one-to-one. For example, if you earn £100 more you may not spend £100 more on consumable goods. You may choose to save some of it, or put it towards paying off your debts instead. If you earn £100 less, rather than spending less, you may choose to save less, spend savings or borrow money, to help meet your spending needs.

How an individual will react to a change in income could depend on a number of factors: why income has changed (i.e. a reduced bonus, a reduction in overtime or the loss of a job); whether the change had been anticipated; how long it is believed the change in income might last; or how easy it would be to borrow money.

Monetary policy decisions to stimulate economic growth often aim to increase consumer spending in the first instance. For example, reducing interest rates reduces the amount people need to spend paying off their debt and make it cheaper for people to borrow money. In theory, this means they have more money to spend. If these policies are successful, consumption should be the first element of the economy to improve, with income and company profits following on from the increase in spending. Although the States of Guernsey does not have the same control of monetary policy as a large jurisdiction, it is affected by the policy decisions made by the UK government and the Bank of England.

Taxes on immovable property, such as TRP, are impacted very little by economic conditions. Liability for TRP does not change with income or with a person's pattern of spending. It is, therefore, among the most stable and predictable of the revenue streams collected in Guernsey. However, the amount paid by any individual does not readily adapt to changes in their circumstances.

Relying heavily on one form of taxation means that government income will be heavily impacted by changes in that area. In Guernsey's case that means changes in the amount people are earning.

More evenly distributing the amount of money the States take from different taxes will reduce the vulnerability to changes in the income from one area of taxation. Although most forms of taxation are affected by economic conditions to some extent, the differences in the way different income streams are affected means that distributing the tax take across a wider base will smooth the impact a change in economic conditions might have on government revenues. It could also provide the States with more time to adapt to a change in economic conditions and more options for doing so.

[18] There is little consumption data available for Guernsey but the relationship has been documented elsewhere. For more information see http://www.stanford.edu/~pista/ann_rev.pdf

7.4 Tax efficiency

As explained in section 4.2, taking money out of the economy in the form of taxes has a negative impact on the economy, but the extent to which taxes affect an economy is different for different income streams. A tax which has little effect on the economy is considered 'economically efficient'. (NB A more detailed explanation is provided in Appendix B.)

The OECD ranks taxes in the following order, with the most efficient first:

- Property taxes (recurrent on immovable property) (e.g. TRP or council tax)
- Consumption taxes (e.g. excise taxes, GST or VAT)
- Personal income taxes (including Social Insurance)
- Corporate taxes

If one combines the amount of tax received from companies and taxes, and contributions charged on personal income, Guernsey sources more than 80% of its income from the two least efficient taxes. It receives only 10% from the two most efficient sources.

The distorting effect of any given tax increases as the rate increases. It is generally considered less damaging for an economy to have a number of different kinds of taxes at low rates than a single type of taxation at a high rate.

7.5 Outline of options available

The section below provides an outline of the personal tax measures which could be taken to mitigate the potential erosion of income receipts and to address the issues of the heavy dependence on direct personal income taxes. The table presented at the beginning of each option provides a brief assessment in terms of sustainability, economic efficiency, fairness and the impact on the distribution of the tax base.

7.5.1 Increasing Income Tax or Social Insurance revenues

Increasing headline rates

Sustainability	Poor
Economic efficiency	Poor
Fairness	Proportional
Tax distribution	Narrower

The States could choose to increase income taxes or social insurance contributions to replace the income lost as the balance of the population shifts. This would be relatively easy to achieve, requiring no new administrative systems or processes. However, since this would gain more income from the same, narrowing tax base, this additional income would, itself, reduce as the population ages.

It would also not deal with the issue of Guernsey receiving a substantial proportion of its revenue from a single source and the risk that that implies; in fact it would make it worse. Increasing income tax or social insurance would only increase the vulnerability to changes in the amount people earn. **If the aim is to diversify the tax base to reduce the impact on revenues of the shrinking workforce and our vulnerability to changes in income, the proportion of revenue generated from these sources should be reduced.**

A higher headline tax rate could also be damaging to our competitive position. Guernsey must source specialist skills and experience from outside the Island and keep the skills it develops locally. These skilled individuals include specialist medical staff, teachers and senior executives in the finance industry. These individuals are very important to Guernsey, promoting high quality public services and generating economic growth, innovation and wider employment in the private sector. Such people are highly mobile and a competitive personal tax system is important in attracting them to Guernsey. Increasing the tax rate to a level higher than our closest competitors would put Guernsey at a disadvantage.

Higher rates for higher earners

Sustainability	Poor
Economic efficiency	Poor
Fairness	Progressive
Tax distribution	Narrower

The results of the public consultation indicate that some people would consider it fair to charge a higher rate of tax to those who have a higher income. Although this would be logistically more difficult than an increase in the general rate, it would not entail the development of any new tax systems.

However, this must be balanced against its competitive effects and the same argument can be made against higher rates of taxation for higher earners as were made against a higher rate. To raise a significant amount of additional money, either the higher rate threshold would need to be comparatively low or the higher rate would need to be high. For example, to raise £20m it is estimated that you would need to charge a rate of 30% on all earnings above £45,000, capturing about 25% of the employed population.

This must also be considered alongside social insurance contributions. The upper limit on contributions in Guernsey is very high - £132,444 compared with £47,016 in Jersey and £41,865 in the UK. The UK applies a higher rate of income tax (40%) to earnings above £41,866; £1 above the upper limit on National Insurance contributions (£41,865). This means that there is no overlap between the higher rate of tax and national insurance contributions. If the same principle was to be applied in Guernsey, only those earning over £132,445 would be subject to the higher rate. At this level, a 30% rate would raise an estimated £3m-£4m.

If set below the upper earnings limit on social insurance, higher rates for higher earners would mean high marginal tax rates (see Box 1) for upper middle and high earners . Using the example presented above, if you were earning £50,000 you would pay 30% on income above £45,000 and 6% social insurance on all your earnings. If you were to earn an extra £100 you would pay £30 in income tax and £6 in social insurance- a combined marginal rate of 36%. If you were self-employed, paying a 10.5% rate of social insurance, your marginal rate would be 40.5%. Such a move could encourage more tax avoidance by increasing the benefits of people planning their monetary affairs to reduce their Guernsey tax bill.

Highly skilled individuals tend to generate economic growth by developing businesses, and devising new products and services. This innovation creates jobs and wealth for people to spend in the wider economy and is good for the community in general. Taking more money from those who earn more may seem attractive, but charging tax rates which could discourage such people from moving to, or staying in, Guernsey could be detrimental for the Island's economy and its growth potential, which must be the States' first priority.

BOX 2: Marginal and average tax rates

- The **marginal tax rate** is the percentage of tax a person would pay on an additional £1 of income.
- The **average tax rate** is the total percentage a person pays in tax on their entire income.

The table below provides some examples of average and marginal rates for an individual paying Income Tax (IT) and Social Insurance (SI) in Guernsey.

Average combined tax rates in Guernsey typically increase up to the upper earnings limit on social insurance contributions. Marginal tax rates remain constant between the value of the personal tax allowance and the upper limit on social insurance.

Self-employed individuals, who pay a higher rate of social insurance (in lieu of the 6.5% paid by employers), pay higher average and marginal rates than employed people up to the limit on social insurance contributions.

Annual income	Employment status	Total IT and SI paid per year	Combined Average tax rate	IT and SI payable on £1 of additional income	Combined Marginal tax rate
£8,000	Employed	IT=£0.00 SI=£480 Total=£480	**6%**	IT = £0.00 SI = £0.06 Total = £0.06	**6%**
£20,000	Employed	IT=£2,065 SI=£1,200 Total=£3,265	**16%**	ITA = £0.20 SI = £0.06 Total = £0.26	**26%**
£20,000	Self-employed	IT=£2,065 SI=£2,100 Total=£4,165	**21%**	ITA = £0.20 SI = £0.105 Total = £0.305	**30.5%**
£50,000	Employed	IT=£8,065 SI=£3,000 Total=£11,065	**22%**	ITA = £0.20 SI = £0.06 Total = £0.26	**26%**
£75,000	Employed	IT=£13,065 SI=£4,500 Total=£17,565	**23%**	ITA = £0.20 SI = £0.06 Total = £0.26	**26%**
£100,000	Employed	IT=£18,065 SI=£6,000 Total=£24,065	**24%**	ITA = £0.20 SI = £0.06 Total = £0.26	**26%**
£100,000	Self-employed	IT=£18,065 SI=£10,500 Total=£28,565	**29%**	ITA = £0.20 SI = £0.105 Total = £0.305	**30.5%**
£150,000	Employed	IT=£28,065 SI=£7947 Total=£36,011	**24%**	ITA = £0.20 SI = £0.00 Total = £0.20	**20%**

Withdrawing tax allowances for higher earners

Sustainability	Moderate
Economic efficiency	Moderate
Fairness	Progressive
Tax distribution	Narrower

The option of withdrawing allowances for higher earners is similar to introducing a higher tax rate for higher earners. However, the impact on any one individual is limited by the size of the allowance. For example, at the current level of personal allowance - £9,675 - the maximum amount of extra tax any person would have to pay from having this withdrawn is £1,935. If other allowances are included, such as the relief given on mortgage interest or the additional allowance given to those over 65, this is higher.

The limited nature of the withdrawal of allowances means that the impact on economic efficiency or sustainability is less, but so are the financial benefits. The issue of high marginal rates outlined above continues to be an issue if the threshold for withdrawal is set lower than the upper limit for social insurance contributions. Withdrawing allowances at the current upper limit on contributions would raise an estimated £2m and affect about 2% of the working population. This figure will increase if personal allowances are increased.

Withdrawing specific tax allowances

Sustainability	Good
Economic efficiency	Good
Fairness	Proportional
Tax distribution	Narrower

The Guernsey tax system offers a small number of specific tax allowances for households in particular circumstances. Each allowance reduces the amount of tax payable by those eligible for it. Unless offset by increases in the personal allowance, withdrawing these would result in a further increase in the percentage of total government income, but there are other advantages to withdrawing these.

Giving specific tax allowances to households in defined circumstances is, in many ways, similar to the provision of a universal benefit. Like the provision of universal benefits, these allowances are in many cases not well-targeted and, in some cases, not effective in achieving their original well-intentioned purpose.

The effect of these specific allowances is to reduce the average tax rate (see Box 1) for households in particular circumstances; in some cases by a considerable amount. The provision of allowances with such narrow criteria inevitably produces inequities between households with similar incomes. For example:

- A married couple, renting, with two incomes earning £50,000 would pay in total approximately 12.3% of their total gross income in income tax (approx. £6,130 per year).
- If the same couple had a mortgage on which they paid £5,000 a year in interest, they would pay 10.3% of their gross income in income tax (approx. £5,130 per year).
- If the couple were both pensioners but had no mortgage, they would pay 10.8% in income tax (approx. £5,420 per year).

These allowances do not (and could not) address every circumstance which may affect a household's standard of living. Drawing on the example above; the cost of rent experienced by the first household could be more than the mortgage paid by the second. The pensioners may have paid off their mortgage and have no accommodation costs at all.

Mortgage interest relief

At the present time home owners can claim tax relief, at 20%, on the interest paid on the first £400,000 of a mortgage on their primary residence. As a result of an amendment placed to the 2014 Budget, this relief is also limited by a £25,000 cap on the amount of interest claimable. At this level, the limit affects 4 households.

Recommendations to remove the relief on mortgage interest were presented in the 2013 Budget, but were not approved at that time.

There are three issues identified with the provision of this relief:

i. The relief transfers a portion of the risk of increasing interest rates from the borrower to States' revenues and therefore, in effect, to all other taxpayers;
ii. Although intended to assist people to buy property, the relief has exerted an upward pressure on house prices. Analysis conducted by Oxford Economics in 2012 suggests it has added £44,000 (approximately 10%) to the average house price in Guernsey;
iii. Providing a subsidy on housing costs to those who have a mortgage, regardless of their financial position, and not to those who pay their housing costs in another form, is regarded unfair by many people.

Additional personal allowances for those over pension age

The personal allowance for someone aged 65 or more is 18% (£1,775) larger than that for a person of working age. This translates to a reduction in their annual income tax bill of £355. Like other allowances covered in this section, this relief is provided irrespective of a person's financial circumstances. This additional allowance for over 65s costs the States about £3m a year; a cost that will increase as more of the population reach pension age.

Making personal allowances uniform between those of working and pension age, as they are in the UK, would reduce the difference in tax payments between the groups outlined in section 7.2.

Allowances for married couples and children

Guernsey assesses married couples as a unit. This means that if one spouse does not have sufficient income to use all their personal allowance, their partner can use the excess to reduce their tax bill. Unmarried, but cohabiting couples, cannot do this unless they have a child together. With an increasing number of couples choosing not to get married, this situation no longer treats people equally.

If the ability to transfer allowances was extended to cohabiting couples the States would need to establish a clear definition of a cohabiting couple and be able to verify that people were living permanently at the same address. This could significantly increase administration of the system and costs and could also result in a significant loss of revenue as more couples use the ability to transfer allowances to reduce their tax bill[19].

Alternatively, Guernsey could adopt independent taxation, as they do in the UK, where each person must complete a tax return for themselves and the ability to transfer allowances between spouses is limited. Whilst this would increase the number of returns that would be submitted, more of these returns could be assessed automatically. The Income Tax Office are also progressing a number of initiatives designed to remove individuals with relatively straightforward financial affairs from the need to complete a return at all.

Related to this, single parents currently receive a charge of child allowance of £6,550 in lieu of the ability to transfer allowances from a spouse. If Guernsey was to move towards independent taxation, this would also need to be reviewed.

7.5.2 Increasing revenues from domestic TRP

Sustainability	Good
Economic efficiency	Very good
Fairness	Proportional/mildly regressive
Tax distribution	Broader

As mentioned previously, Tax on Real Property on commercial premises was increased significantly as part of the package of measures applied in the wake of the introduction of the Zero/10 tax regime. As such, there is little room for further increase in the context of this project. In contrast, domestic TRP is very low in comparison with many jurisdictions. The average TRP bill in Guernsey is about £150 a year (up to twice this much if you include Parish rates depending on where you live). The average property tax bill in most jurisdictions is much higher. By way of example, in the UK average council tax is closer to £1,500.

TRP is chargeable to the owner of a property, but it is possible that some landlords will seek to pass on any increase in TRP to their tenants via an increase in rent – although their ability to do so will depend on the rental market. A low income household is likely to have a smaller property, and thus a lower TRP bill. However, relative to income TRP typically represents a larger percentage of gross income for a low income household than middle or high income households. As such, TRP could be considered mildly regressive.

The amount of property on the Island changes very little from year-to-year, so the revenues generated are very stable and predictable. TRP also has very little impact on people's behaviour; it is very difficult to avoid; and it is very cheap and simple to administer. **Combined, all these factors make domestic TRP an attractive option to be included in any package of measures.**

However, domestic TRP raises only £4m a year. Whilst there may be scope to increase domestic TRP rates, to make a significant difference to the distribution of income revenues, it would need to be increased to a level comparable with that charged in the UK, and to offset this with a reduction in income tax or social insurance rates. Many people might find an increase to this level unacceptable. **In short, TRP may be part of the answer but it unlikely to be the whole solution.**

[19] It is not possible to produce an accurate estimate of the cost with the data currently available.

7.5.3 Annual vehicle taxes

Sustainability	Good
Economic efficiency	Moderate
Fairness	Mildly regressive
Tax distribution	Broader

The reintroduction of an annual motor tax fee was raised numerous times in the consultation process. The previous motor tax, which was abolished in 2008, raised £4m per annum in revenue. An annual vehicle tax could provide a reliable income stream of a similar revenue value to domestic TRP. Whilst the systems which were previously used to administer this system are no longer in use, there may be alternative, and more efficient, methods of collection; for example, it may be possible to arrange for insurers to collect the tax when collecting premiums.

However, to provide full context, there are two charges relating to vehicles which need to be considered: first; the duty on motor fuels, which was increased in 2008 when the annual tax was abolished and, secondly, the vehicle importation tax approved by the States in May 2014. In light of this, any further moves to tax motorists would need to be considered carefully.

7.5.4 Increasing revenues from consumption taxes

Sustainability	Good
Economic efficiency	Good
Fairness	Regressive
Tax distribution	Broader

As previously stated, Guernsey already receives approximately 6% of its revenues from consumption taxes in the form of excise duties on alcohol, tobacco and motor fuel. In total these raise £35m a year.

These consumption taxes are applied to a very limited number of products, often with the intention of discouraging people from buying them. In order to raise a significant amount of money on charges on such a narrow range of goods, the increase in the charges made would need to be high and this would have a knock on effect on consumption. For example, all duty charges could be doubled over a period of time, but final excise revenues would be substantially less than twice their current level as people would choose to buy fewer of the goods subject to punitive excise charges and to spend their money elsewhere.

Whilst this may be a desirable outcome if the aim was to discourage these activities, it is not the focus of this review. In terms of raising revenues for the purpose of diversifying the tax base, increases in excise taxes would show a diminishing return if increased too far.

Broader-based consumption taxes are applied almost universally throughout the developed world in various forms. In 2001, 120 countries applied some form of consumption tax and this is now believed to be approaching 150. Guernsey is in a very small minority in not applying one. When approached by a jurisdiction for assistance, the International Monetary Fund (IMF) routinely reviews the tax systems of the applicant and, where a consumption tax is absent, recommends its introduction. To quote from one such example:

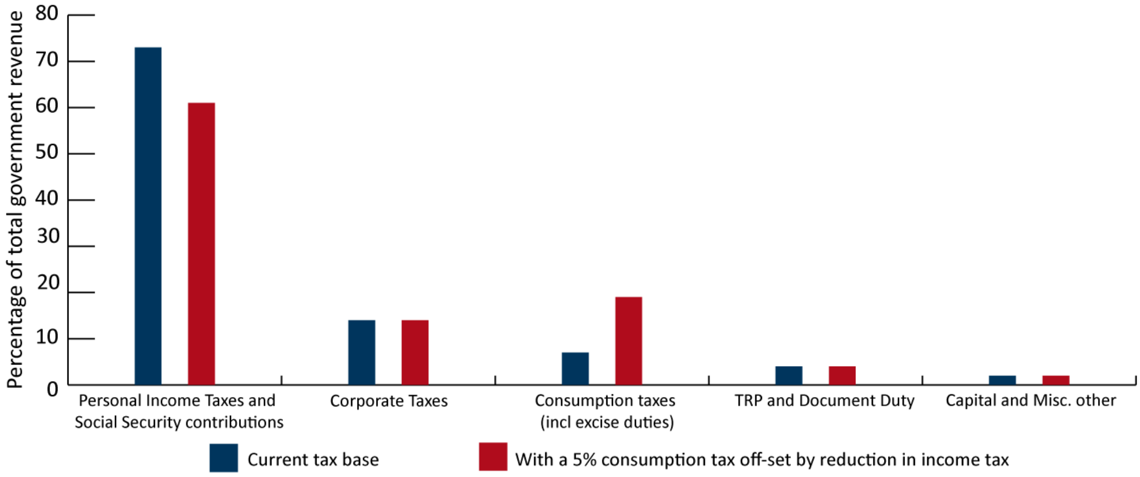
"The VAT has been seen as a key instrument for securing macroeconomic stability and growth by placing domestic revenue mobilization on a sounder basis, so that the IMF has attached considerable importance to its proper design and implementation."

The modern VAT, IMF Nov 2001

If applied on a wide range of goods and services, a consumption tax could raise a significant amount of revenues at a comparatively low rate. At 5% (which would be a low rate compared with most jurisdictions and the same rate as applied in Jersey) a broad-based consumption tax could raise in the region of £50m per year. If offset against a reduction in the amount of revenue collected via direct taxes (i.e. income taxes), this could mean a significant change in the distribution of income (see Figure 7.5.1).

Consumption taxes also have the advantage of being applicable to anyone who spends money in Guernsey, including those not currently captured by the direct tax system in Guernsey. This will include low income households who are earning less than their personal allowance (who would need to be protected in any proposals), but would capture additional income from those living primarily on capital or accumulated wealth or whose income from outside of Guernsey is not wholly captured by the income tax system. In addition, whilst most consumption tax regimes include the facility for visitors to reclaim taxes paid on large purchases, tax on smaller purchases is not reclaimable. This would also extend the tax base to capture a contribution from visiting tourists and business visitors, allowing a smaller overall burden on local residents.

Figure 7.5.1: Broadening the tax base with a 5% consumption tax



In Jersey, the GST system also incorporates an optional flat rate exemption fee for financial institutions, which allows them to "opt out" of administering the tax that can be complicated for businesses with both taxable and non-taxable income streams. This contributes £9m to GST receipts in Jersey, enabling Jersey to increase the contribution to public revenues from the finance sector over and above the 10% income tax rate on profits typically applied to that sector.

Consumption taxes are considered regressive and become more so at higher rates. This is because those with a higher income tend to save and invest a larger proportion of their income than those with lower income and, therefore, pay slightly less tax as a proportion of their income[20]. This can, to some extent, be counteracted by introducing exemptions. For example, those on low incomes typically spend a larger proportion of their income on their rent and accommodation costs, so exempting these can make the system less regressive. However, exemptions reduce the amount of money a consumption tax would raise. They also make it more expensive to administer, typically reduce compliance and make it less economically efficient.

In order for a consumption tax to improve the distribution of the tax base, it could be partially or wholly offset by a reduction in income tax receipts. There are two ways by which this could be achieved: reducing the headline tax rate or increasing the personal allowance. Figures 7.5.2 and 7.5.3 below compare how these two methods could affect the average tax rate of a household (including a consumption tax and other indirect taxes). The options presented are used simply to illustrate the different impacts on the tax burden experienced by different households. Allowing for the cost of administration and additional expenditure on pensions and benefits, the two alternatives presented are broadly net neutral (i.e. they would raise a similar amount of money to that currently received).

- An increase in the tax allowance could:
    - benefit middle income households. For many, a 5% consumption tax offset by an increase in tax allowance could mean a reduction in the total amount of tax they would pay;
    - remove some lower income households from the need to pay income tax at all;
    - return personal allowances to a level above the UK;
    - make the overall tax system more progressive; and
    - increase the overall tax burden for very low income households (these households would need to be protected by other means).
- A decrease in the headline rate could:
    - benefit higher income households proportionally more than those with lower incomes;
    - provide a competitive advantage in the international labour market;
    - make the overall tax system more proportional; and
    - increase the overall tax burden for very low income households (these households would need to be protected by other means).

[20] However, when these savings are spent, they are liable to consumption taxes. By this argument taxation on savings and investment is merely deferred until the money is spent.

Figure 7.5.2: Comparison of the impact of methods of offsetting consumption tax by reducing direct taxes-Couples, not pensioners

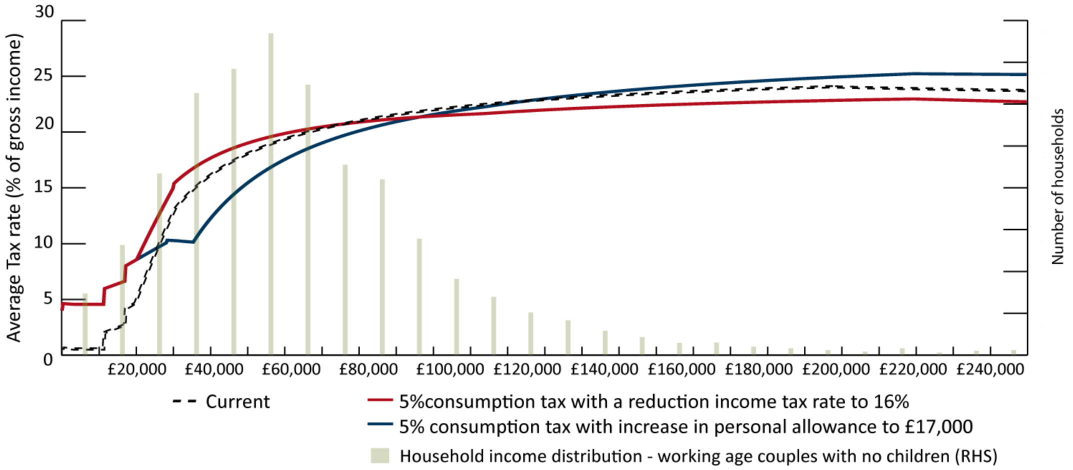
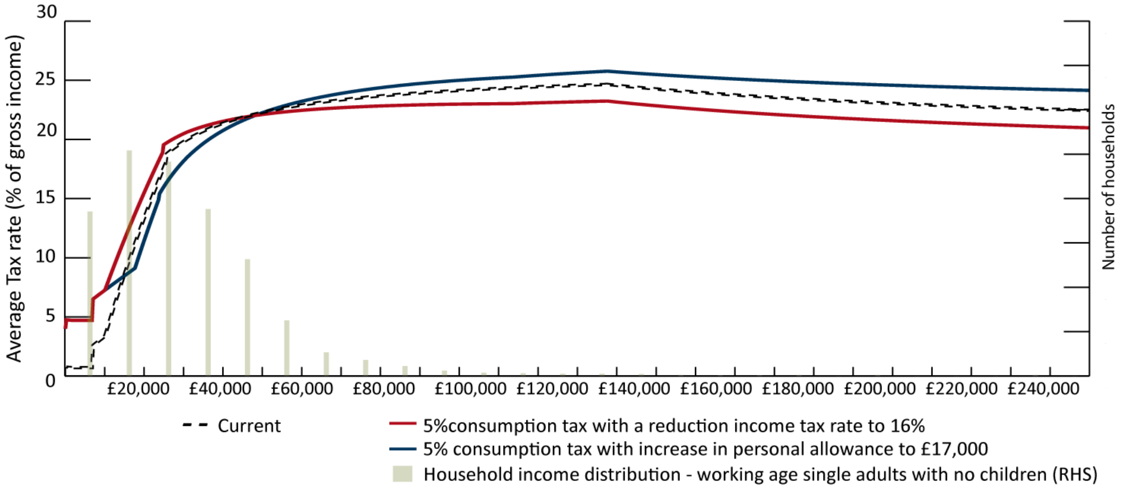


Figure 7.5.3: Comparison of the impact of methods of offsetting consumption tax by reducing direct taxes-Single adults, not pensioners



It should be noted that, once a household is removed from the income tax bracket, it will get no further benefit from tax allowances: people cannot be compensated via a reduction in their tax bill if they do not pay any tax. Others would argue that increasing the number of people not subject to direct taxes and, therefore, who may have little perception of a stake in government, could reduce public pressure on the States to restrain spending. At present, at any one time only about 70% of the adult population are direct taxpayers.

Those in the bottom quartile (the poorest 25%) are likely to be in this position. Since many of those in this category will already be in receipt of either a pension or benefit, the benefits system would be the simplest mechanism available to compensate them.

A consumption tax would result in a one-off increase in prices, which would be apparent in the annual change in the retail price index measures (RPI and RPIX) for 12 months. Provisional estimates suggest that a 5% GST would increase RPIX by just less than 4%. However, Jersey's experience was that the impact on RPI was less than expected. Anecdotally, this appears to be because some businesses, particularly national retailers who already charge the same VAT inclusive price as they use in the UK, absorbed GST rather than passing it on to their customers.

An increase in inflation would feed into the normal uprating practices for increasing pensions and benefits but, under normal circumstances, it could take up to a year for the increase to be applied. It is possible to estimate the impact a consumption tax would have on inflation, and this could be pre-empted so that those in a vulnerable position would not have to wait before their benefits were increased to reflect the increase in price. There is a cost implication of doing this.

There is a small minority of low income households who neither pay tax nor receive benefits. Mechanisms for protecting these households would need to be considered in any final proposals.

Despite public perception, a simple broad-based consumption tax would not be expensive for the States to administer. The experience in Jersey suggests that each £1 of income collected through GST costs 1p to collect. By comparison, it currently costs the Income Tax office about 1.5p for every £1 it collects (including tax on both personal and corporate income). Introducing a consumption tax would require new IT and administrative systems, which would entail an additional set-up cost.

Businesses are a key partner in the collection of these types of consumption tax and it is recognised that there would be a cost to businesses of administering the system and that this is, understandably, of some concern to the business community. The relative burden to a business will be dependent on the complexity of any proposed system and this is a strong argument in favour of keeping a consumption tax as broad and simple as possible, if this avenue is to be pursued further. OECD international guidelines on GST/VAT systems state:

"Compliance costs for businesses and administrative costs for the tax authorities should be minimized as far as possible;"

OECD international VAT/GST guidelines April 2014

How to minimise the compliance cost to businesses would therefore need to be an important consideration in the design of any new system.

It should be noted that, because of the wide use of consumption taxes in other jurisdictions, modern till systems and accounting packages are almost always designed with the capacity to calculate consumption tax and, provided the system is kept simple, the burden on companies would be much less than what may have been experienced by many business owners in the UK in the early days of VAT. Small businesses without access to modern systems may carry, in relative terms, a larger burden than their counterparts with access to more administrative resources and more sophisticated systems. A high turnover threshold for compulsory registration, such as those applied in Jersey, could protect these businesses.

8 Mitigating factors

The preceding paragraphs have outlined the negative consequences of an ageing population, but there are some lights on the horizon.

First and foremost, the States remain committed to the growth and diversification of the economy through the implementation of the Economic Development Framework drawn up by the Commerce and Employment Department in 2013 (see www.gov.gg/EconomicFramework).

Secondly, while the numbers of older Islanders are set to increase very significantly, the stereotype of the 'older person' is becoming outdated. The so-called "baby boomers" will not be the older people their parents were. They are, in general, better educated, wealthier, more assertive and fitter than any previous generation. Many will be looking forward to an active retirement and will continue to make a valuable contribution, both in the workplace and the community, well beyond the age at which they can begin claiming their pension. Promoting their independence and continuing contribution to society will thus be of benefit to all.

Thirdly, planning for the first era in which our population is more senior than junior using current health, housing and social care models would be both short sighted and expensive. If the States are to provide a sustainable support system for the next generation of older people and promote more independent lifestyles, they will need to move away from anachronistic models based on dependency and paternalism to models based on providing support and partnership. Rather than continuing systems of housing, health and social care designed to cater to, and care for, older people, the work on SLAWS is intended to offer the next generation of older people opportunities to promote their own health and wellbeing and to pursue lifelong growth and fulfilment, which will be of benefit to everyone.

9 Population and economic growth

As highlighted in the introduction, this paper has been compiled on the primary assumption that net migration levels will continue at a similar rate to that experienced in the recent past. However, whilst it is not the function of this review to set new population policy, it would not be complete unless it considered the impact that migration assumptions have on income and expenditure projections.

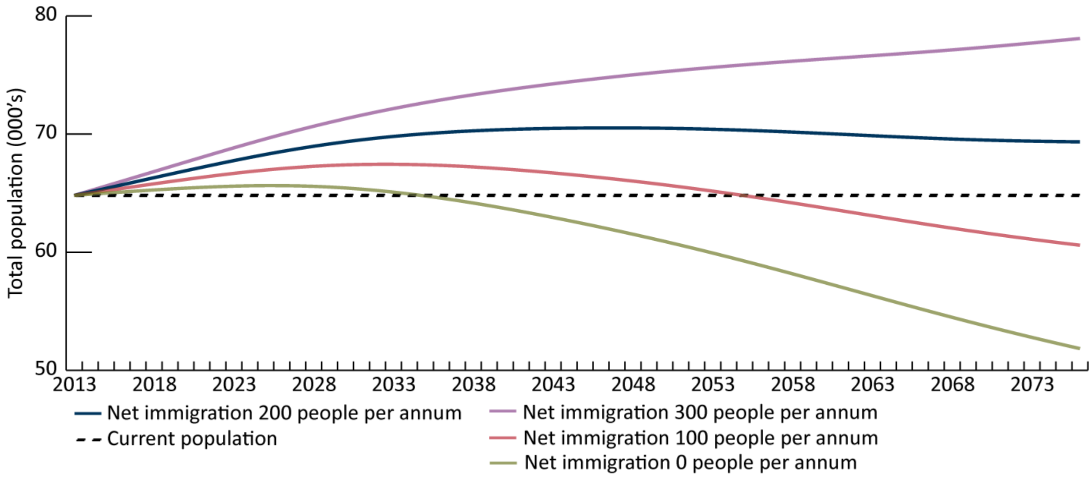
The States' agreed policy (Guernsey's Strategic Population and Migration Policy, Billet D'Etat IV, February 2007) is to maintain the population size at the level it was in March 2007. However, the population has already exceeded this level.

In addition, while the suite of recommendations agreed by the States in June 2013 were intended to establish a Population Management regime to provide greater control of levels of migration and ability to remain resident in the Island, it is highly unlikely that, through this alone, the States can achieve the level of control necessary to achieve the States' Population Policy.

For example, the number of births in Guernsey in any one year is typically higher than the number of deaths and is likely to continue to be so for a number of years yet. This means that even if there is no net immigration (i.e. the number of people who move to Guernsey is equal to the number of people who move away), the population will continue to increase until approximately 2026[21], reaching a projected peak of 63,739 (65,640 including Alderney). Therefore, in order to maintain a constant population, the States would need to achieve net *emigration* for approximately 10 years.

Figure 9.1.1: Population projections (Guernsey and Alderney) – Total population

Source: UK Government Actuary's Department



As explained earlier, migration assumptions can have a significant impact on the make-up of the population. Migration levels are typically highest among those of working age and, as such, changing migration assumptions has little impact on the retired population for another 30 years. However, the net movement of

[21] This is not the case in Alderney where there are typically more deaths than births each year. Alderney has also experienced net emigration in four of the last five years

people into the population does increase the number of people of working age. Dependent on the levels of migration assumed, this slows or even prevents the decline in the working age population that results from the 'baby boom' generation moving into retirement. **Therefore, there may be a trade-off: if the States wish to maintain the size of its working age population, total population growth is necessary; if the States choose to limit population growth, the working age population will decline.**

A declining working age population has both fiscal and economic implications. In simple terms, GDP - the principal measure of the size of an economy - is the sum of company profits and wages. This means that, for the most part, economic output is generated by people who are working. Fewer people of working age implies fewer people who are working and, therefore, less economic output. It also implies that the States will receive less money from the population in total, whilst needing to support a similar size population beyond the working age.

Figure 9.1.2: Population projections (Guernsey and Alderney) – Aged 65 or older

Source: UK Government Actuary's Department

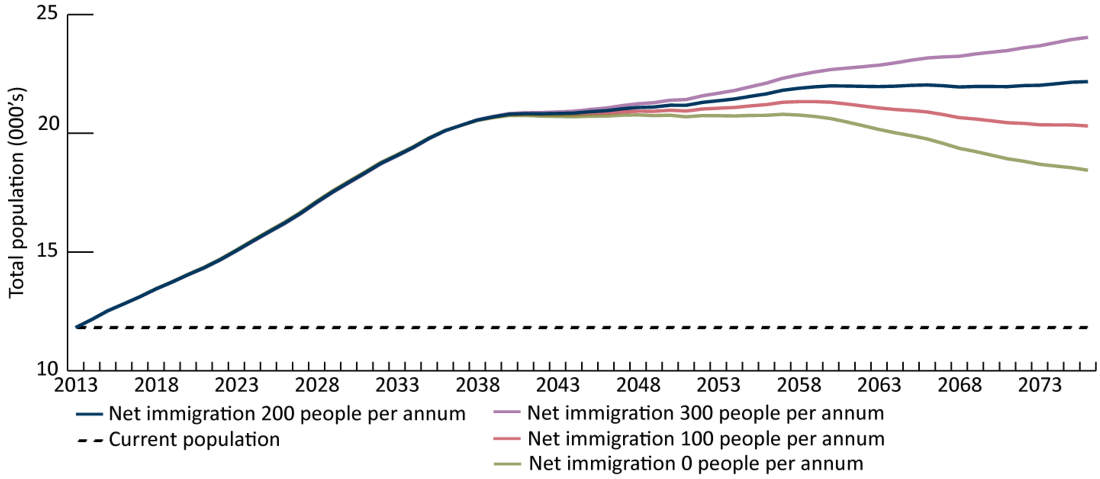
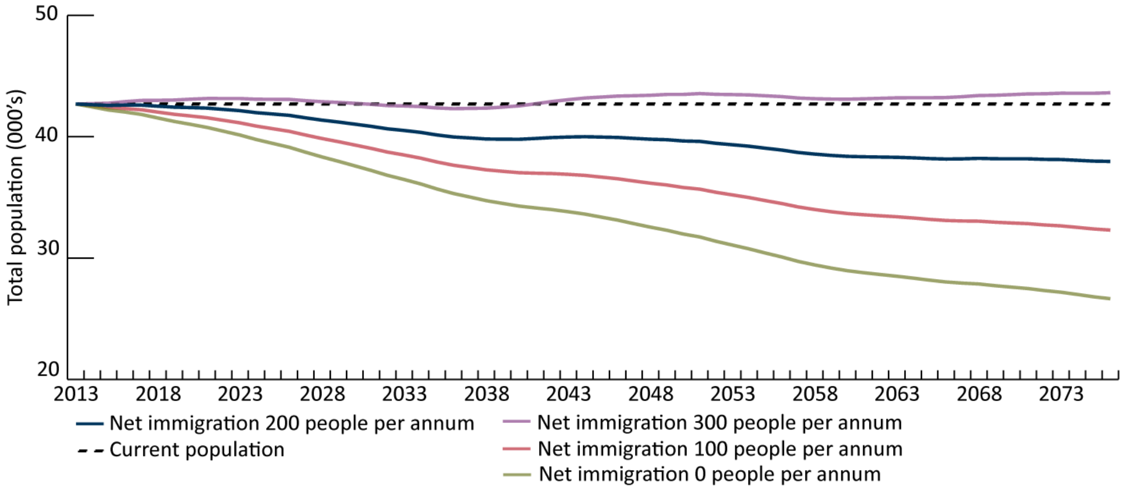


Figure 9.1.3: Population projections (Guernsey and Alderney) – Working age population aged 16-64

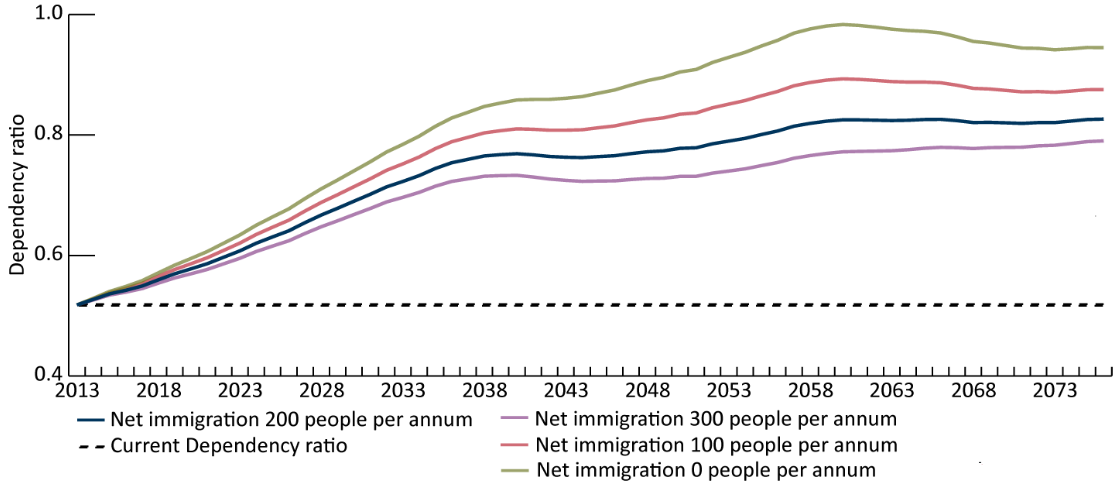
Source: UK Government Actuary's Department



This is best demonstrated by looking at the dependency ratio - the ratio of the number of people who are either above or below working age, compared with those who are of working age (currently 16-64). Broadly speaking, this is indicative of the number of people who, on balance, utilise a greater value of services (such as education, pensions and health and social care) than they are currently paying in tax and social insurance (net recipients), compared with the number of people who are typically paying more in tax than they are currently receiving in services (net contributors). The higher the dependency ratio, the greater the number of net recipients being supported by each net contributor.

Figure 9.1.4: Population projections (Guernsey and Alderney) – Dependency ratios

Source: UK Government Actuary's Department, Policy Council



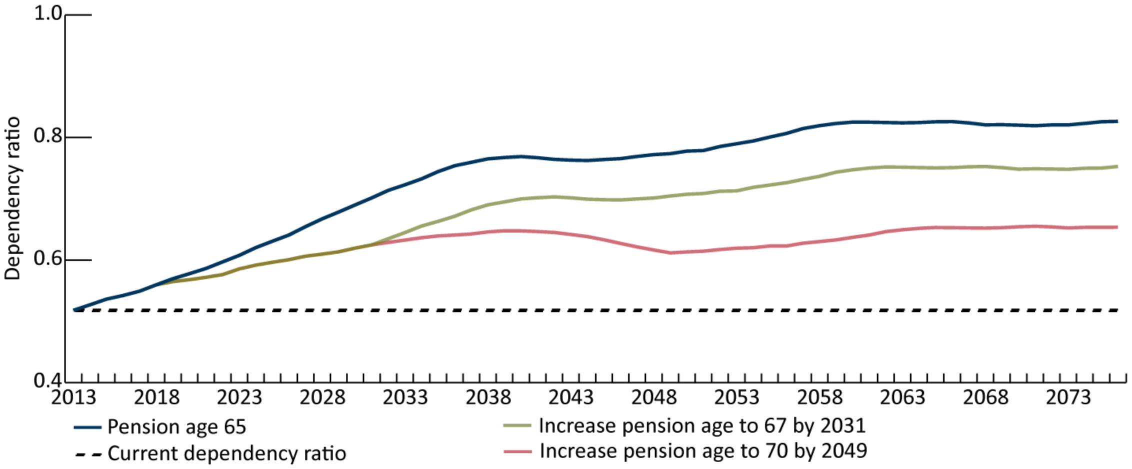
Increasing immigration assumptions has two primary impacts on the dependency ratio - it both delays and reduces the peak. For example, unadjusted for any increase in the retirement age, an assumption of no net migration results in a peak in the dependency ratio of 0.98 (i.e. 98 net recipients for every 100 net contributors) in 2060. If an assumption of net immigration of 200 people is used, the peak shifts to the late 2070s and reduces to 0.83 (i.e. 83 net recipients for every 100 net contributors).

Increasing the pension age lowers the dependency ratio by keeping people in the net contributor category for longer - increasing the number of net contributors and decreasing the number of net recipients. Increasing the pension age to 67 reduces the projected dependency ratio in 2060 from 0.83 to 0.75. If the pension age is increased as far as 70, this reduces to 0.64.

As mentioned above, the workforce is the primary driver of economic activity. A smaller workforce implies less economic activity and slower growth. Projections show that reducing the assumed rate of net immigration from 200 to 100 people per year reduces the level of GDP estimated for 2025 by 2.7%. By 2035, the difference between the projections of GDP using these two assumptions widens to 4.6%, more than £130m at today's prices. The total impact on total government income is expected to be similar, whilst the impact on government expenditure is less: as an estimate - 2.2% in 2025 and 3.3% in 2035.

Figure 9.1.5: Population projections (Guernsey and Alderney) – Impact of changing pension age on dependency ratios

Source: UK Government Actuary's Department, Policy Council, assuming net immigration of 200 people per year



However, if the States should decide to revise its policy on population, it is not as simple as opening the doors and letting people in. Increasing the levels of net immigration is only effective in softening the impact of the changing profile of the population if those people coming to the Island are economically active. If they simply stay and grow old, increased immigration simply adds to the problems of an ageing population.

Furthermore, whilst the economy will struggle to grow without a sufficient workforce to drive it, to increase net immigration will be difficult to achieve unless the economic conditions are attractive and there is suitable accommodation and work available to bring people to the Islands to make them net contributors. As would appear to be the experience in Alderney, a shrinking workforce and a struggling economy go hand in hand. In short, policies on population and economic development must work hand-in-hand if Guernsey is to maintain a healthy and vibrant economy.

10 Summary of challenges and options

Challenges

The challenges facing the Island, which are identified and explored in this report, are summarised below:

1. The current system of personal tax, pensions and benefits is unsustainable due to circumstances that were neither envisaged nor planned for when the present systems of taxation and social insurance were created some 50 years ago.

2. In the short-term, as a result of adopting the zero/10 tax regime coupled with global economic conditions, the States are running a budget deficit equivalent to 4% of General Revenue income.

3. In the long-term, Guernsey's ageing population will lead to significant increases in expenditure to fund both old age pensions and the health and social care needs of the growing number of older people who are increasingly living longer.

4. The single system of means-tested benefits, which it is proposed should replace the current overlapping rent rebate and supplementary benefit systems, is likely to require additional funding.

5. At the very time that States' expenditure increases to meet these needs, there is a risk that income will reduce as there will be a smaller proportion of the population of working age, the number of new people joining the work force being projected to be less than those retiring.

6. Continuing to rely on a tax base which is heavily dependent on personal income tax opens the Island to an increased risk of a serious drop in States' funds as the proportion of the population which is working diminishes, or if unemployment rises.

7. Beyond the need to fund the increased cost of old age pensions and related social and health care services, the Islands face the need to continue investment to maintain and develop key infrastructure (e.g. adapting coastal defences in response to climate change) at a level that cannot be met from current income.

8. The ability of the Islands to meet existing and future commitments in terms of public services and investment will be undermined if the States fail to exercise appropriate financial discipline and sacrifices long-term need for short-term gain.

9. To limit increases in the working age population in fulfilment of the State's Population Policy may inhibit economic growth and the resultant income that would be generated, at a time when it is most needed to meet changes in the demographic profile of the Island.

Options

The Joint Boards have identified a number of potential options for change with the aim of creating a more sustainable Personal Tax and Benefits system. These options have simply been set out in no particular order of priority at this stage, nor is any particular combination of options being recommended. A more detailed analysis of these options, their likely impact and an assessment of the degree to which they conform with the guiding principles adopted by the Joint Boards, will be presented in a States' Report later in 2014. That Report will contain clear recommendations.

Pensions

Option 1 Increasing the income of the Guernsey Insurance Fund

Option 2 Reducing the assumed level of annual uprating of pensions

Option 3 Increasing the pension age

Option 4 Allowing deferral of the old age pension

Option 5 Ensuring private pension provision

Benefits

Option 1 Restructuring the provision of long-term health and social care services

Option 2 Reducing or removing universal benefits e.g. family allowance, subsidies on medical prescriptions and GP and nurses consultations, and free TV licences for over 75s.

Financial Discipline

Option 1 Extending the effort to make better use of States' resources beyond the life of the FTP which ends in 2014.

Option 2 Setting a limit on aggregate States' income as a means of ensuring on-going expenditure control.

Taxation

Option 1 Increasing revenues from income tax or social insurance contributions including:

a) Increasing headline rates of tax and social insurance contributions
b) Higher rates for higher earners
c) Withdrawing tax allowances for higher earners
d) Withdrawing specific tax allowances (mortgage interest relief, the additional personal allowances for those over pension age, and the ability to transfer allowances for married couples and those with children)

Option 2 Increasing domestic TRP

Option 3 Introducing consumption taxes (GST)

Population

Option 1 Reviewing the current States' policy of 'no growth' in population

Next Steps

The Joint Boards fully recognise that, whilst this paper identifies the challenges and issues arising from our current systems of Tax, Pensions and Benefits and touches briefly on possible options to provide a more sustainable system, States' Members, the public, the business community and special interest groups will all want to consider these matters in more detail.

The purpose of this paper has been to provide a broad introduction to the subject as a backdrop to more detailed discussion on specific recommendations, which the Joint Boards are in the process of formulating and which will be published in a States Report later in 2014. At that time, more detail will be provided, including impact assessments of the likely implications of proposed changes.

Appendix A: Summary of responses to the public consultation

Extract from Personal Tax, Pensions and Benefits Review; Public Consultation Report 2013.
A full copy of the report is available at www.gov.gg/ptr.

Executive summary

We would like to offer our thanks to all those who took the time to complete the consultation on the Personal Tax, Pensions and Benefits Review. The number and diversity of responses received showed the complexity of the issues involved and their importance to us all. We have been impressed with the quality of responses received and the information gained from this exercise will be invaluable in informing the review and ensuring that the final proposals reflect what is best for Guernsey and Alderney in the long-term.

This report provides a summary of the responses to the public consultation on the issues covered and an outline of some of the alternative options available, which could be further investigated.

The objective of the review is to strike the right balance between the fairness, efficiency and sustainability of the tax and benefits regime in the long-term. At a political level, sustainability is considered the core principle with States' members of the two boards feeling that a sustainable tax system is key to providing high quality public services in the long-term.

The consultation highlighted the issues presented by the projected increase in the number of older people in our population. In March 2012 the Policy Council[22] published a report containing a projection of government expenditure over the next three decades, assuming a continuation of current services. The report stated that:

'What is apparent from the projections is that either revenue must rise as a share of GDP, or projected spending must fall—or some combination of the two outcomes must be achieved to ensure the States remains in balance over the projected period.'(to 2040)

Setting the scene for an analysis of the rest of the responses, most respondents felt that there was a limit to the amount of household income which the government could take to fund public expenditure. Limits provided averaged approximately 27%, slightly higher than the current 26% combined marginal rate of tax and social insurance experienced by most employed people. A key theme of responses to this question was the need to maintain Guernsey's competitive status as a relatively low tax jurisdiction.

In general, respondents were not in favour of increasing taxation to cater for all the increased cost associated with providing for the projected increase in demand for public services caused by ageing demographics. The general preference was for a reduction in expenditure (by implication, 'other' expenditure perhaps), whether by a move towards a greater level of personal responsibility for the costs involved or a reprioritising of public services. However, many people felt that a combination of the two

[22] Potential long-term implications of demographic and population change on the demand for and costs of public services, Policy Council, March 2012

approaches would be most appropriate – a view mirroring the conclusions of Policy Council's 2012 report referenced above. The need for efficient provision of services was a key theme within the responses received with many people feeling that the States should demonstrate that the services provided are value for money before increasing revenues.

On the subject of how to continue the provision of the universal old age pension, education and personal responsibility were recurring themes expressed in the responses. The majority (63%) of respondents were supportive of the current scheme, but only 38% would be willing to pay more to continue it. Most would prefer to maintain the long-term sustainability of the old age pension scheme by either limiting increases in pensions to inflation or further extending the pension age to reflect increases in life expectancy (with the latter option receiving more support than the former).

Respondents were more willing to favour an increase in taxation in some form to pay for the increased demand in health than for pensions. Far fewer respondents were in favour of decreasing the level of tax funded healthcare (41%) than were in favour of limiting growth in States' spending generally (69%), with almost as many (37%) feeling that the level of tax funded healthcare should not be reduced. The theme of personal responsibility, although recurring in the section on health and long-term care, was balanced by a feeling that everyone should be entitled to access a good standard of healthcare and people should not be excluded for financial reasons.

In the area of welfare (in this context mainly supplementary benefit type expenditure) the majority of people expressed the view that a benefits system should provide sufficient income to fund essentials (food, fuel, housing and clothes etc.) but that it should not be generous enough to provide what respondents considered luxury items (e.g. Sky TV, alcohol, tobacco). One of the key themes recurring in response to the questions in this section was that the system should incentivise work and that people should be encouraged to become self-sufficient and not remain on benefits long-term. A majority (75%) of respondents felt that some form of benefit limitation should be retained; the largest consensus in the consultation.

The consultation presented three examples of how the tax system could be modified without raising additional revenues. Ranked in order of preference, with the most preferred first, these were:

- **Removing specific tax allowances and Family Allowance and increasing the universal personal tax allowance**
- **Introducing different income tax rates for low and high earners**
- **Reducing the general rate of income tax and introducing Goods and Services Tax**

Of the three options presented the removal of specific tax allowances and Family Allowance combined with an increase in the universal tax allowance received by far the largest number of favourable comments, with several respondents stating they viewed this as a simplification of the current system as well as creating a more transparent and equitable system. Most comments focused on the removal, reduction or limitation of Family Allowance and the limitation or removal of mortgage interest relief.

The introduction of different tax rates for lower and higher incomes received a more mixed response. Some expressed the opinion that higher earners could afford to pay more, whilst others felt that this would be unfair, particularly in light of the recent increases in the upper earnings limit on social insurance contributions. The overriding concern expressed by many would be the potential for this to damage

Guernsey's competitive position in attracting and recruiting firms and highly skilled professionals to the Island.

Respondents were, in general, not in favour of the introduction of a Goods and Services Tax (GST), even when offset by a lower general tax rate, referring to it as regressive and inflationary (albeit technically the inflation effect is a 'one off', impacting headline inflation figures for only twelve months), and a burden on business. A minority of people were in favour of this highlighting the difficulty in avoiding consumption taxes and the benefit of broadening the tax base.

The consultation documentation also set out a number of ways in which the States could raise additional revenue from the personal tax system. The seven examples, ranked in order of preference with the most preferred at the top, were:

- **Removing specific tax allowances and Family Allowance**
- **Raising domestic tax on real property**
- **Increasing social insurance contributions**
- **Introducing environmental taxes**
- **Introducing a higher earners' rate**
- **Increasing the general tax rate**
- **Introducing GST**

The removal of specific tax allowances and Family Allowance received the most positive comments. An increase in TRP also received, on balance, more positive comments than negative. Increases in social insurance contributions and the introduction of environmental taxes each received a similar number of positive and negative comments. A higher earner's rate, an increase in the general tax rate and introduction of GST all received more negative than positive comments with the latter receiving more than four times as many comments against its introduction than in favour of it.

It is recognised that, as far as identifiable[23], responses from Alderney had a different viewpoint to those from Guernsey. Hopes were expressed that consideration would be given to the possibility of different approaches for the two Islands. It is acknowledged that the difference in economic circumstances in Guernsey and Alderney would warrant this being considered and the issue of whether or not a differential approach is possible or appropriate will be reviewed.

As with all public consultations of this type, we must accept that the views submitted represent only those of a small proportion of the population and that some sectors of the population are more likely to respond to this type of exercise than others (a breakdown of the sample distribution is provided in **Appendix 1** together with the best available data on the distribution of the population as a whole). As such, the review of Personal Taxes, Pensions and Benefits will proceed with careful deliberation, with due consideration given both to the opinions expressed in this consultation and the potential impact of any changes on all members of our community.

[23] Respondents were not asked to identify which Island they were resident on.

Appendix B: Explaining efficiency

All taxes distort people's behaviour in some way; different taxes change behaviour in different ways.

Increasing income taxes reduces the value of work to the employee. For example, the current tax and social insurance rates, if you are an employee on an average salary and work some overtime and earn an extra £100 you would take home an extra £74; £100 less £20 of income tax and £6 of Social insurance.

If the income tax rates were increased to 30% you would take home £64 for working the same amount of overtime; £100 less £30 of income tax and £6 of social insurance. Increasing the income tax rate has reduced the amount of money you receive in return for your work and therefore reduced the benefit you get from working so your incentive to work is smaller.

Consumption taxes increase the cost of buying goods. For illustration, if you have £100 in the absence of any consumption tax you could buy £100 worth of goods. If you were to introduce a 10% consumption tax you would be able to buy £90.91 worth of goods on which you would have to pay £9.09 in tax (a total expenditure of £100). Increasing the consumption tax has reduced the amount of things you can buy with your money so your incentive to spend is smaller.

Taxes on property (such as TRP) increase the cost of owning a property (or renting, since the cost to your landlord would typically be included in your rent). At the current rates, the average TRP bill is about £150 a year. Increasing this would increase the cost of living in a property. Given that tax on property in Guernsey is charged based on its size, this means that increasing TRP reduces the incentive to live in larger properties. However, as you must live somewhere and your housing needs are likely to outweigh the financial incentive to live in a smaller house, the impact on people's behaviour is smaller than other forms of taxes.

Acronyms

EU	European Union
FTP	Financial Transformation Programme
GST	Goods and Services Tax
GDP	Gross Domestic Product
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
SWBIC	Social Welfare Benefits Investigation Committee
SLAWS	Supported Living and Ageing Well Strategy
TRP	Tax on real property
VAT	Value added tax

Glossary of Terms

Ageing population	a continuous increase in the median age of the population due to changes in birth rates and increases in life expectancy.
Allowances	refers to one or more income tax allowances.
Average tax rate	the combined income tax and social insurance contributions paid as a percentage of an individual's total income .
Baby boom	the period between the end of World War II and the mid to late 1960s that was characterised by a greatly increased birth rate.
Baby boomers	individuals born during the baby boom.
Budget deficit	the State's forecast expenditure exceeding expected revenue.
Consumption tax	a tax on spending on goods and/or services.
Co-payment	the portion paid by the consumer towards the cost of receiving long-term care.
Deficit	the amount that the State's expenditure or liabilities exceed income or assets.
Dependency ratio	the ratio of the number of people who are either above or below working age, to those who are of working age (currently 16 to 64 years).
Employee Tax Instalments	The total amount of income tax paid to the Income Tax Office (on a quarterly basis) by employers on behalf of their employees. Similar to Pay-as-you-earn (PAYE) schemes in the UK.
Excise duties/taxes	an tax on the import or sale of specific goods.
Financial Transformation Programme	programme whose aim is to deliver reoccurring annual saving by transforming the way the States deliver services in order to be more efficient.
Fiscal Framework	a set of principles that the States abide by to facilitate an economic position of long run permanent balance (i.e. income is equal to expenditure over the medium-term).
General revenue	funds received by the States, primarily through income taxation, that is not allocated for a specific purpose.
Guernsey Health Service Fund	portion of social insurance contributions allocated to the Guernsey Health Service Fund to fund health related services such as subsidies on primary care and prescriptions and specialist medical services provided by the Medical Specialist Group
Guernsey Insurance Fund	portion of social insurance contributions allocated to the Guernsey Insurance Fund to fund the old age pension and other contributory benefits such as unemployment and invalidity benefit.
Horizontal equity	when individuals or households with the same income pay the same amount of tax.
Independent taxation	each individual completes an annual tax return and is assessed independently of any other member of their household. Each individual has an annual personal allowance and is unable to transfer any portion of the personal allowance to a partner should the individual earn less than the personal allowance
Investment income	income generated from the investment of balances held in reserve in The Guernsey Insurance Fund, The Guernsey Health Service Fund and The Long-Term Care Fund.
Joint Boards	the Treasury and Resources Board and the Social Security Department Board.
Long-term	For the purpose of this report, long-term is considered to be 10 or more years.

Long-term care	care services provided to individuals who require assistance in caring for themselves for an extended period of time.
Long-Term Care Insurance Fund	portion of social insurance contributions allocated to the Long-Term Care Insurance Fund to fund long term residential or nursing care.
Marginal (tax) rate	the percentage of combined income tax and social insurance contributions which would be paid on an additional £1 of an individual's income.
Median	a method used to calculate an average number by arranging all the observations from lowest value to highest value and picking the middle one.
Net expenditure	total expenditure from general revenue, not including services funded by fees and charges and other departmental operating income.
Net income	total income received by general revenue, not including fees and charges and other departmental operating income.
Operating deficit	the amount that the States' expenditure exceeds income. This does not include any income generated from investment activities.
Per capita	per person
Proportional *(taxation)*	each individual pays the same proportion of their income in tax.
Progressive *(taxation)*	individuals pay a larger proportion of their income in tax as their income increases.
Regressive *(taxation)*	individual earners above a certain threshold pay a smaller proportion of their income in tax
Short-term	For the purpose of this report, short-term is considered to be less than 5 years.
Sub-prime mortgage market	the financial markets investing, directly or indirectly, in mortgages or other loans to high risk clients with low credit scores and poor quality assets.
Tax on real property "TRP"	tax paid on the plan view measurement of a property's built environment and land.
The Review	The Personal Tax, Pensions and Benefits Review
Universal benefit	welfare benefits available equally to all individuals, regardless of level of income and number of social insurance contributions
Uprating	increase (typically annual) in the monetary value of pensions or benefits
Zero/10	Guernsey's corporate tax regime, introduced in 2008, which applies a headline rate of income tax on company profits of 0%. A rate of 10% applied to specific regulated finance activities. A rate of 20% is applied to real estate activities and regulated utilities.

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Appendix 2: Public Consultation Feedback Report

STATES OF GUERNSEY

Personal Tax, Pensions and Benefits

A joint review by the Social Security and Treasury and Resources Departments

Public Consultation – Report

Summary of responses

August 2013

Contents

1. Executive summary

We would like to offer our thanks to all those who took the time to complete the consultation on the Personal Tax, Pensions and Benefits Review. The number and diversity of responses received showed the complexity of the issues involved and their importance to us all. We have been impressed with the quality of responses received and the information gained from this exercise will be invaluable in informing the review and ensuring that the final proposals reflect what is best for Guernsey and Alderney in the long-term.

This report provides a summary of the responses to the public consultation on the issues covered and an outline of some of the alternative options available, which could be further investigated.

The objective of the review is to strike the right balance between the fairness, efficiency and sustainability of the tax and benefits regime in the long-term. At a political level, sustainability is considered the core principle with States' members of the two boards feeling that a sustainable tax system is key to providing high quality public services in the long-term.

The consultation highlighted the issues presented by the projected increase in the number of older people in our population. In March 2012 the Policy Council[1] published a report containing a projection of government expenditure over the next three decades, assuming a continuation of current services. The report stated that:

'What is apparent from the projections is that either revenue must rise as a share of GDP, or projected spending must fall—or some combination of the two outcomes must be achieved to ensure the States remains in balance over the projected period.'(to 2040)

Setting the scene for an analysis of the rest of the responses, most respondents felt that there was a limit to the amount of household income which the government could take to fund public expenditure. Limits provided averaged approximately 27%, slightly higher than the current 26% combined marginal rate of tax and social insurance experienced by most employed people. A key theme of responses to this question was the need to maintain Guernsey's competitive status as a relatively low tax jurisdiction.

In general, respondents were not in favour of increasing taxation to cater for all the increased cost associated with providing for the projected increase in demand for public services caused by ageing demographics. The general preference was for a reduction in expenditure (by implication, 'other' expenditure perhaps), whether by a move towards a greater level of personal responsibility for the costs involved or a reprioritising of public services. However, many people felt that a combination of the two approaches would be most appropriate – a view mirroring the conclusions of Policy Council's 2012 report referenced above. The need for efficient provision of services was a key theme within the responses received with many people feeling that the States should demonstrate that the services provided are value for money before increasing revenues.

On the subject of how to continue the provision of the universal old age pension, education and personal responsibility were recurring themes expressed in the responses. The majority (63%) of respondents were supportive of the current scheme, but only 38% would be willing to pay more to continue it. Most would prefer to maintain the long-term sustainability of the old age pension scheme by either limiting increases in pensions to inflation or further extending the pension age to reflect increases in life expectancy (with the latter option receiving more support than the former).

Respondents were more willing to favour an increase in taxation in some form to pay for the increased demand in health than for pensions. Far fewer respondents were in favour of decreasing the level of tax funded healthcare (41%) than were in favour of limiting growth in States' spending generally (69%), with almost as many (37%) feeling that the level of tax funded healthcare should not be reduced. The theme of personal responsibility, although recurring in the section on health and long-term care, was balanced by a feeling that everyone should be entitled to access a good standard of healthcare and people should not be excluded for financial reasons.

[1] Potential long-term implications of demographic and population change on the demand for and costs of public services, Policy Council, March 2012

In the area of welfare (in this context mainly supplementary benefit type expenditure) the majority of people expressed the view that a benefits system should provide sufficient income to fund essentials (food, fuel, housing and clothes etc.) but that it should not be generous enough to provide what respondents considered luxury items (e.g. Sky TV, alcohol, tobacco). One of the key themes recurring in response to the questions in this section was that the system should incentivise work and that people should be encouraged to become self-sufficient and not remain on benefits long-term. A majority (75%) of respondents felt that some form of benefit limitation should be retained; the largest consensus in the consultation.

The consultation presented three examples of how the tax system could be modified without raising additional revenues. Ranked in order of preference, with the most preferred first, these were:

- **Removing specific tax allowances and Family Allowance and increasing the universal personal tax allowance**
- **Introducing different income tax rates for low and high earners**
- **Reducing the general rate of income tax and introducing Goods and Services Tax**

Of the three options presented the removal of specific tax allowances and Family Allowance combined with an increase in the universal tax allowance received by far the largest number of favourable comments, with several respondents stating they viewed this as a simplification of the current system as well as creating a more transparent and equitable system. Most comments focused on the removal, reduction or limitation of Family Allowance and the limitation or removal of mortgage interest relief.

The introduction of different tax rates for lower and higher incomes received a more mixed response. Some expressed the opinion that higher earners could afford to pay more, whilst others felt that this would be unfair, particularly in light of the recent increases in the upper earnings limit on social insurance contributions. The overriding concern expressed by many would be the potential for this to damage Guernsey's competitive position in attracting and recruiting firms and highly skilled professionals to the Island.

Respondents were, in general, not in favour of the introduction of a Goods and Services Tax (GST), even when offset by a lower general tax rate, referring to it as regressive and inflationary (albeit technically the inflation effect is a 'one off', impacting headline inflation figures for only twelve months), and a burden on business. A minority of people were in favour of this highlighting the difficulty in avoiding consumption taxes and the benefit of broadening the tax base.

The consultation documentation also set out a number of ways in which the States could raise additional revenue from the personal tax system. The seven examples, ranked in order of preference with the most preferred at the top, were:

- **Removing specific tax allowances and Family Allowance**
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The removal of specific tax allowances and Family Allowance received the most positive comments. An increase in TRP also received, on balance, more positive comments than negative. Increases in social insurance contributions and the introduction of environmental taxes each received a similar number of positive and negative comments. A higher earner's rate, an increase in the general tax rate and introduction of GST all received more negative than positive comments with the latter receiving more than four times as many comments against its introduction than in favour of it.

It is recognised that, as far as identifiable[2], responses from Alderney had a different viewpoint to those from Guernsey. Hopes were expressed that consideration would be given to the possibility of different approaches for the

[2] Respondents were not asked to identify which Island they were resident on.

two Islands. It is acknowledged that the difference in economic circumstances in Guernsey and Alderney would warrant this being considered and the issue of whether or not a differential approach is possible or appropriate will be reviewed.

As with all public consultations of this type, we must accept that the views submitted represent only those of a small proportion of the population and that some sectors of the population are more likely to respond to this type of exercise than others (a breakdown of the sample distribution is provided in **Appendix 1** together with the best available data on the distribution of the population as a whole). As such, the review of Personal Taxes, Pensions and Benefits will proceed with careful deliberation, with due consideration given both to the opinions expressed in this consultation and the potential impact of any changes on all members of our community.

2. Introduction

This report provides a summary of the responses received to the public consultation phase of the Personal Tax, Pension and Benefits Review. The analysis highlights not only the broad distribution of responses but also key ideas and themes identified.

Quotations from individual responses have been used to provide a flavour of the range of opinion received and although these have been selected as representing a common point of view, they are not necessarily representative of all the responses.

3. Next steps

This review is being conducted over a two year period in two phases.

The progression of phase one will continue with both Boards following their routine budgetary processes. In addition, the Social Security Department will also be presenting a report on the Modernisation of the Supplementary Benefit Scheme to the States later this year. The Boards will give due consideration to the public opinion expressed in the consultation in their usual deliberations.

In phase two, during 2014, the Treasury and Resources and Social Security Departments will bring a joint report to the States outlining the findings of the review including its recommendations (in favour or otherwise) regarding the wider issues in the review and more significant structural changes.

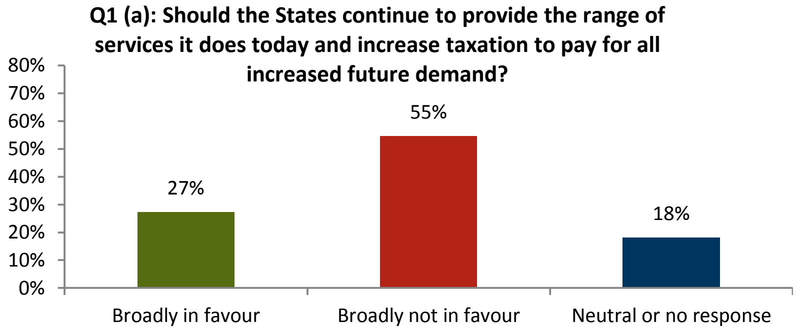
4. Response to Questions

This section provides analysis of the responses received. A written summary of the responses received is provided for each question, or group of questions, together with a small selection of quotes extracted from the responses received.

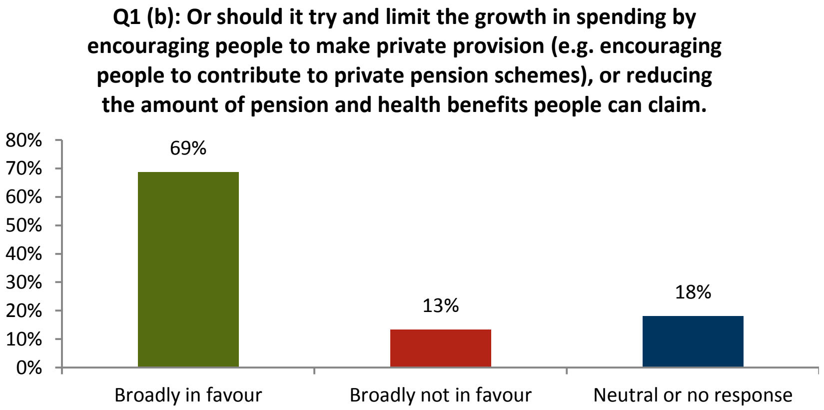
The written summaries are intended to highlight the general consensus and the most significant issues apparent in the responses. Although every effort is made to make this as unbiased as possible it is not possible to cover every point raised. The quotes used are not necessarily representative of the general view but used to illustrate the range of responses received and the type of issues highlighted.

4.1. What are your views on the total level of service provision in Guernsey?

Respondents were generally of the view that the States should not increase taxation to pay for *all* increases in expenditure required, with only 27% of respondents supportive of this. More than half of respondents (55%) said they would not accept an increase in taxation to pay for *all* increased demand, although some would accept some increase in combination with measures to reduce costs.



Almost 70% of respondents were supportive of limiting growth in public spending by encouraging greater private provision or reducing pensions or health benefits. 20% of respondents thought this should be done in combination with some increase in taxation creating a balance between increased taxation and reduced expenditure.



Common themes raised in the responses to these questions included support for those who are vulnerable, the efficiency and prioritisation of service provision and personal responsibility (particularly with reference to pension provision).

"The States must balance what money is available to the Island against what services are essential/ required; the result of that must be a considered, balanced solution and may result in some services being ample rather than exemplary. It is not simply a case that personal taxes must raise so that our States can spend money on services indiscriminately."

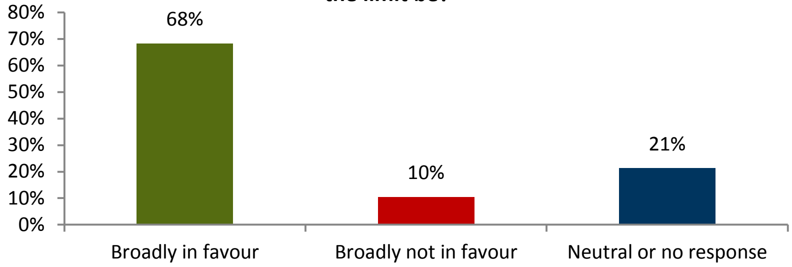
"When it comes to pension and health, these should not be reduced. It is already too expensive in Guernsey to access primary care, and the state pension is already not enough to live on."

"The States have a duty not just to maintain but to increase and improve its services, which in many cases I believe already and have done for years fall short of the services that are available in the U.K."

"The States cannot commit to provide the same range of services that it does today. Demographic changes, increased costs of services, above inflation increases in health services all militate against such a policy."

"The States needs to review the services and charge where it can. Raising taxes without reviewing the expenditure of central costs is wholly unacceptable"

Q2: Do you think there is a limit to how much of a household's income the States should take to fund public expenditure (be it on public services, pensions or welfare) and if so, what should the limit be?



This question outlined one of the most widely supported principles in the consultation, with 68% of respondents indicating that there is a limit to how much of a household's income the States should take to fund public expenditure.

Most found this difficult to quantify but approximately a third of respondents gave an indication as to what that limit should be. The limits provided ranged from 10% to 50%. The majority of these fell between 20% and 40%, with the average being 27% of a household's income (slightly higher than the 26% marginal rate of income tax and social insurance currently experienced by the majority of employed individuals).

Several households stated that they felt that there are many households which are struggling financially with increasing costs and stagnant wages. A number of respondents thought that wealthy people should pay a higher percentage. Others said households should pay as little as possible and that the States should provide essential services only.

"Some limitation must exist even if means tested. It is important people have disposable income to spend to generate cash flow in the economy and ensure small businesses survive thus aiding employment and income tax returns"

"Not as long as the percentage taken is a fair percentage for all households. i.e. we all pay the same percentage. Allowances should be made for the very poor and vulnerable"

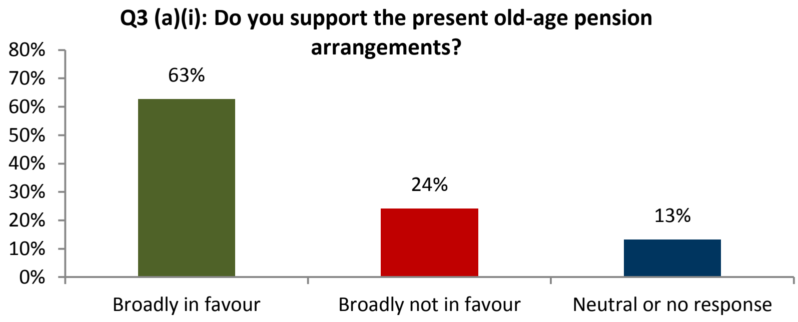
"The limit is already reached and surpassed. No increases in taxation"

"Yes. Many families are struggling while all services are increasing in cost but wages are not. Before raising taxes make efficiency savings such as means testing family allowance & parents have to apply. Unsure on what limit should be - but a fair amount depending on income"

"Of course, there should be a limit on the % of household income that the States should take to fund public expenditure and this should NEVER exceed 40% of household income"

"20 to 25%, with a cap on earnings taxed. In relation to the cap, it should be borne in mind that most other tax regimes permit deductions for donations to charitable causes whereas this is not the case in Guernsey"

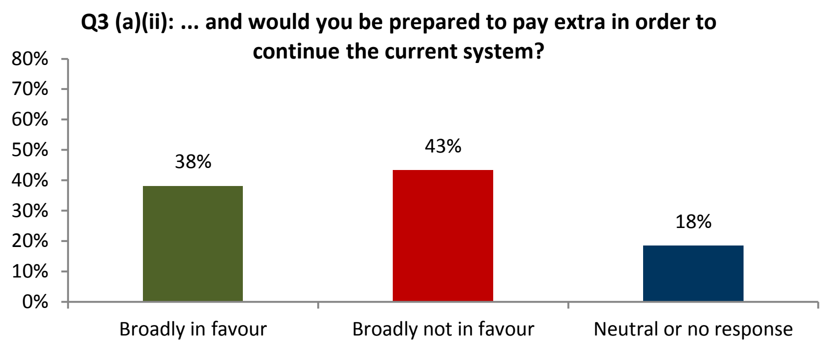
4.2. What are your views on old-age pension provision in Guernsey?



The majority of respondents (63%) support the current pension arrangements, but approximately a quarter of respondents did not. Of those supporting the current system, many expressed the view that providing at least a basic state pension is important.

Of those who did not support the current system the reasons given included: that greater emphasis should be placed on taking personal responsibility for retirement; that the current system is unsustainable; that the level at which pensions for the lower paid are subsidised by those better off is too high and that the current system is biased toward older people who will have paid less in the boom years.

Responses were more divided with regards to paying more to continue the current system with 43% indicating that they would not be willing to pay more to continue the current system. Many of these respondents indicated that they would prefer an increase in retirement age (effectively paying more by working longer) to an increase in the rate of contributions.



"I largely support the present old age pension arrangements. They should not be means tested and the funds should remain ring-fenced. They should always increase by inflation because pensioners do not have the options to increase their income that the rest of us have…"

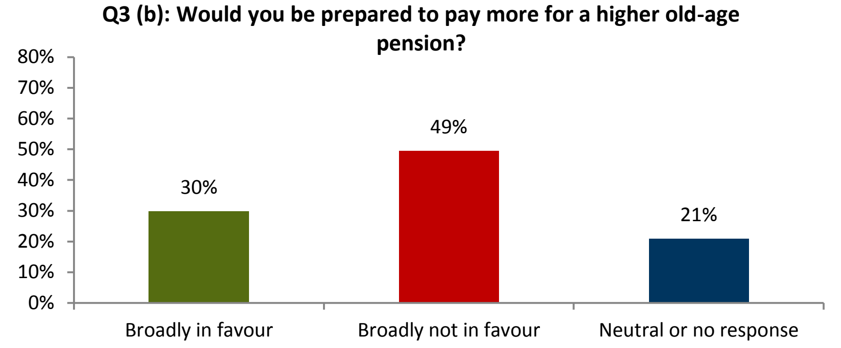
"Yes, I support it and would pay more rather than have it reduced"

"I do support the present old age pension arrangements, however, I do not believe pension increases of above inflation rates are sustainable and should be reduced to inflation levels. No I would not want to pay more than I currently do as I think private pensions should be encouraged"

"In principle, the current system meets the needs of old age pensioners and its removal would be very difficult given that people have contributed over time and therefore have an expectation of return. But it would be acceptable to incentivise private arrangements and reduce the growth in the current state pension as both a carrot and stick approach. The current increases above RPI are unsustainable and should be stopped immediately"

"I would not be prepared to pay extra, therefore if the benefit has to fall then so be it"

"No, as a higher paid individual i accept a certain amount of subsidising the less well paid in respect to contributions but that limit is well below the current position."



Only 30% of respondents were in favour of paying more for a higher old age pension with some of these suggesting that this should be voluntary.

Of the 49% of respondents who would not be prepared to pay more for a higher old age pension many stated that they would prefer to make their own provision via private schemes. Some also felt that ensuring an individual has sufficient pension provision should not be the responsibility of the States and that separate private pension provision should be encouraged instead.

Q3 (c): How could the States encourage people to make greater private pension provision?

Suggestions for encouraging private pension provision fell into three broad categories: tax relief, education and legislation.

Many respondents acknowledged the existing tax relief on private pension contributions, and described it as adequate. However, a number of respondents suggested making pension payments tax-free or taxing them at a reduced rate indicating some of the population may be unaware of the existing tax relief on pensions contributions.

A large number of respondents felt education was the key to encouraging greater private pension provision with a focus on encouraging young people to start saving for their retirement early in their careers and emphasising the subsistence nature of the old age pension.

Many respondents felt that it is necessary to make private pension contributions compulsory though a small number of respondents were concerned about the lack of choice of private pension providers on the Island and about the cost of pensions offered by such providers. Suggestions included compulsory workplace pensions, where the employer is also required to contribute; or a selection of States' sponsored schemes. Several respondents felt that a States-sponsored pension scheme should be set up for those who cannot afford a private scheme.

"Yes, but only if there was a direct link between what you put in and what you take out. Individuals should have their own "ring fenced" pension... this will encourage "ownership" and greater responsibility, and reduce the risk to the States"

"I think the current levels (adjusted for RPI) are high enough, so no"

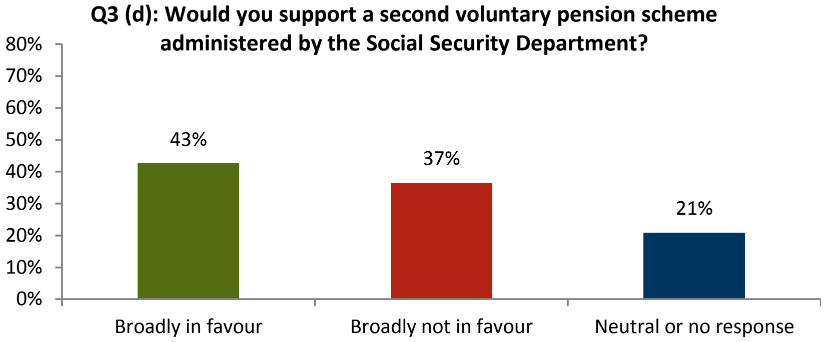
"No. The pension should be set at a basic level for survival and people should save or pay into their private pension fund as a top-up"

"No is the short answer, there is already the opportunity to fund a pension privately. Incentives will encourage more people to contribute if tax breaks are offered during funding, or perhaps a reduced tax of say 10% on the receipt of your private pension in later life"

"Encourage employers to set up schemes, set up a matching contribution scheme whereby the States match any contributions to a private scheme (subject to a limit), This could be used to lower/cap the states pension. Ensure tax/social security reliefs are available"

"It's all about education. I strongly believe that all school children should be taught the fundamentals of personal finance and have to pass some kind of test to show that they have understood. This should include savings/budgeting/ pensions and investment for the long term, renting and buying property"

"I believe that the current arrangements for making private or occupational pension contributions non-taxable adequately incentivise people."



There was a very mixed response to this question, with 43% of respondents in favour of such a scheme and 37% against. In addition, 12% of respondents said that they would support such a scheme if it was run efficiently, well-managed, received good returns compared to a private scheme and was run on a not-for-profit basis.

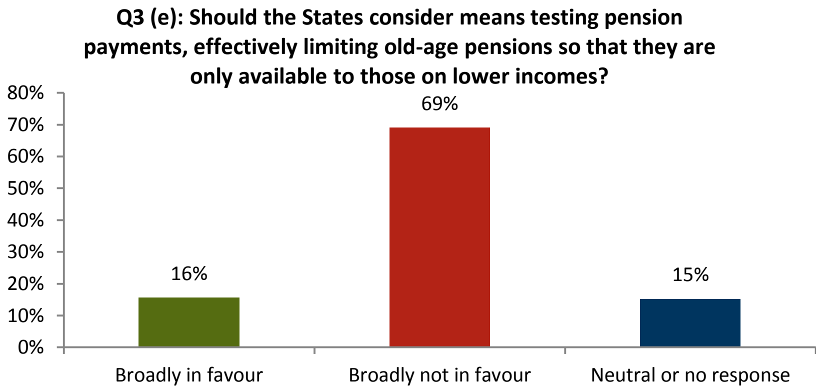
Approximately 22% of respondents against a second States run scheme stated such schemes should be administered within the private sector. Reasons given included that operating such a scheme would add to the cost of running Social Security, and third party providers would have the expertise to run the scheme more efficiently. A small number of respondents felt that such a scheme should be compulsory instead of voluntary.

"Yes. If it was underwritten by the States and had a defined benefit. Similar to the Civil Service scheme"

"Yes. I would, however, have concerns with SSD administering it - I believe that commercial pension providers have the expertise and track record of providing such services in a competitive environment where there are real responsibilities for controlling costs…"

"Leave it to the private sector to offer products"

"The States should not be taking on further services which can be left to the private sector. However there may be a role for the States to facilitate more provision by the private sector. Only if the private sector is unwilling to provide a competitive product should the state step in"



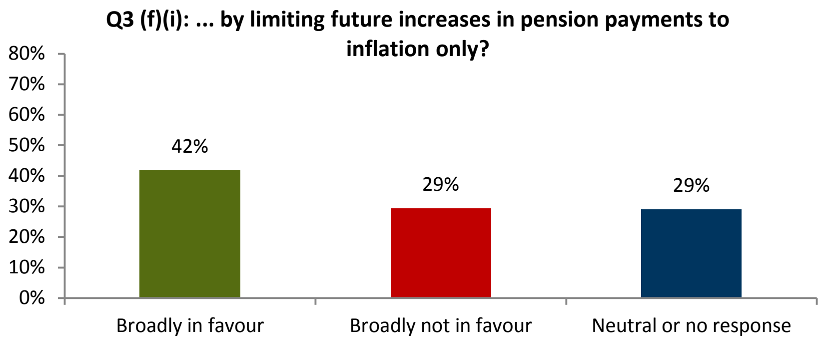
The majority of respondents were against means testing pension payments, with 69% of people not in favour. Most felt that, having contributed to the scheme, people have a right to an old age pension, particularly for those who work and contribute to it all their life. Some felt that means testing the old age pension would discourage people from making private provision.

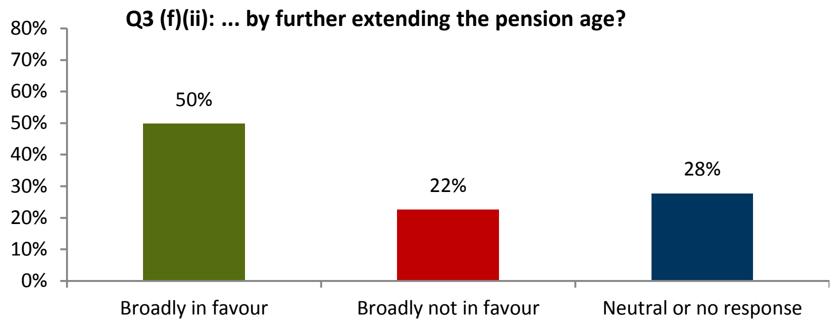
16% of respondents felt that pensions should be means tested on the basis that those who are wealthy and can afford to support themselves should not be entitled to a public pension they do not need.

"No. I believe it would be wrong to expect everyone to pay into a pension pot during their working life, and to receive very little or nothing for themselves even though they contributed all their working life"

"Absolutely not. If you means test old age pension, you merely reward those who chose not to make provision for their old age and punish those who did."

Q3 (f): Should the States make payments less generous …





Considering the two approaches presented together, 18% of respondents were not in favour of making pensions less generous by either method, whilst 64% of respondents were in favour of making the payments less generous in some way. However, there was a mixed response to this question in terms of how this should be done.

Limiting payments to inflation was supported by 42% of respondents. However, several respondents suggested that the scheme should be flexible enough to limit increases to inflation when necessary but also allow above inflation increases when money is available.

More respondents (50%) would support a further increase in the pension age. Several respondents felt that the pension age should be increased to be in line with life expectancy changes and should be reviewed regularly. A small number of respondents said that the pension age could be increased sooner than the current policy[3].

28% of respondents would support both of the suggested approaches (limiting increase to inflation and increasing the retirement age).

"Further extending the pension age would be preferred. We live for decades after retirement now, unlike previous generations"

"At times of Austerity, it could be wise to limit the pension to inflation only. This would then allow it to be monitored and changed as required as things improve"

"Pension increases should be in line with inflation - provided the index being used represents a realistic measure of the cost of living in Guernsey"

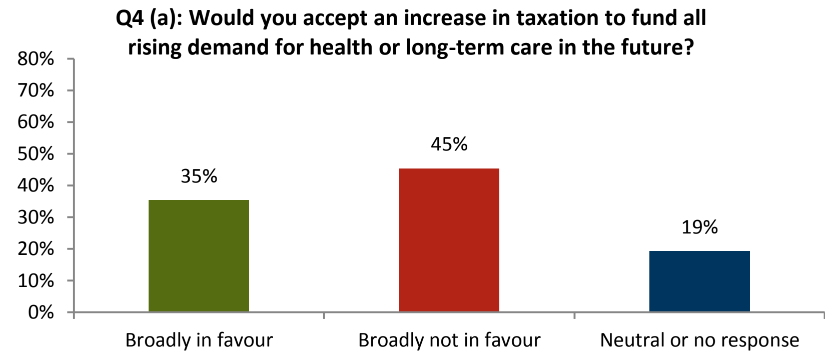
"Extensions to the pension age may be counter-productive, as forcing people to continue to work into their old age may reduce the opportunities for progression for new employees and increase the incentive for younger workers to leave the Island -reducing the economically active population, and therefore the States' ability to generate revenues"

"I support the current general policy of uplifting pensions at the rate of RPI plus 1pc. If you start to uplift only by inflation, there will be more of a burden on the general revenue budget by way of supplementary benefit payments. I agree with extending the pension age."

"The States should make payments less generous by increasing the pension age. The fact that people live for longer should not mean that the "pension life" should simply be extended; people should have to spend more time in employment as well."

[3] In 2009 the States' agreed a resolution to increase the age at which the old-age pension is claimable from 65 to 67 between 2020 and 2031.

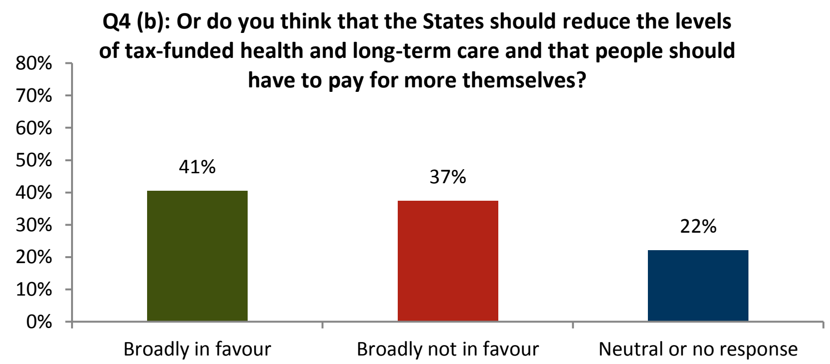
4.3. What are your views on the provision of health and long-term care in Guernsey



Again, there were mixed views on accepting an increase in taxation to fund *all* rising demand for future health or long-term care. Only 35% of respondents would accept an increase of taxation, whilst 45% would not.

A number of the respondents who were against an increase in taxation (approximately 18%) indicated cuts and efficiencies had to be found elsewhere to bring on-going costs under control. Other respondents suggested a thorough review of health contracts; a focusing on prevention of illness and an increase in charges for some services.

A few who disagreed with the increase to fund all increased demand felt that it was unrealistic to think you can ever meet all the demands of healthcare. A small number of people supported the increase for healthcare but not for long-term care.



In terms of reducing the levels of tax-funded health and long-term care, requiring people to pay more for themselves, the view of the respondents was fairly balanced. 41% of respondents said that the level of care should be reduced and that people should pay more for themselves. Some went on to say that private health insurance should be encouraged by the States by introducing tax relief for individuals who take out private insurance. Others suggested that there should be some degree of means testing whereby healthcare for lower paid individuals continues to be funded by the taxpayer, but those who can afford it pay more.

37% of respondents said that levels of tax-funded care should not be reduced as many people cannot afford private insurance, particularly the elderly. Again, some respondents suggested cuts and efficiencies could be found elsewhere to reduce expenditure without reducing health services.

"No, the States needs to understand that it has an obligation to live within its means which should not be an excuse for reducing services. Real evidence of efficiencies is required"

"I think it is inevitable, but efforts should be made to limit the rises by looking very closely at all healthcare contracts with outside providers…"

"A conditional yes to more expenditure, but no to meeting all future demand. It will not be possible"

"I think guaranteeing health is one of the key roles of the state and we should make sure there are enough resources to cope with demand… I am, however, undecided whether this needs to be funded by greater taxation, or diverting from other departments"

"The use of health insurance should be wider in the working and able population. There should be less reliance on the States to meet healthcare provisions and more reliance on health insurance provisions"

"No - there are already people who struggle with the high costs of medical treatments"

"If the current level is maintained & run efficiently this would not be required. The encouragement of private healthcare would allow the health service to derive income from another source other than the States"

"Yes, the cost of running state retirement and long term care homes needs immediate investigation a cost comparison with private establishments will show significantly lower figures"

4.4. What are your views on the payment of benefits in Guernsey?

Q5 (a): What principles should be considered when setting benefit levels?

The principles that respondents most frequently thought should be considered when setting benefit levels included:

- Benefits should be claimable where there is genuine need.
- Benefits payments should enable the claimant to maintain a reasonable standard of living, covering the cost of essential items such as food, clothing, housing and fuel but should not be sufficient to provide luxuries.
- Benefit levels should not be set at a level at which they prove a disincentive to work.

Other principles highlighted included:

- Benefit payments should reflect the contribution history of the claimant, their employment opportunities and the overall economic situation.
- Benefit levels should reflect the average cost of living in Guernsey.
- Benefits should be a short-term safety net with encouragement to become independent in the long-term.
- Benefits should not exceed the income of the average working family.
- Benefit levels should be set at a level which is affordable and sustainable.

Q5 (b): What factors should be taken into account when assessing the needs of a household?

Respondents suggested a wider range of factors which should be considered when assessing a household. The most common of these included:

- Household income and assets
- Number of children/dependents
- Capacity to work
- Contribution history
- Housing costs
- Fuel costs
- Cost of food and other necessities
- Medical costs/Health requirements
- Childcare costs

Overall the responses to these two questions indicates that respondents would prefer a subsistence type benefits system which supports basic living cost but does not provide for luxuries. Several respondents suggested that benefits could be paid in kind (i.e. food vouchers, fuel credits etc.). There is also clear support for incentivising work and valuing contribution.

The treatment of children within the benefits system received mixed comments with some respondents suggesting priority should be given to children in low income families, whilst others suggested that there should be a limit on the number of children for which a household can claim benefits.

"Benefits should be paid only to those who are able to demonstrate a genuine need. The level of benefits should be set such that they cover only essential living costs, and provide a real incentive to seek work. The situation should never arise where a person turns down work because to accept would leave them worse off than to receive benefits…"

"To have a large family is a life style choice and there should not be a higher benefit payment to facilitate this. As an earner if I have a larger family I have to earn more money... to meet my outgoings. This should be the same throughout society..."

"First we need a coherent social policy to ensure that those in need are given proper support to become economically active where possible. Benefits should then be directed to support those genuinely in need."

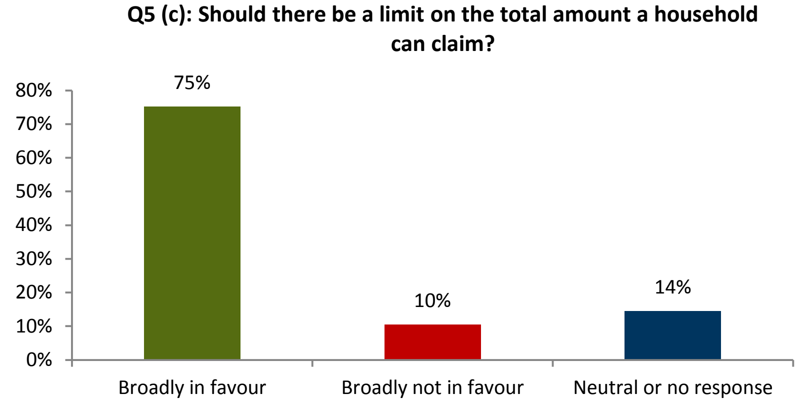
"Children should not be brought up in poverty."

"Basic needs - food, utility bills etc. Not cigarettes, alcohol, Sky TV, new car. If there are savings then medical benefits etc. should not be payable."

"Contribution history, genuine need, willingness to help themselves."

"The needs should be based on the cost of living in Guernsey. If the family is on low income then they should have help with housing costs as these are extremely high in Guernsey. However they should be encouraged to increase their earnings by training and education as much as possible."

"… Where adults in a household are capable of work, benefits should provide for only limited periods on unemployment."



The concept of a benefit limitation was supported by 75% of respondents; only 10% of respondents thought that there should be no limit.

Although many respondents did not specify what they felt the limit should be, there were a variety of suggestions made regarding the level and format of the limit. Some respondents indicated it should be no more than minimum wage in order to incentivise work; others said it should be limited to the cost of providing necessities for a family with 2 to 3 children. Several respondents felt the current cap of £500 for supplementary benefit as being adequate.

There were a few suggestions made about introducing a system of vouchers issued to be spent on certain essential items to encourage the benefit to be spent in the way it was intended.

"Yes. I don't know how it could be decided what that is. But surely they should have enough to cover rent, bills and the food needed for the week. There shouldn't be extras if they are not making some effort to earn them…"

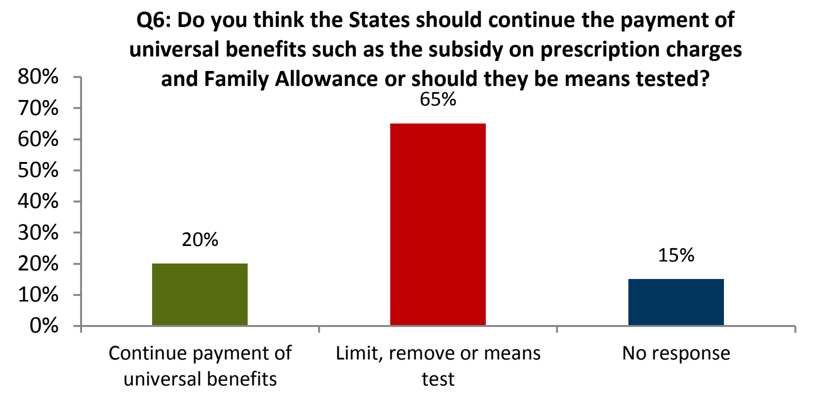
"Yes. The current limit seems very fair"

"I agree with some form of benefit limitation but we have to acknowledge that larger families struggle as a result of it at present"

"Yes, the limit should be based on the requirements for a household with two children"

"No. But there should be conditions attached to payment demonstrating attempts to reduce reliance on benefits"

Q6: Do you think the States should continue the payment of universal benefits such as the subsidy on prescription charges and Family Allowance or should they be means tested?



The continued payment of universal benefits under the current system was supported by approximately 20% of respondents, some of whom were against means testing in principle due to the costs involved, whilst others felt it important to maintain the interest of higher income households in the social insurance system.

A total of 65% of respondents were in favour of some form of limitation, removal or means testing on some or all universal benefits. Approximately 30% of respondents said that universal benefits, particularly Family Allowance, should be means tested. However, many of those that were in favour of means testing felt that the upper limit should be set above average earnings so only the high earners were affected.

Fewer than 10% thought that Family allowance should be abolished completely with fewer respondents in favour of completely removing prescription subsidies/all universal benefits.

The remainder of respondents had a range of suggestions for reducing or limiting universal benefits which included:

- Capping the number of children for which you can claim Family Allowance, typically to 2 children.
- Limiting prescription subsidies to those with long-term conditions.
- Limiting health benefits to certain groups, e.g. pensioners and children.

"Primary care charges are too high already and I think all health services like GP & prescriptions should be supported, since they are not discretionary. Family allowance should be scrapped."

"On balance yes, but Family Allowance should be limited to payment for a maximum of two children."

"No, such benefits can be removed for those on higher incomes."

"No they should not and these two benefits should be means tested. There is absolutely no need for free prescription charges for all."

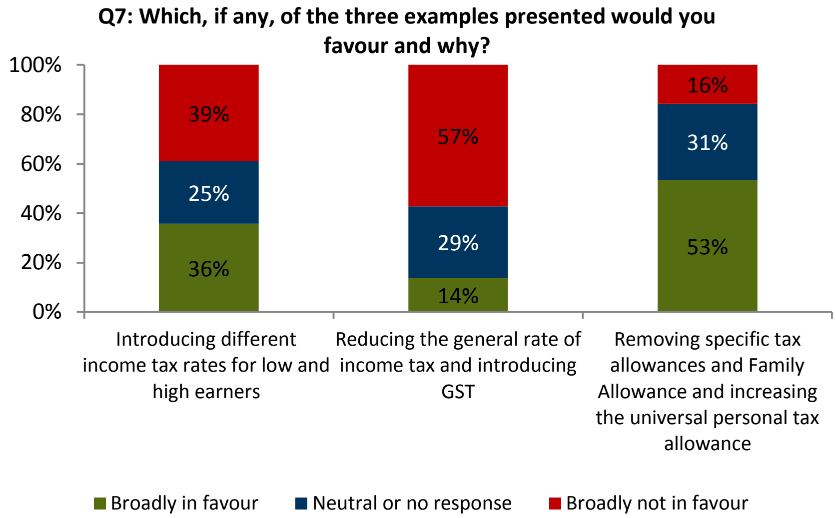
"Yes, the current system is simple and easy to run. Adding a level of means testing would add to the cost of running the scheme."

4.5. What are your views on the income neutral examples presented?

Due to the structure of responses received, responses to questions 7a and 7b have been combined in this section. When scoring responses positive scores were awarded for comments made in favour of the general principles outlined in the options presented, even if the respondent had different views on the implementation (e.g. they support the idea of different tax rates for low and high earners but would prefer the higher rate to be set at a higher level of income). Some respondents favoured more than one option whilst others did not favour any of the options.

The three options presented are:

- **Introducing different income tax rates for low and high earners**
- **Reducing the general rate of income tax and introducing GST**
- **Removing specific tax allowances and Family Allowance and increasing the universal personal tax allowance**



Of the three income neutral examples presented, the most popular was removing specific tax allowances and Family Allowance and increasing the universal personal tax allowance, with 53% of responses favouring it. The option for different income tax rates for low and high earners was the second favourite, with 36% of respondents indicating that they would accept such a proposal.

The example of lowering the general rate and introducing GST received the most negative comments with 57% of respondents indicating that they would not be in favour of such a scheme. However, there was more support for this example among professional bodies who felt that GST would broaden the tax base, increasing the sustainability and efficiency of the Guernsey tax system. It was also highlighted that almost all jurisdictions use some form of consumption tax.

"I favour the last option [removing specific tax allowances and Family allowance and increasing the Universal personal tax rate]. Different rates of income tax encourage tax avoidance schemes. Disposable income from high earners is required for a more buoyant economy. GST is a lazy easy way of raising taxes and penalises the lower income groups"

"Introducing GST, some differentiation for low and high earners"

"I favour option three because it is the least bad option. Different rates for higher earners seems wrong because they pay more tax anyway and have the power of paying themselves more, or of leaving the island, so the laws of unintended consequences seem likely to come into effect. GST: Guernsey is not big enough for GST. … The result will be regressive unless they choose to increase the price of luxury items by more than the price of essential items. Their [businesses] accountancy costs will increase as will the costs of the tax collecting States departments…. My support for the third option comes from a belief that subsidies are generally undesirable."

Introducing different income tax rates for low and high earners

The most common comments in favour of introducing different income tax rates for low and high earners were that those with higher income can afford to pay more. However, many thought that the threshold for the higher earners' rate should be at a higher level than that used in the example.

The most common comments made by those not in favour were that Guernsey would not be internationally competitive; it would prove a disincentive for people to progress financially and may encourage wealthier individuals to leave the Island.

Reducing the general rate of income tax and introducing GST

It was clear that the introduction of a GST, even in combination with a reduced tax rate, was not popular. Particular concerns were its inflationary effect, particularly with regards to food and essential items; its regressive nature and effect on low income households, and the impact on local businesses with particular reference to the cost of administration.

Those who would support this option commented on the more efficient nature of consumption taxes, the benefits of diversifying the tax base and capturing more revenue from visitors to the Island.

Removing specific tax allowances and Family Allowance and increasing the universal personal tax allowance

There was general support for removing specific tax allowances and Family Allowance and increasing the universal personal tax allowance with more than three times as many people commenting in support of this measure compared to those who made negative comments. Comments made in favour highlighted the advantage of simplifying the tax system and providing a more equitable system. More specifically many felt that the distorting effect of mortgage interest relief should be withdrawn or the financial risk posed by it should be limited.

Arguments made by those not in favour of removing the specific tax allowances and Family Allowance include the intention of these allowances to encourage particular behaviours such as home ownership. Others felt that the removal of mortgage interest relief would put a financial strain on first time buyers and might lower house prices.

"Higher tax for higher earners makes sense as they have a smaller proportion of their household budget allocated to essentials and more on luxuries."

"Different rates of income tax are inefficient, cause extra work, cause distorting effects/behaviours at the margins and are less effective than simple 'flat rate' taxes (such as we have at 20%) in numerous studies"

"GST seems an especially poor idea. It damages high street growth and is particularly indiscriminate in those who it targets."

"GST, fair and its worked well in Jersey… You pay tax on what you consume"

"I favour the third option of removing specific tax allowances. I don't think child benefit should be paid to couples who are working and earning good wages and should only be paid if the parents are on low income. I also don't think that individuals over 65 should automatically have a higher tax allowance..."

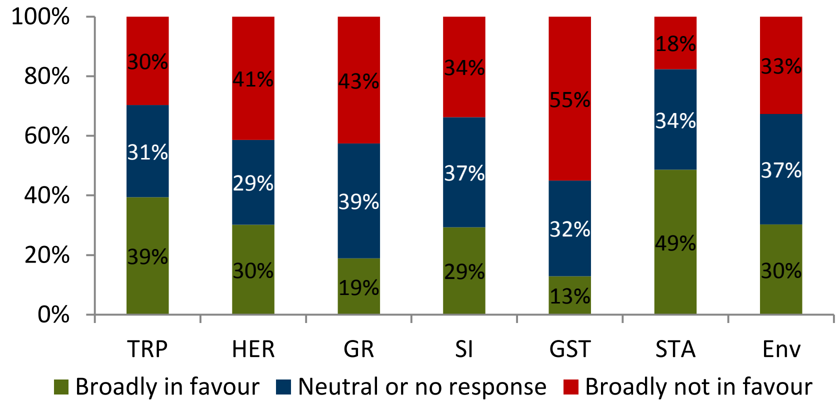
"I think an increased universal personal allowance would create as many anomalies as it might try to solve - better in my opinion to have specific allowances that promote what we want in our society, i.e. home ownership and building a family"

4.6. What are your views on the revenue raising examples presented?

The options presented are:

- **Raising domestic tax on real property (“TRP”)**
- **Introducing a higher earners’ rate (“HER”)**
- **Increasing the general tax rate (“GR”)**
- **Increasing Social Insurance contributions (“SI”)**
- **Introducing GST (“GST”)**
- **Removing specific tax allowances and Family Allowance (“STA”)**
- **Introducing environmental taxes (“Env”)**

Q8: What are your views on the pros and cons of the approaches, particularly with regards to the fairness, efficiency and sustainability issues?



Once again many respondents liked more than one option whilst others favoured none. Of the revenue raising examples, the clear preference was to remove specific tax allowances and Family Allowance, with 49% of respondents finding this option attractive. The second favourite was increasing domestic TRP, which received favourable comments from 39% of respondents. GST was the least favourite, with only 13% of respondents commenting in favour of this option.

Raising domestic tax on real property (“TRP”)

There were more people respondents supportive of this option than not and many described this option as fair. TRP was also commonly described as an efficient tax. Many of those in favour felt the current level of tax was low and that there was room for an increase; many felt that “five times as much”, as used in the example, would be excessive. There was some support for focusing on raising the tax on higher value, second or vacant properties or those dwellings only occupied on a part-time basis. One respondent supported an increase in TRP on permanent homes and associated out buildings but not on land, in order keep the costs to farmers down. Other suggestions were to increase TRP but abolish document duty as TRP is harder to avoid.

Many of those against a rise in TRP thought it would hit lower income families. A few respondents thought raising TRP to be unfair as they did not believe that house size necessarily reflects the owner’s ability to pay the tax. Some of those against TRP were against any increases in taxes. Some commented that the States must curb spending first before raising taxes.

“Sustainability: We regard this principle as the most important of the three [objectives], although it cannot be divorced from the other two. To be sustainable, a tax regime cannot be viewed as unfair by a majority of taxpayers and it must be efficiently administered.”

“Fairness is subjective but if we are looking to the future with a long transition period it should be assessed without reference to winners and losers compared to the current system which is not fair in many respects.”

“…In the end, the fairest tax system is simply proportional. Everyone then contributes proportionately according to their resources and means…”

“In a small economy, it is important that the regime can be administered as efficiently as possible. Equally, we agree that, as far as possible, a tax and benefits regime should not of itself influence the behaviour of its citizens. In a business context, a company’s tax affairs should be a consequence of their commercial behaviour; their commercial behaviour should not be determined by tax measures.”

“Raising taxes on property is very sensible. For those on low incomes who occupy high value properties there could be a mechanism to defer payment until the property is sold”

“TRP is very low by UK standards and could be increased over say 5 years by say 50% without too much of a 'backlash'”

“I believe that raising TRP would be inefficient, and potentially unfair - the size of home you own does not necessarily reflect your ability to pay tax..”

Introducing a higher earners' rate ("HER")

Those in favour of a higher earners' rate felt this option was fair as it targeted those that could afford to pay more. However, some questioned its sustainability. Some felt the higher rate should be applied at a high threshold (£50,000 and £100,000 were among the thresholds suggested). Other respondents felt that the cap on income tax should be removed, whilst some felt the tax rate on higher earnings should be kept low to deter emigration.

The majority did not favour a higher earners rate. Many thought this approach was unfair as it did not apply to the entire population, and higher earners already contribute more. Many also thought it would discourage businesses and high net worth individuals moving to the Island. A few felt this tactic would discourage talent and that it is a tax on success.

"Differential marginal tax rates are the best solution as it shifts the burden to those with most ability to pay"

"No. This is divisive in society, and is not fair as higher earners already contribute, in fact, a greater percentage of funds used for the whole public than do lower earners"

Increasing the general tax rate ("GR")

Increasing the general tax was the second least popular option but for those in favour, it was considered the most fair as it applies to everyone. It was also considered efficient as it is already in place, therefore, easy to administer with no additional costs. Many of those in favour approved only of a small increase e.g. 1-2p. A few expressed that it needs to be tailored to ensure it does not adversely affect the least wealthy.

For those against an increase in general tax, many were concerned that Guernsey would lose its competitiveness with its neighbours. Some also cited the States as needing to control expenditure.

"I believe the cons outweigh the pros for higher earners rate, increasing the general tax rate, increasing social insurance contributions and introducing GST. In all cases these would lead to Guernsey being less competitive in terms of attracting new business and individuals"

"Increase the General Tax rate is the easiest and fairest way."

Increasing Social Insurance contributions ("SI")

The public were uncertain on this issue with approximately a third supporting it, a third against and a third undecided. Of those in favour many approved of this option to fund the pension gap or maintain healthcare. A few respondents preferred a higher earners' tax rate before increasing social security contributions and some would approve of removing the current upper limit on Social Insurance contributions. Some also indicated that employers should bear the burden of any increase in contributions. Similar to increasing the general income tax rate it was commented that this option already existed so would "maintain simplicity".

There was a common opinion amongst those not in favour of this option (and some in favour), that social security contributions are no longer *insurance* but have become a *"stealth" tax.* Many consider for this reason that it should no longer be administered separately to general tax. Some also support the combining of income tax and social insurance as this will simplify the system, saving on costs.

An issue also raised with regard to social insurance contributions was the current higher level of contributions paid by those who are self-employed (10.5%). This has been acknowledged and will be taken into consideration in any further investigations in this area.

"Any increase in Social Insurance contributions would be welcomed, but it would need to be tied to specific benefits, such as paying for all general healthcare needs on the Island specifically through social security payments"

"Social Insurance Contributions could increase if this is what will fund more age-related pensions and some healthcare. This would be fair in matching 'cause and effect'."

"Social Insurance contributions are a tax on jobs and risks reducing the number in employment"

Introducing GST ("GST")

Introducing GST was unpopular with 55% of respondents against this option. Many commented that this was an unfair tax that would hit lower income earners the most. Others commented that GST was an inefficient tax, difficult to administer and a burden to businesses. Some respondents were concerned this would drive people to buy more on the internet; therefore, avoiding GST. A few people thought goods were already expensive in Guernsey when compared with the UK. A few also believed that once introduced, GST would be too easy to increase in the future.

Only a small percentage (13%) of respondents favoured GST and some of those in favour only approved of its introduction if it were imposed on luxury or non-essential goods only. Once again, professional bodies were more supportive of a GST than individuals.

"Forget GST. It's the tax of last resort and is incredibly inefficient and punitive to commerce and the lower paid"

"GST would have a very damaging effect on the retail industry and would further drive spending off Island via the internet"

Removing specific tax allowances and Family Allowance ("STA")

The removal of specific allowances was the most favoured option. Several respondents in favour of this option clearly stated support for the removal of mortgage interest relief and/or Family Allowance. A reduction in mortgage interest relief, limiting Family Allowance to a specified number of children or means testing Family Allowance were alternative suggestions. These types of allowances were cited as unfair but efficient and sustainable.

"Wherever possible, distorting allowances such as Mortgage Interest Relief should be abolished (on a phased basis). Thereafter, all other allowances should be means-tested"

"Increase the earnings cap for social security, remove family allowance for the very wealthy keep mortgage tax relief if you can afford to do so"

Introducing environmental taxes ("Env")

There was a fairly balanced opinion on introducing environmental taxes. Many of those in favour were keen to solve the traffic problem by making it more expensive to buy and/or drive a car and to encourage greater use of the bus service. Many felt "*user pays*" was a fair policy.

Some respondents, from both sides of the camp, were concerned this type of tax would impact those with a low income (unfair) and one suggested additional schemes may need to be run to transition away from coal to more environmentally friendly fuel. People, both in favour and opposed to environmental taxes felt this tax was not appropriate for revenue raising as funds raised in this manner should be reinvested in green initiatives e.g. subsidies for solar panels, improving bus service. A few thought environmental taxes may be inefficient, though sustainable.

"I like the idea of environmental taxes from a green standpoint but I do not think it would be appropriate to use a green tax to raise revenues unless they were specifically ring fenced for green initiatives "

"Environmental taxes sound fine, but have unintended consequences, are often difficult to collect and do not make a great deal of difference in practice. They may be politically correct, but the net gain in introducing them would need to be rigorously considered and justified."

4.7. What could be done to make the system simpler

Some respondents believe Guernsey's system is simple now and, therefore, no changes are required, whilst others were of the view that taxation is a complex issue and that efforts to simplify the system would be unsuccessful. However, many ideas were put forward regarding how Guernsey's personal tax and benefit systems could be simplified.

As expected the most common suggestion for making the system simpler involved amalgamating, in some way, the Social Security and income tax systems. Combining the systems that process collections into one joint collection system was a common recommendation. Many of respondents favouring this felt that the ring-fencing on Social Insurance funds should remain but that this could be achieved in a unified system as easy as it is using two separate systems. Others would like the States to go one step further and merge income tax and social insurance contributions into a single tax; removing the need to assess individuals for two separate payments.

Another suggestion was to introduce self-assessment or simplify tax returns to enable automated assessment with little or no manual intervention by administrative staff[4]. Other suggestions to increase the efficiency of processing the returns from individuals with simpler tax affairs included raising the tax allowance to remove more people from the system, removing specific tax allowances and allowing the banks to deduct tax on interest at source. Abolishing the cap on income tax and Social Insurance contributions was also suggested as a method of simplifying the system.

With respect to the provision of benefits a streamlining of the social housing and supplementary benefit systems into a single system was supported by a number of respondents. Whilst some respondents were in favour of means testing others felt that this would further complicate the system and make it more expensive to administer.

4.8. Do you have any further comments or suggestions you wish to put forward?

Many of the responses to this question mirrored the responses to other questions asked in the consultation, for example, comments in relation to the States reducing spending levels or amalgamating the Tax and Social Security Departments. However, additional suggestions were presented in this section covering a range of topics.

The introduction (or reintroduction[5]) of a motor tax was favoured by some with variations on this idea including higher rates on larger or more polluting vehicles. Other transport related proposals included the introduction of a vehicle importation tax and paid parking. One respondent would like to see a reintroduction of horse and cycle tax, while another would prefer to see tax breaks for healthy lifestyle choices including cycling.

Although outside the scope of this review, corporate taxes were raised by a number of respondents who felt that businesses should carry or share the burden of increasing costs. Some suggested that the 10% corporate rate of tax should be extended to include other finance sectors[6] whilst others would see this extended to incorporate other sectors.

Others would like to see capital gains taxes introduced; some specifically thought property developers building apartments should be targeted. The possibility of the differential treatment of Alderney was also raised, highlighting the difference in the current economic conditions in the two Islands and the different impact any changes may have.

Suggestions for reducing expenditure included an increase in sharing services with Jersey to reduce some of Guernsey's costs. Several respondents felt that the public sector pension arrangements should be changed to reflect those in the private sector. The reconciliation of health spending, which is currently divided between general revenue and social insurance, was also suggested.

A number of respondents highlighted Singapore, where pensions are accrued on an individual basis, as a better model on which to base pension policies than the systems employed in the UK.

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[4] It should be noted that income tax returns filed online are already automatically cross checked against data held in the income tax computer database and against certain predetermined criteria, to enable, where possible, assessments to be issued automatically..

[5] Motor tax in Guernsey was removed in 2008 and replaced by an additional premium on motor fuels.

[6] The 10% company intermediate income tax rate was extended in 2013 to domestic insurance business, insurance management business and fiduciary business.

5. Alternatives to increasing revenues

There are a number of possible alternatives to maintaining the long-term stability of States expenditure which could be investigated further. Some of these options were outlined in the consultation document; others have arisen in response to suggestions made by respondents.

5.1. Increase in private provision

Increasing private provision of pensions, health and long-term care would increase the level of personal responsibility enabling a scaling back of tax-funded services. The likelihood is that this would take the form of either voluntary or compulsory insurance type schemes.

Such a move would require careful planning and a long lead in time before tax-funded benefits are reduced to enable individuals to acquire sufficient cover to meet their needs. It must also be accepted that lower income households are unlikely to be able to afford sufficient private insurance or pensions to cover their needs in the long-term and as such some level of tax-funded provision or subsidy for lower income households would be required.

Options for reducing the level of tax-funded benefits could include the limitation of increases in the old age pension to inflation. Although this would limit the increase in the cost of providing old-age pensions, the decrease in the value of the old-age pension relative to earnings could result in an increased number of pensioners claiming supplementary benefit partially offsetting the benefit of the limitation.

5.2. Extension of the pension age

At its inception in the 1930s, the age at which you could claim an old age pension in Guernsey was later than average life expectancy and was designed to support those who had become physically too infirm to work. Life expectancy has increased considerably since then, with the average person now expected to live for a further 20 years after they begin to claim their pension, a number which is still increasing. Many people will spend most of these years in relatively good health. Moves to increase pension ages and, in some cases link them to increases in life expectancy, are common in many western economies including the UK and throughout Europe.

The extension of the pension age would mean people paying into the scheme for a longer period of time and claiming for fewer years, improving the sustainability of the scheme. However, at the present forecast, assuming a continued long-term increase in benefits of 1% above inflation, the fund which supports the old age pension in Guernsey and Alderney is expected to be heavily depleted by the time the current proposed increase in pension age to 67 is completed in 2031. As a result, any further increase after this point, although reducing the year on year cost, has only a very limited impact on available reserves.

In order for a further extension of the pension age to be effective in improving the sustainability of the fund over the period of imbalance, it would need to be combined with either an acceleration of the current increase in retirement age, a restriction of the increase in the pension payment or an increase in contributions.

More flexible arrangements on an individual basis, such as voluntary deferral of old age pension claims in return for an increased pension payment or lump sum or other incentives to encourage people to extend their working life, could also be considered.

5.3. Increased means testing

The public consultation indicated that there would be little support for means testing pensions, however, there are other areas where a level of means testing could be considered. Family Allowance is one area in which respondents felt that means testing may be appropriate although most felt that the level at which it was withdrawn should be set at a relatively high level. Other potential areas in which means testing could be investigated include medical prescriptions, GP and other medical subsidies and long-term care.

As highlighted in many responses in the consultation, means testing requires a substantial amount of administration and the cost associated with the increase in staff time required to assess claims would be likely to erode some of the benefit of introducing further means testing of benefits.

5.4. Reconciliation of health spending

At present, healthcare in Guernsey is funded by two separate but interrelated systems and various aspects of healthcare funding were highlighted by respondents as an area in which they felt the States could achieve better value for money. Primary care subsidies and care provided by the Medical Specialist Group are primarily funded from Social Insurance contributions supported by the Guernsey Health Service Fund. Other health services, such as hospital treatment and mental health are funded from General Revenue. Although outside the remit of this review, a review of the structuring of healthcare funding is recommended in the Health and Social Services 20:20 vision review.

5.5. Withdrawal of tax allowances for higher earners

Termed "20 means 20", the intention of such a proposal is to withdraw the universal tax allowance for high income households, effectively charging them 20% tax on their entire income. There are two ways in which this could be done.

The system implemented in Jersey involves the use of a higher "marginal rate" of tax (27%) in combination with allowances. Households are assessed both against this marginal rate with allowances and against a flat rate of 20% without any personal allowance and pay the lower of the two assessments. The result is that lower income households pay 27% tax on part of their income whilst higher earners pay 20% on their entire income. This system, whilst avoiding very high marginal rates caused by the phased withdrawal of allowances, is administratively complex and difficult for the public to understand.

The system employed in the UK is a withdrawal of the personal allowance by £1 for every £2 earned over £100,000. Although easier to understand, such a system results in high marginal rates (the percentage of tax paid on each additional £1 earned) for those earning just above the limit. For example, if such a system were implemented in Guernsey and assuming the continuation of the flat 20% tax rate, an individual earning £100,002 would pay 20% on their additional £2 of income (£0.40) and 20% on the £1 lost from their personal allowance (£0.20) resulting in a marginal tax rate of 30%.

Both options, although increasing the amount of revenue raised would add a level of complication to Guernsey's currently very simple tax system and would require an increase in administration.

5.6. Streamlining of income collection

Although, for the most part, assessed on the same income, at present income tax and Social Insurance contributions are collected by two separate Departments. There is little support either publically or politically for removing the ring fence on Social Security's funds, however, there is scope for combining the collection of funds into a single department with funds subsequently diverted to General Revenue or Social Security as necessary. There are potential efficiencies in such a measure, with a single point of assessment likely to reduce administration.

However, at present the assessments of Social Insurance contributions and income tax are conducted on a different basis in many areas, for example, income tax of married couples can be assessed together, whilst social insurance contributions are assessed on individual incomes. As a result, the reconciliation of the two systems and the development of software capable of processing the combined systems would likely require a significant amount of initial investment.

6. Conclusion

The public consultation revealed a wide range of opinion on the future of Guernsey's personal tax, pensions and benefit system. The majority of respondents felt that there was a limit to how much revenue the States could raise from personal taxes. A range of limits were suggested but on average it was felt that this was little higher than the current level.

Although it was acknowledged by many that some level of increased revenue generation may be necessary to support the provision of public services in the long-term, the majority of respondents felt that alternative options, such as the extension of the pension age or the restriction of universal benefits, were preferable to an increase in personal taxation sufficient to cover all the increased demand resulting from the changing demographics.

When asked to consider changes to the current personal tax regime, respondents generally preferred a streamlining of the current system by removing specific tax allowances combined with an increase in the personal allowance. More structural changes to the tax system, such as the introduction of higher and lower earners' rates or a Goods and Services Tax, combined with a decrease in the general tax rate, were considered less favourable.

The Treasury and Resources and Social Security Departments will be presenting the General Revenue Budget and the Social Security annual reports on benefits, contributions and pensions to the States in October 2013. Whilst some preliminary measures may be presented in conclusion of phase one of the project, the Review's recommendations for phase two, regarding any longer term measures, will be presented to the States in 2014 with a view to incorporating recommendations, where appropriate, into the 2015 budgetary process.

Appendix 1. Coverage of Responses

In total, 248 responses to the consultation were received. Although responses to the consultation were diverse, some groups are inevitably under represented. It must be noted that consultations of this type are more accessible to some groups than others and as a result the distribution of personal responses are skewed towards middle to higher income households.

In order to capture the interest of those groups who are less likely to engage with the consultation process, Non-Government organisations were invited to respond, representing the interest of their members. 14 organisational responses were received. Some represented the interest of a specific group (such as older people or employers); others presented a more general view.

Figures 6.1.1a to 6.1.1c below provide a breakdown of the personal responses received by the categories listed.

Figure 6.1.1a. Breakdown of personal responses by employment status

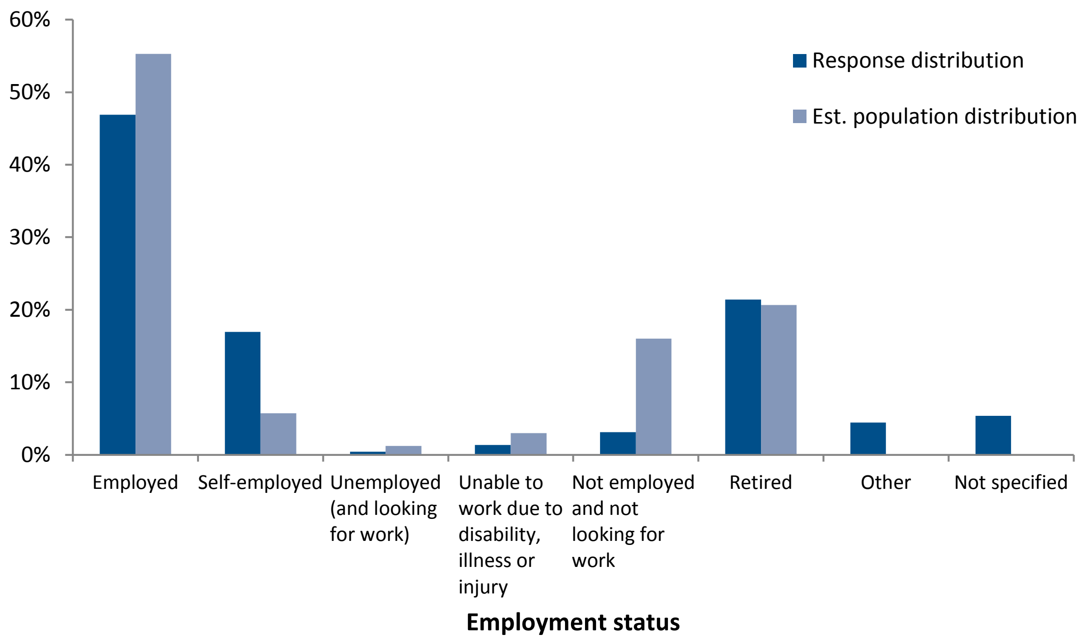


Figure 6.1.1b. Breakdown of personal responses by age group

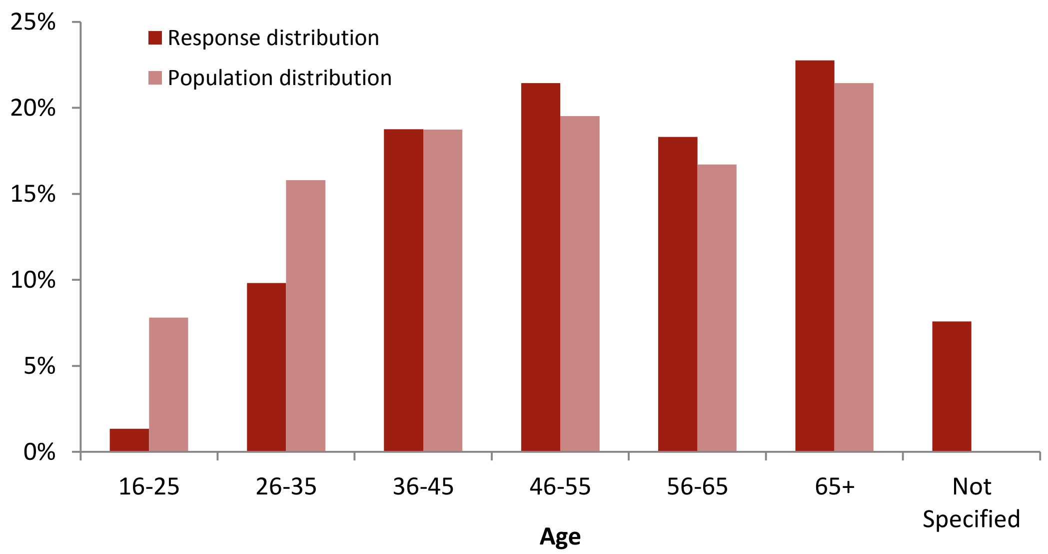


Figure 6.1.1c. Breakdown of personal responses by household income bracket

Appendix 3: Corporate tax

Background

A3.1 In October 2009, following communication from the UK government that certain EU Member States had concerns regarding the Zero-10 regimes of the three Crown Dependencies, the States of Guernsey resolved to commence a review of corporate tax (Billet d'État XXIX, October 2009). Five principles were set out in the 2010 corporate review:

- **To be competitive;**
- **To be simple;**
- **To be internationally acceptable;**
- **To provide a sustainable economy;**
- **To tax the provider, not the product, thus retaining the important tax neutral platform that is key to maintaining Guernsey's international fiscal competitive position.**

A3.2 The Bailiwick of Guernsey is not part of the EU, however the States of Guernsey made a voluntary commitment to adhering to the principles of the Code of Conduct on Business Taxation ("the Code").

A3.3 The Policy Council's Fiscal and Economic Policy Group launched a public consultation in June 2010, inviting "comments, opinion and analysis from the public, business and all stakeholders on a movement away from the current Zero-10 corporate tax regime and in particular to provide views on the potential alternative technical options for the basis of a revised corporate tax regime." The consultation feedback was published in November 2010, with the following, generally consensus views, expressed by those that responded:

- Concerns were expressed regarding the unwelcome uncertainty that the review had created surrounding the corporate tax regime and the desire for certainty for business.
- Concerns were expressed regarding the risks involved in a unilateral change of corporate tax regime by Guernsey. Any non-zero rate of tax would need to be competitive and the rate and scope of such a change would need to be consistent across the Crown Dependencies.
- The preferred alternative option, with sizeable support, was to amend the present Zero-10 regime to remove any non-compliant aspects.

A3.4 In April 2012 the European Union's Code of Conduct Group on Business Taxation determined that Guernsey's Zero-10 regime was harmful, due to the deemed distribution regime. In June 2012 (Billet d'État XVI, 2012), the States approved that the deemed distribution provisions be repealed with effect from 1 January 2013. Following an assessment of the roll-back measures, ECOFIN formally endorsed the Code Group's assessment that Guernsey's corporate tax regime now complied with the principles of the Code in December 2012, at which time the corporate tax review was formally closed.

A3.5 The repeal of deemed distributions was expected to result in an estimated fall of income of £4m per annum, albeit some of the loss would be due to timing, as most income will ultimately be distributed.

A3.6 To address the deficit and balance the budget, the company intermediate income tax rate (10%) was extended to licensed fiduciaries, licensed insurers (in respect of domestic business) and licensed insurance managers in 2013, raising £6m. This rate will also be extended to fund administrators in 2015, estimated to raise a further £3m.

Territorial Taxation (extract from the corporate tax review public consultation feedback published November 2010)

A3.7 *Under a territorial regime, tax liability is typically restricted to the income that is regarded as having its source in the jurisdiction concerned.*

A3.8 The general consensus arising from the public consultation is that a territorial system with an exemption for passive investment income is acceptable to the majority of industry sectors, with the notable exception of administered trading entities. Within that category would fall captives, international trading companies and property development structures.

A3.9 The banking sector responded that a territorial system with a 10% rate was acceptable to them, provided the position for their clients (predominately fiduciary clients) remained tax neutral. Similar responses were received from other professionals, such as lawyers, accountants and corporate service providers.

*A3.10 The key issues with a territorial system relate to the definition of **"Guernsey source"** and **"permanent establishment"**. However, the key advantage is that other EU Member States already operate a full/partial territorial system of taxation. For example, Gibraltar operates a full territorial system whereas France and the UK (with its dividend exemption) operate a partial territorial system.*

A3.11 With regard to the definition of "Guernsey source", some responses queried whether different source rules could be introduced for different industries. These and other responses try to expand on the theory of taxing the provider not the product, although determining what constitutes a "product" also throws up difficult questions.

A3.12 Key points to consider that emerged from the responses received with regard to a territorial style system of taxation are as follows:

- *Whether companies managed exclusively by a local Corporate Service Provider ("CSP") where the companies do not have their own staff, office, etc could be excluded from the definition of permanent establishment.*

- *Whether investment income could be exempt from tax even where it derives from a Guernsey source (e.g. fiduciary deposits) as this income is mobile.*

- *Whether specific definitions of source could be considered for certain industries. For example, insurance business where the risk is based; e gaming business where the customers are resident; property development where the property is located.*

A3.16 The definitions must be sufficiently robust to protect against greater challenges by other tax authorities where a company is found to have no source of income in Guernsey that such income is sourced in their country.

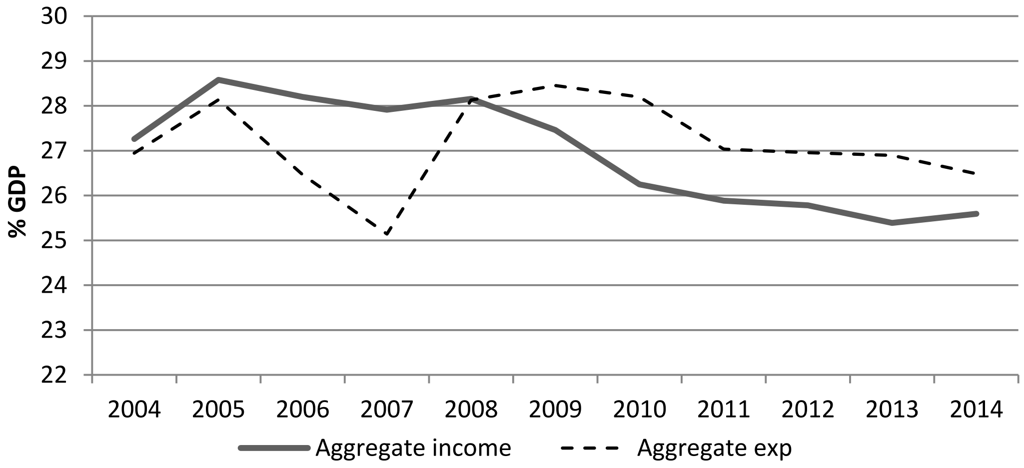
Appendix 4: Establishing an appropriate limit to aggregate income

A4.1 The level at which a limit on aggregate income is set is, by its nature, a judgement call. There is no one right answer and, internationally, there are wide varieties of models which could be used to justify both higher and lower levels for total government income than the States currently extract from the Guernsey economy.

A4.2 The Joint Board feels that it is important that Guernsey retains its status as a low tax jurisdiction and that, consistent with the feedback received from the public consultation, total levels of government income should not be increased significantly above historic norms. However, expenditure pressures cannot be ignored and unless there is an appetite for a reduction in services, in the medium- to long-term it may prove necessary to increase government revenues beyond their current level.

A4.3 Aggregate government income, including General Revenue income, Social Security contributions and departmental operating income, is currently significantly lower than the historic average. Over the five-year period immediately prior to the introduction of Zero-10 (2003-2007) income averaged 28.2% of GDP. Despite increases in revenues from Social Security contributions and some indirect taxes, the move to the Zero-10 corporate tax system resulted in a fall in income relative to GDP. Between 2010 and 2014 aggregate income averaged 25.7% of GDP (see figure A4.1) with a combined deficit (including both General Revenue and the operating deficit on the Social Security funds) of 0.9% of GDP expected in 2014, which is anticipated to fall to 0.7% of GDP in 2015.

Figure A4.1: Estimated total government income as a Percentage of GDP (including General Revenue, Social Insurance contributions and operating income)



A4.4 As well as the deficit position, there are a number of known expenditure pressures which could require additional funding in both the short- and long-term. Assuming, for the purpose of illustration, that no actions are taken to mitigate expenditure pressure in these areas, additional annual income and expenditure requirements can be broadly summarised as follows.

Table A4.2: Outline of current expenditure pressures

Expenditure item	**Estimate of additional income required (The "do nothing" position)**	**Notes**
General Revenue and capital expenditure requirements (including deficit position).	£20m	Broad estimate based on known under-funding of the capital programme and other agreed but unfunded work streams
Supplementary Benefit	£4m-£7m (based on cost estimates presented in 2013)	Subject to the outcome of the SWBIC project
Parental Benefits	£2m	
Pensions (central estimate)	£20m (equivalent of increase in Social insurance contributions required to maintain 2 years of expenditure in reserve based on the 2011 actuarial review)	Assumes annual uprating of halfway between prices and earnings and net immigration of 200 people per annum
Long-term care (central estimate)	£18m (as above)	Subject to the outcome of the SLAWS project
Health and Social care	Unknown	
Total	£67m	
Current total income (2015 estimates)	£603m	26.3% of GDP
Required Total	£670m	28.8% of GDP

A4.5 To fund the entire projected cost of all the above, excluding the unknown pressure on healthcare and social care, would require an increase in revenue to an estimated 29% of

GDP. Long-term pressures on health spending are difficult to model with any degree of accuracy. Although this has been attempted in the past[1], estimates of the pressure on healthcare funding as a result of demographic change range from 0% to 6% of GDP.

A4.6 The table below presents a brief summary of the range of options available, from a limit set at current levels of income to a limit set at a level which would allow the funding of the majority of the expenditure pressures outlined above, without extensive mitigation.

Table A4.3: Summary of options for placing a limit on total government income

Option	Impact
No change i.e do not establish a limit to capture total government income	The principle of a limit to General Revenue income, set out in the Fiscal Framework, remains but is not extended to Social Insurance Contributions. Retain more independence from General Revenue in setting of Social Security benefit and contribution rates.
Establish limit on aggregate income incorporating taxation, social insurance contributions and departmental operating income	Extension of fiscal discipline to incorporate Social Security contributions. Ensure closer co-ordination between general taxation and contributions and greater awareness of overall tax burdens.
Limit of 26% of GDP ↓ Limit of 30% of GDP	Tight discipline on expenditure required to keep current expenditure sustainable within this limit in the long-term, with potential social and economic consequences. Internal efficiencies or restructuring of services are unlikely to be sufficient to maintain sustainable services within this limit in the long-term and further mitigation and service cuts may be required to maintain permanent balance within this limit in the long-term. Less emphasis on expenditure discipline but less likelihood that service cuts will be required to maintain a permanent balance. More scope for additional revenue generation to adapt to expenditure pressures and demographic change. Increased risk that revenues will be increased to meet short term objectives to the detriment of long-term stability.

A4.7 Responses to the public consultation that efforts to raise taxes to a level sufficient to fund the full extent of the potential increase in funding required to continue to provide all public services in their current form would be unpopular. Responses also suggested that the general public would prefer to see a greater level of responsibility placed on the individual for providing for their own well-being.

[1] Potential long-term implications of demographic and population change on the demand for and cost of public services, Policy Council 2012

A4.8 **Guernsey's economic success is founded on its reputation as a low tax jurisdiction and this should be maintained. In addition, the Joint Board feels that the limit should be set at a level which implies a level of fiscal discipline to maintain whilst acknowledging that measures to mitigate expenditure pressures in order to stay within this limit may have social and economic consequences and need careful consideration.**

A4.9 That said, as outlined in section 4.2 the long-term pressures on expenditure, particularly that resulting from the ageing population need to be considered. In the medium- to long-term it is unlikely that the States will be able to continue to provide the current range of public services without some increase in the total amount of revenue they receive or real cuts in expenditure beyond that which can be achieved by efficiencies alone.

A4.10 The Joint Board has identified areas within the scope of this Review where expenditure pressures could be reduced including the provision of old-age pensions and the universal benefits administered by the Social Security Department, reducing the estimated expenditure pressure from £67m to £33m (see table A4.3).

A4.11 Estimates of expenditure on Supplementary Benefit or long-term care have not been revised. These await the outcome of the SLAWS and SWBIC projects. The recommendations of these projects could result in an increase or decrease in projected expenditure requirements.

A4.12 Once again, because of the lack of certainty surrounding long-term expenditure on health and social care these have not been included.

Table A4.4: Outline of possible annual expenditure pressures

Expenditure item	**Current estimate of additional long-term expenditure demand.** **(The "do nothing" position)**	**Revised estimate with mitigating actions as outlined in this review**	**Notes**
Capital Expenditure and General Revenue requirements.	£20m	£20m	On-going work to improve internal efficiency will reduce this. However, estimates are unavailable at this time.
Supplementary Benefit	£7m	£7m	Estimates unrevised and subject to the outcome of the SWBIC project.
Old-age pensions (central estimate)	£20m	£0	Subject to increased pension age, reduced annual increase and introduction of supporting policies and earnings growth of 1.5% per annum. If it is assumed that economic conditions improve from their current status, parental benefits could also be funded from within the GIF without further increases in contributions.
Parental Benefits	£2m	£0m	
Long-term care (central estimate)	£18m	£18m	Estimates unrevised and subject to the outcome of the SLAWS project.
Universal Benefits administered by SSD	-	-£12m (max)	Includes the phased withdrawal of Family Allowance and the primary care grant and changes to the structure of prescription charges.
Health and Social care	unknown	unknown	
Total	£67m	£33m	
Current total income (2015)	£603m		26.3% of GDP
Required Total	£670m	£636m	
Required total as % of GDP	28.9%	27.1%	

A4.13 Given the scale and nature of the expenditure pressures faced, many of which are heavily dependent on demographic pressures, which are outside the States' sphere of influence, the Joint Board is of the view that some allowance for increased revenues in the future is necessary.

A4.14 The Joint Board feels that the sustainable provision of services within an income limit of 28% of GDP is achievable. This is broadly equivalent to the average level of income prior to the introduction of Zero-10 in 2008.

A4.15 Some level of expenditure mitigation will be necessary to ensure the sustainable provision of services within this level, particularly if pressures on the provision of health and social care should manifest in a substantial increase in the expenditure needs of the Health and Social Services Department and the Guernsey Health Benefit fund.

States of Guernsey Policy Council

Pensions Survey

February 2012

Pension Provision Research

Background

The States of Guernsey Policy Council needed to obtain information on private sector pension provision to try and anticipate the future implications of such provision for the States of Guernsey old age pension. The cost of the current States' pension provision is known.

Following a discussion with Dr Andy Sloan (12 July 2011), the scoping of the project highlighted that the Policy Council required an indication of:

- The extent and range of private sector pension provision amongst the island population, and
- A quantification of contributions and benefits.

Aim

The primary aim of this research was to stimulate a Policy debate on the topic of pensions' provision. The final objective is to be able to estimate the amount of private pension income that will be received in 20 years' time. This would enable the States of Guernsey to make provision for anticipated requirements from the public pension scheme and to identify whether there may be any problems in future funding requirements.

Methodology

1,000 face-to-face interviews were carried out of a representative sample of the Island population. The questionnaire was set out to determine the following:

- pension provision across a range of age groups
- when pensions were set up (if held)
- reasons for non-uptake of pension provision
- awareness and knowledge of future benefits
- pension provision across sectors
- pension provision across a range of incomes
- perception of whether individuals think that they save enough

In particular, the research was focused to gain an idea of whether the level of pension provision subscribed to had altered over time and will change in the future.

To ensure that a representative sample was achieved with regard to income, employment and age group, the research was carried out in phases. Initially, face-to-face interviews with 700 people was undertaken and the results inputted. Targeted sampling was then undertaken to ensure the final sample (1000) would be truly representative of the required range of individuals. A 5% over-sample (total 1,050) was planned to ensure targets were achieved.

Summary Results

Overall, 45% of respondents currently contribute to a personal or company pension scheme. 55% were not currently contributing to a pension (although 16% of the non-contributors had previously been contributing to a scheme). Of those that contributed to a scheme, just under 40% had a personal scheme, 50% a company scheme, and 10% had both a company and a personal scheme to which they currently contributed.

The likelihood of currently contributing to a pension increases with age up to the 40 to 44 year age group, a peak of almost 70%. After this age there is a slight reduction in the likelihood of contributing.

There is a threshold income within the £20,000 to £30,000 gross annual wage bracket when there is a greater likelihood for the individual to be currently contributing to a pension. Once an individual is earning over £30,000 gross annually, there is a much greater number who would be currently contributing to a pension.

The sector in which the individual is working also influences the current contribution to a pension. There is greater likelihood for an individual to be contributing to a company pension scheme if working in the finance, utilities, and non-profit sectors. Those employed in the recreation, manufacturing, hostelry and IT sectors were far more likely to be currently contributing to a personal pension.

Those in younger age groups were more likely to be in a company pension than a private pension in comparison to older respondents - over 85% of pensions being company-based in the under 25s, as opposed to 52% amongst 35 to 49 year olds.

Average contributions to personal pensions as a percentage of gross annual salary was approximately 6.7% per pension. Company contributions to personal pensions averaged at approximately 6% where relevant.

22% of company pensions held were non-contributory by the individual. The average contribution by those who did contribute to their company pension was 5.9% of their gross annual income. Company contributions were approximately 8.3% where known.

With regard to those who knew the details of their personal pension contributions, the average length of time that people had contributed to personal pensions was 12.5 years. Older age groups who would have had potentially more time in employment were more likely to have been contributing for longer periods. However, in the 50 to 64 year age groups, this average duration of contributions had reduced in comparison to the 45 to 49 age group.

The type of company pension held also varied by age group. The proportion of those receiving a defined benefits company pension was greatest in the 45 to 49 age groups. Defined contribution pensions were most frequently held in the other age groups.

Of those who had a pension scheme, 11% of respondents voluntarily contribute more than the standard rate towards their company pension, 53% contribute at a standard rate, whilst 31% did not know whether their contributions are standard. Just over 5% of these company pensions were non-contributory. Respondents in the 25 to 34 and the 50 to 64 year age groups were more likely to pay a higher percentage than the standard rate towards their company pension. Reasons given by some in the 35 to 49 age group was that they would like to pay more but were waiting for children to grow up or were currently paying off more towards their mortgage.

If the number of respondents currently contributing to a pension is analysed by age group and aged by 5 years and current non-contributor information included, the data indicates that the percentage of individuals over the age of 25 currently contributing to a pension is very similar to 5 years previous.

Almost a quarter (24%) of respondents who were currently contributing to a pension did have previous schemes they had paid into. 16% of those that were not currently contributing to a pension had previous schemes. Of these, representation was highest in the 35 and over age groups.

Of the 55% who do not currently contribute to a pension, the reasons for not currently having any arrangements include: No company scheme (26%); Can't afford payments (24%); Other (24%); Never got round to it (18%); Too young (16%); Will use spouses pension (7%). The reasons given by the younger age groups were primarily linked to their age and affordability of payments.

The likelihood of using a spouse's pension increased with age group - a larger proportion of female respondents than male.

Approximately 16% of the sample did not have a spouse or partner. The trend observed was that if a respondent had a pension themselves, their partner was also likely to have a pension, 49% in comparison to the 28% of current non-contributors to pensions. Of those who knew that their partners had a pension, the older the individual the more likely they were to know the details of or have a partner with a pension. For example, 60% of 50 to 64 year olds knew that their partner had a pension, 52% of 35 to 49 year olds, 23% of 25 to 34 year olds and 6% of 15 to 24 year olds.

This trend was also noted amongst the current non-contributors to pensions, However, there was less awareness recorded of partner's pensions. 53% of 50 to 64 year olds knew that their partner had a pension, in comparison to 37% of 35 to 49 year olds, 17% of 25 to 34 year olds and 5% of 15 to 24 year olds.

With regard to the details of their partner's pension, their partner's contributions, the partner's employer's contribution and the expected benefits, a high proportion of respondents did not know any of the details. Where respondents were aware of payments to a pension, the awareness was usually based upon a cash sum rather than a percentage of the partner's gross annual wage. Awareness, as noted earlier was greatest in the older age groups.

Over a third of respondents (37%) who were currently putting money into a pension had decided on a target age for retirement. The average was 62.3 years. The average target age for retirement for respondents with no current payments into a scheme was 63 years.

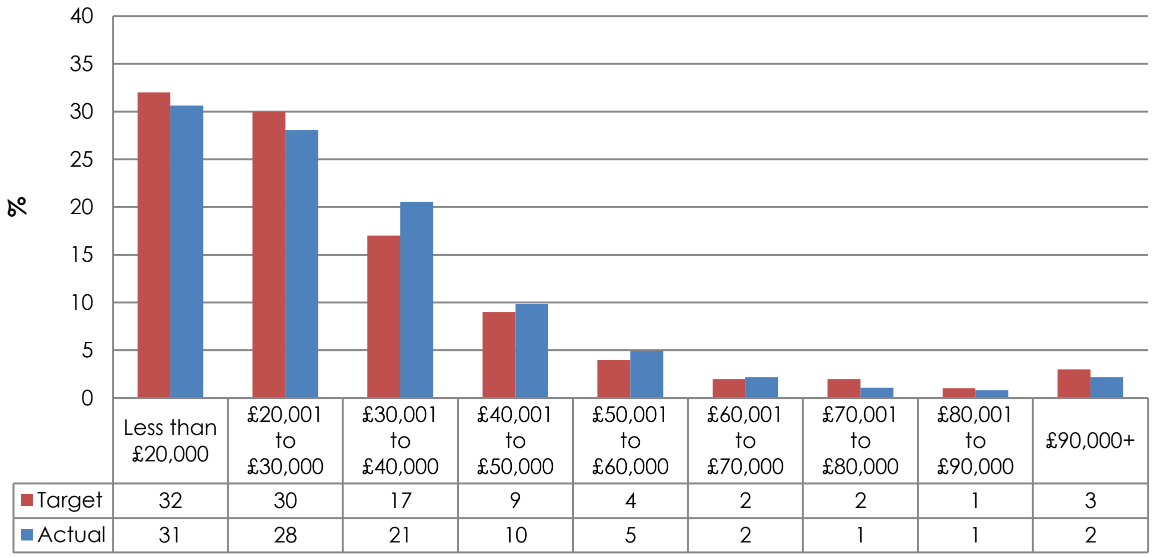
For those who stated that they did not currently believe that they were setting aside sufficient sums for their retirement the most frequent answers from those who were contributing to a pension was to either do 'nothing' (32%) or to increase contributions to their current pensions (32%). For the non-contributors to current pensions, 52% stated 'nothing', whilst the next most frequently indicated intention was to begin contributing to a new pension.

Results

Total survey sample overview

The survey sample was targeted according to income brackets, or gross annual salary of the individual as provided by the Policy Council. 1000 surveys were included in the analysis providing a margin of error of ±3%. A good representation of actual sample population income was achieved in comparison to the target (Figure 1). Therefore, confidence in the representative nature of the results is enhanced.

Sample population income profile - gross salary of individual

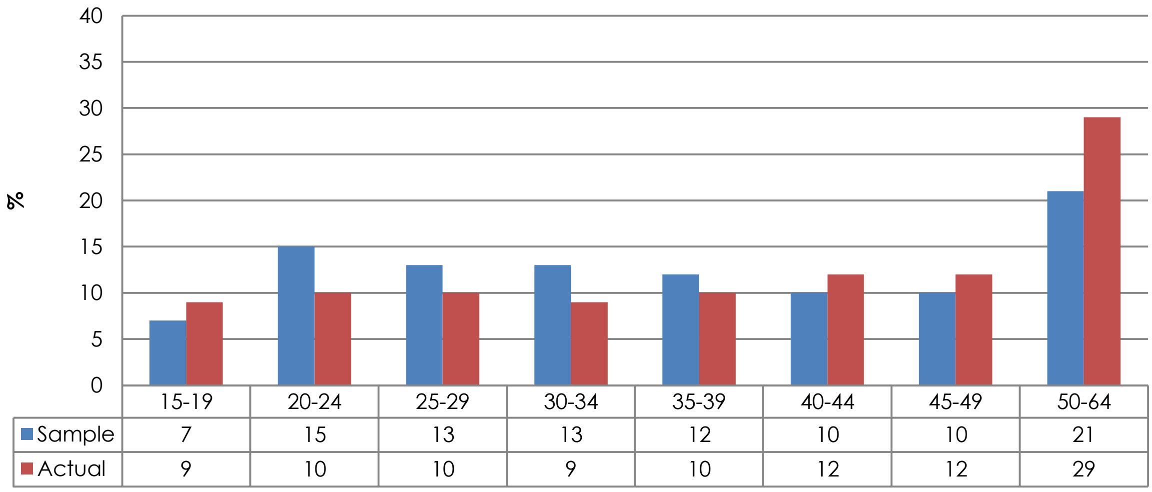


	Less than £20,000	£20,001 to £30,000	£30,001 to £40,000	£40,001 to £50,000	£50,001 to £60,000	£60,001 to £70,000	£70,001 to £80,000	£80,001 to £90,000	£90,000+
Target	32	30	17	9	4	2	2	1	3
Actual	31	28	21	10	5	2	1	1	2

Figure 1

Age profile

Age profile of sample population



	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-64
Sample	7	15	13	13	12	10	10	21
Actual	9	10	10	9	10	12	12	29

Figure 2

A good range of ages were sampled following a defined income profile (Figure 2). The total number of 50 to 64 year olds was slightly less than the local population, but the emphasis for this research was on younger age groups (i.e. those who were going to be a pension concern in the long-term rather than in the next ten to fifteen years).

Residential status

With regard to residential status, over 54% of respondents were home-owners, with 32% of these being mortgage free and 68% with a mortgage. 21% of respondents resided in privately let residences and 5% in States' rental properties. 21% were currently residing with family or parents (these individuals were primarily in the youngest three age categories).

Housing status

95% of respondents were locally qualified residents, the remainder were housing licence holders, with an average of 6.7 years remaining on their licence.

Employment status

Four out of five (82%) respondents were employed or self-employed, 6% were unemployed, 5% were students, and 4% had retired earlier than 65. Of the 3% covered in the 'other' category, these included housewives, carers at home, and those who were not working due to ill health (and may be on disability benefit). One point of note was that a number of those who may be classified as 'unemployed' could also have been categorised as housewives depending on their own personal definition of their employment situation.

Profiling of current contributors to pensions

Overall 45% of respondents currently contribute to a personal or company pension scheme. 55% were not contributing at the present time to a pension (although 16% of the non-contributors had previously been contributing to a scheme).

Of those who were contributing to a scheme, just under 40% had a personal scheme, 50% a company scheme, and 10% had both a company and a personal scheme to which they currently contributed.

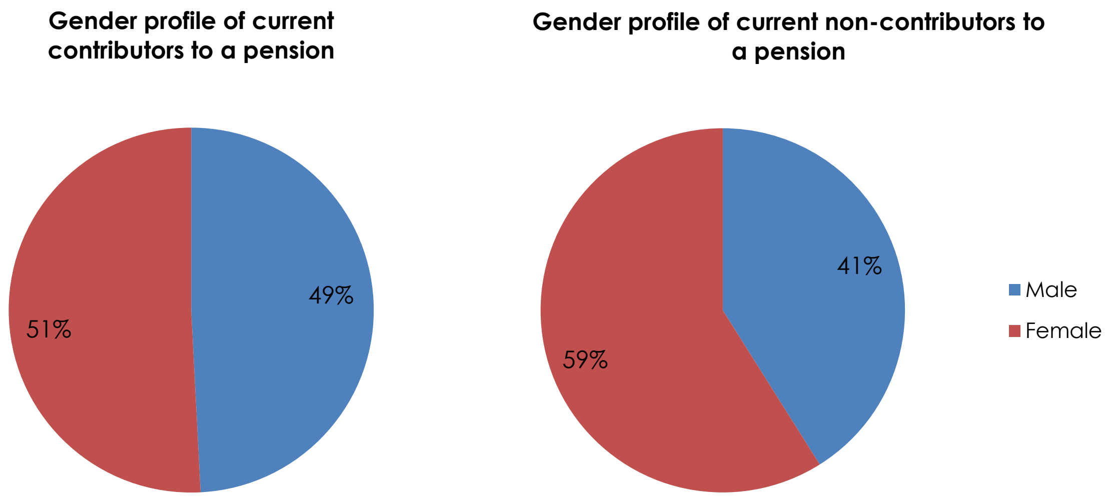
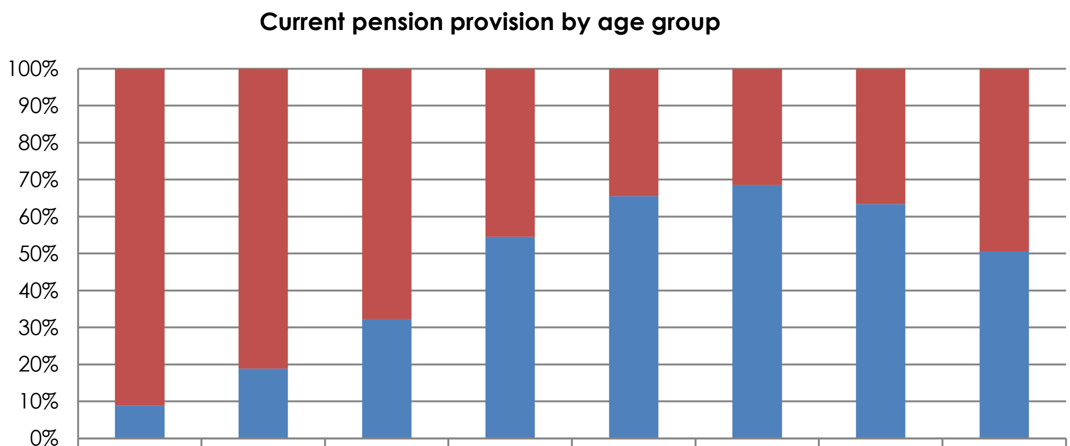


Figure 3

When this is analysed by gender, it can be seen that male respondents (49%) were more likely than the female respondents (41%) to currently be contributing to a pension (Figure 3).



	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-64
No pension	91	81	68	45	34	31	37	50
Pension	9	19	32	55	66	69	63	50

Figure 4

When the data is compared by age group, the likelihood of currently contributing to a pension increases with age up to the 40 to 44 year age group, with a peak of almost 70%. After this age, there is a slight reduction in the likelihood of contributing. This was for a variety of reasons - some older respondents indicated that they:

- had alternative investments,
- were relying on downsizing their property, or
- were relying on a partners' pension rather than holding their own.

Some had already cashed in their pension and re-invested it elsewhere.

The employment situation of respondents and their current pension provision is displayed in Figure 5.

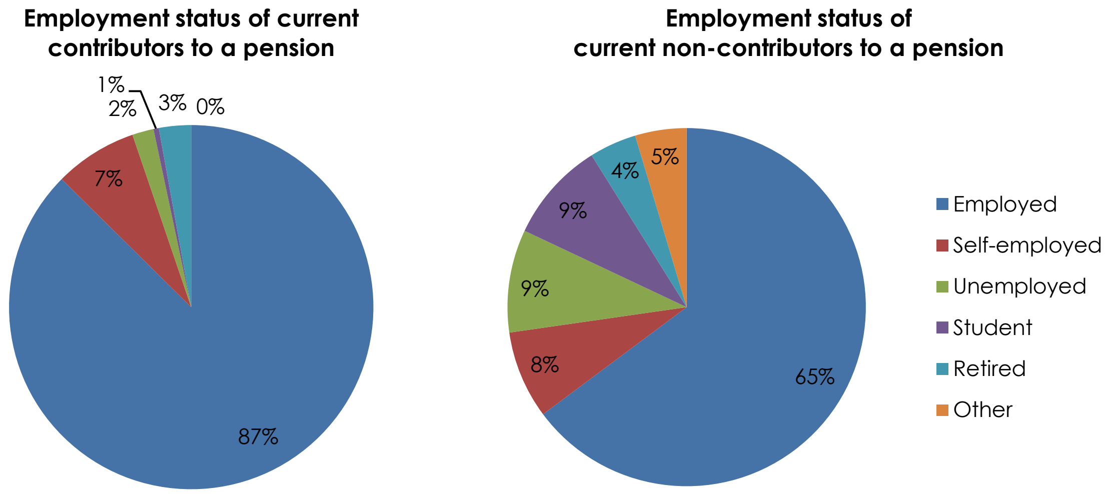
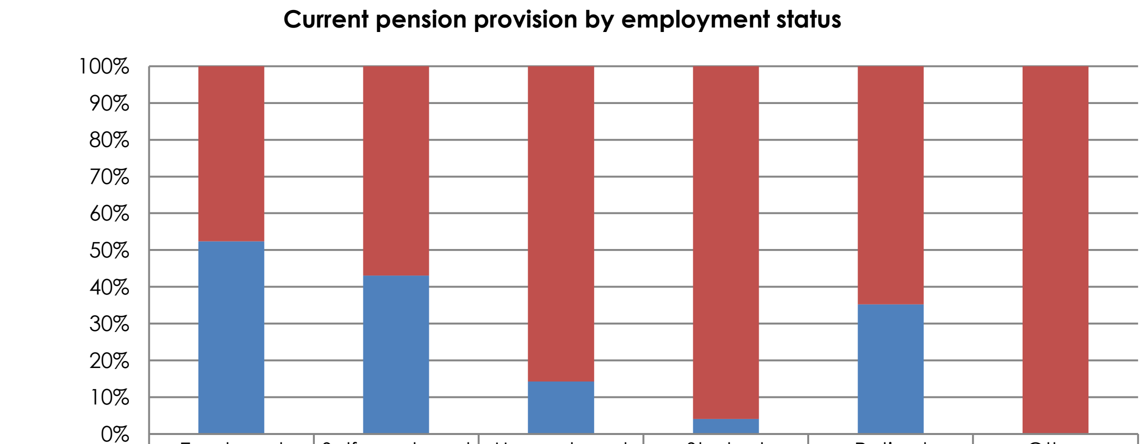


Figure 5



	Employed	Self-employed	Unemployed	Student	Retired	Other
No Pension	48	57	86	96	65	100
Pension	52	43	14	4	35	0

Figure 6

When the distribution of current pension provision is compared to employment, there is a greater likelihood that if one is employed rather than self-employed that one would be contributing to a pension (Figure 6). Unemployed respondents and students were less likely to be contributing to a pension, with those on unemployment benefit often passing comment that they were not able to receive/claim benefits if they were currently contributing to a pension.

Housing tenure

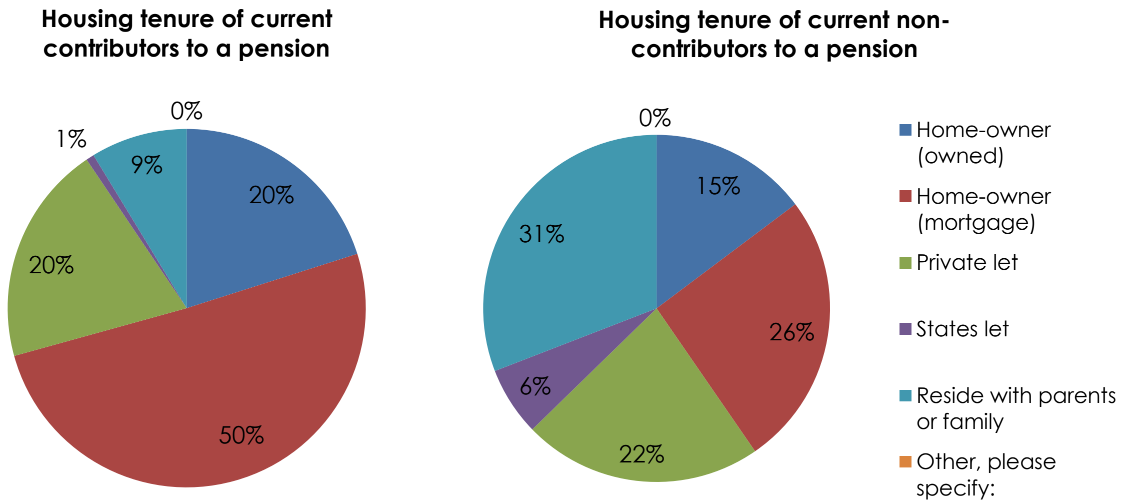
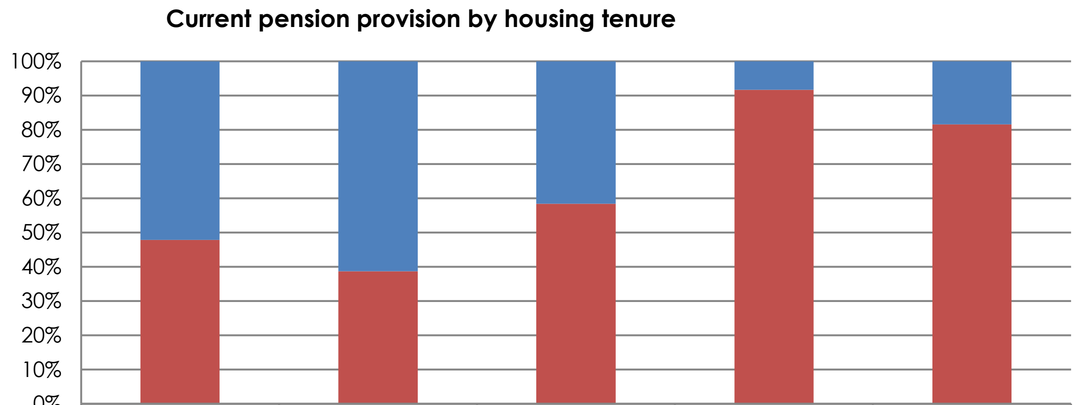


Figure 7

Homeowners accounted for over 70% of those currently contributing to a pension (Figure 7), those with a mortgage being slightly more likely to also be contributing. Residents in States let property were the least likely to be contributing to a pension (8%), followed by those residing with parents or family (19%), and then private let residents (42%) (Figure 8).



	Home-owner (owned)	Home-owner (mortgage)	Private let	States let	Reside with parents or family
Pension	52	61	42	8	18
No Pension	48	39	58	92	82

Figure 8

Housing status

95% of total respondents were locally qualified residents, the remainder were housing licence holders. With regard to the number living on a licence the average number of years' on the licence or resident was 6.7 years with a median and modal value of 5 years. The breakdown of housing status by current pension provision is shown in Figure 9.

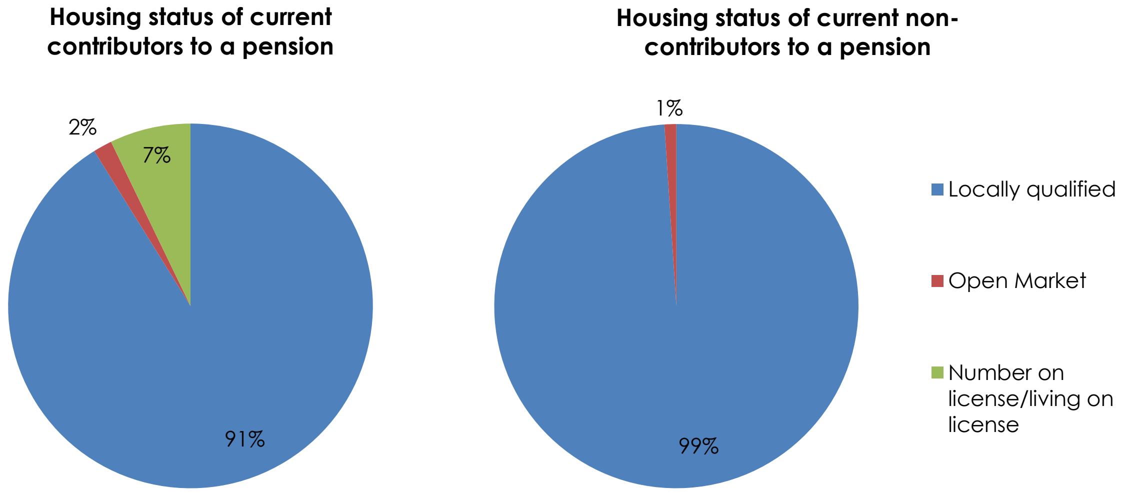


Figure 9

Pension distribution by income

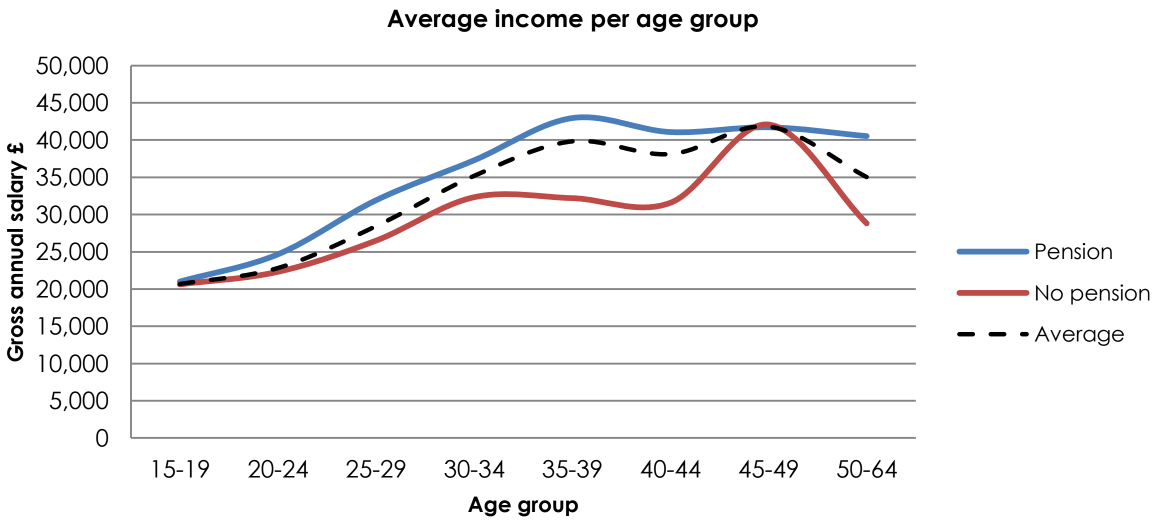
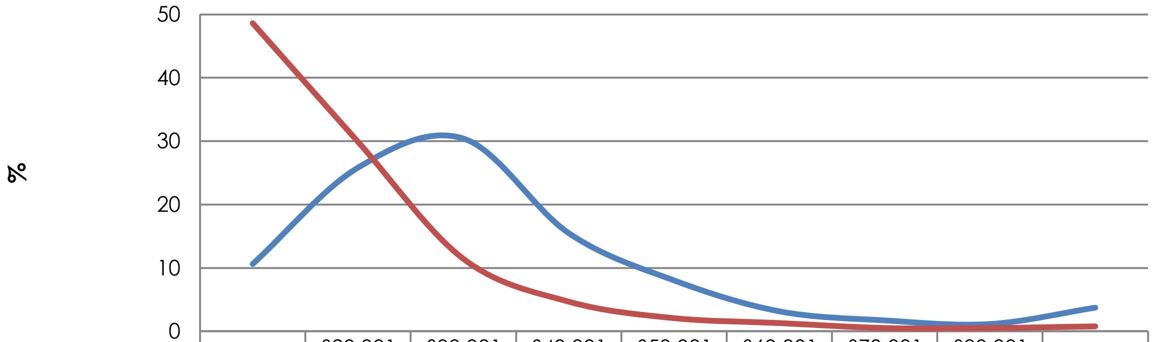


Figure 10

The profile of average income per age group when considering current pension contribution is indicated in Figure 10. The general trend up to the age of 44 years appears to be that those who are not currently contributing to a pension are on a slightly lower gross annual wage than those who are contributing to a pension. The difference in annual wage seems to increase up to the 40 to 44 year age group, by which time the figure has plateaued. There is a sudden rise in average income for non-contributors in the 45 to 49 year age group to match that of the current pension contributors. This falls away again for the 50 to 64 year age group. Contributing to this decrease included the number of people who have already retired or opted to work part-time or reduced hours.

Current pension provision by income distribution

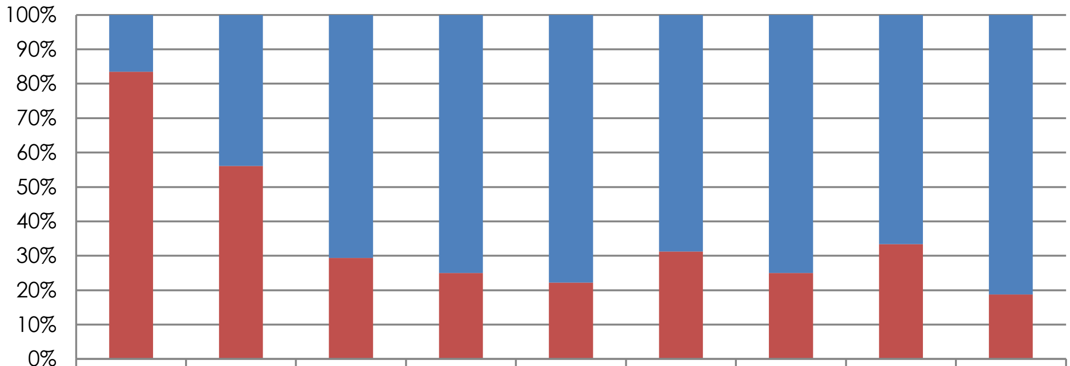


	Less than £20,000	£20,001 to £30,000	£30,001 to £40,000	£40,001 to £50,000	£50,001 to £60,000	£60,001 to £70,000	£70,001 to £80,000	£80,001 to £90,000	£90,000+
Pension	11	26	30	15	8	3	2	1	4
No Pension	49	30	11	5	2	1	1	1	1

Figure 11

When the current pension provision status of respondents is analysed by their income, it can be seen that there is a threshold income within the £20,000 to £30,000 gross annual wage bracket when there is a greater likelihood for the individual to be currently contributing to a pension (Figure 11).

Current pension provision by income



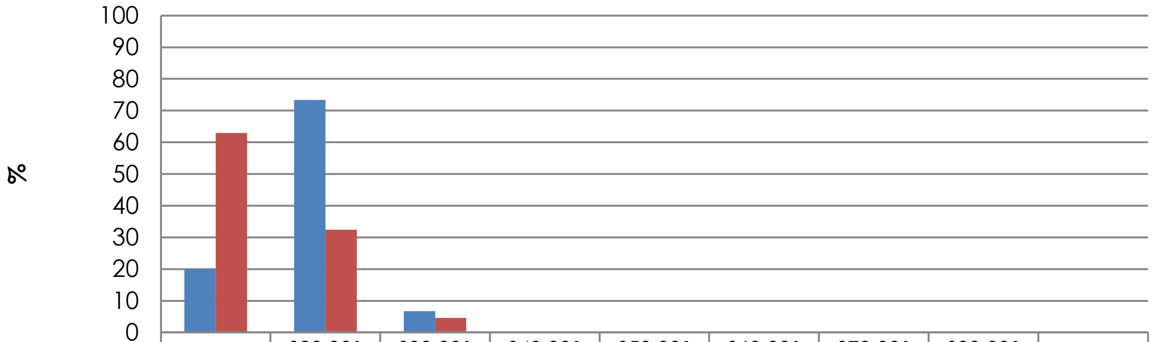
	Less than £20,000	£20,001 to £30,000	£30,001 to £40,000	£40,001 to £50,000	£50,001 to £60,000	£60,001 to £70,000	£70,001 to £80,000	£80,001 to £90,000	£90,000+
Pension	17	44	71	75	78	69	75	67	81
No Pension	83	56	29	25	22	31	25	33	19

Figure 12

Once an individual is earning over £30,000 gross annually, approximately 70% or over are more likely to currently be contributing to a pension (Figure 12).

This trend is seen further in 20 to 24 year old age groups and the 30 to 34 year age groups (Figures 13 and Figure 14). The 40 to 44 year age group demonstrate a departure from the trend observed in the other age groups, although 68% of individuals earning £30,000 or over are likely to currently be contributing to a pension in comparison to 58% of those who are not currently contributing earning this amount.

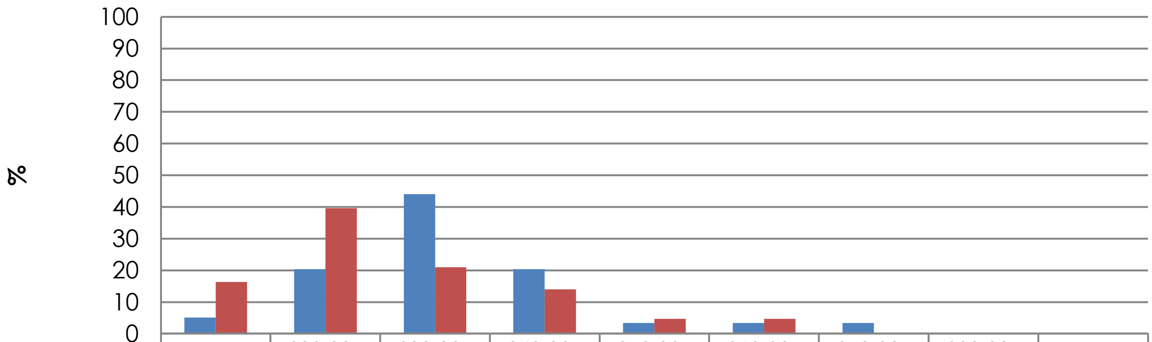
Income and pension contribution for 20 to 24 year age group



	Less than £20,000	£20,001 to £30,000	£30,001 to £40,000	£40,001 to £50,000	£50,001 to £60,000	£60,001 to £70,000	£70,001 to £80,000	£80,001 to £90,000	£90,000+
Pension	20	73	7	0	0	0	0	0	0
No pension	63	32	5	0	0	0	0	0	0

Figure 13

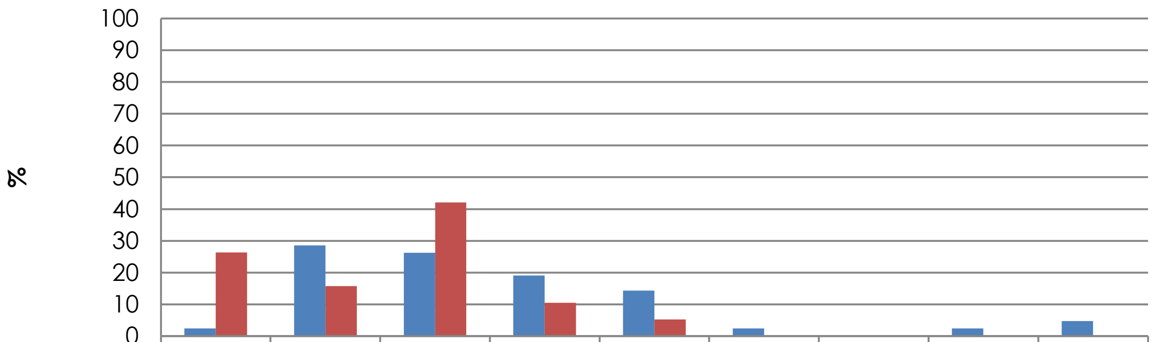
Income and pension contribution for 30 to 34 year age group



	Less than £20,000	£20,001 to £30,000	£30,001 to £40,000	£40,001 to £50,000	£50,001 to £60,000	£60,001 to £70,000	£70,001 to £80,000	£80,001 to £90,000	£90,000+
Pension	5	20	44	20	3	3	3	0	0
No pension	16	40	21	14	5	5	0	0	0

Figure 14

Income and pension contribution for 40 to 44 year age group



	Less than £20,000	£20,001 to £30,000	£30,001 to £40,000	£40,001 to £50,000	£50,001 to £60,000	£60,001 to £70,000	£70,001 to £80,000	£80,001 to £90,000	£90,000+
Pension	2	29	26	19	14	2	0	2	5
No pension	26	16	42	11	5	0	0	0	0

Figure 15

Table 1

Table indicating current contributors to pension by income

Option	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-64
Less than £20,000								
£20,001 to £30,000								
£30,001 to £40,000								
£40,001 to £50,000								
£50,001 to £60,000								
£60,001 to £70,000								
£70,001 to £80,000								
£80,001 to £90,000								
£90,000+								

Key

0 to 10%

10 to 25%

25 to 50%

50 to 75%

76 to 90%

91 to 100%

The main issues raised are the affordability of pensions especially whilst trying to purchase a property or raising children. This has resulted in a proportion of respondents putting current pension plans on hold to permit greater flexibility of household expenditure.

Alternative investments and arrangements are often investigated but there are indications that younger age groups are relying on inheritance from family members or assets from property sales to boost savings and to provide income in old age. The effects of affordability by income and age can be seen in Table 1 above. There is a definite "hot zone" of those that are currently contributing to pensions as a whole out of the entire sample population.

Pension arrangements by employment sector

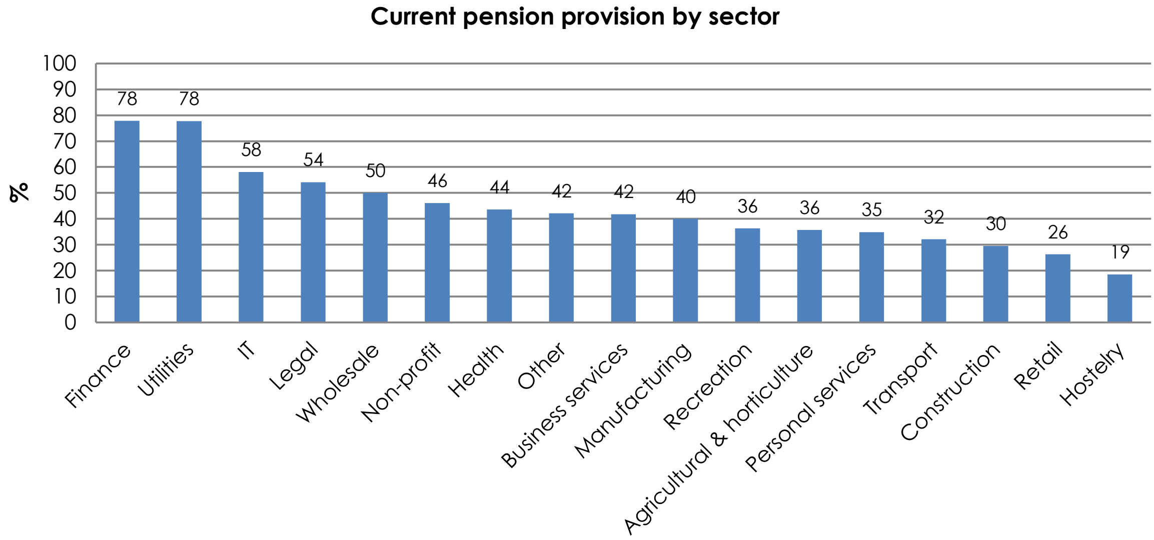


Figure 16

The sector in which the individual is working also greatly influences the current contribution to a pension. This was headed overall by the finance and utilities sectors (Figure 16). A further breakdown of whether the individual is contributing to either a company or a private pension is depicted in Figure 17.

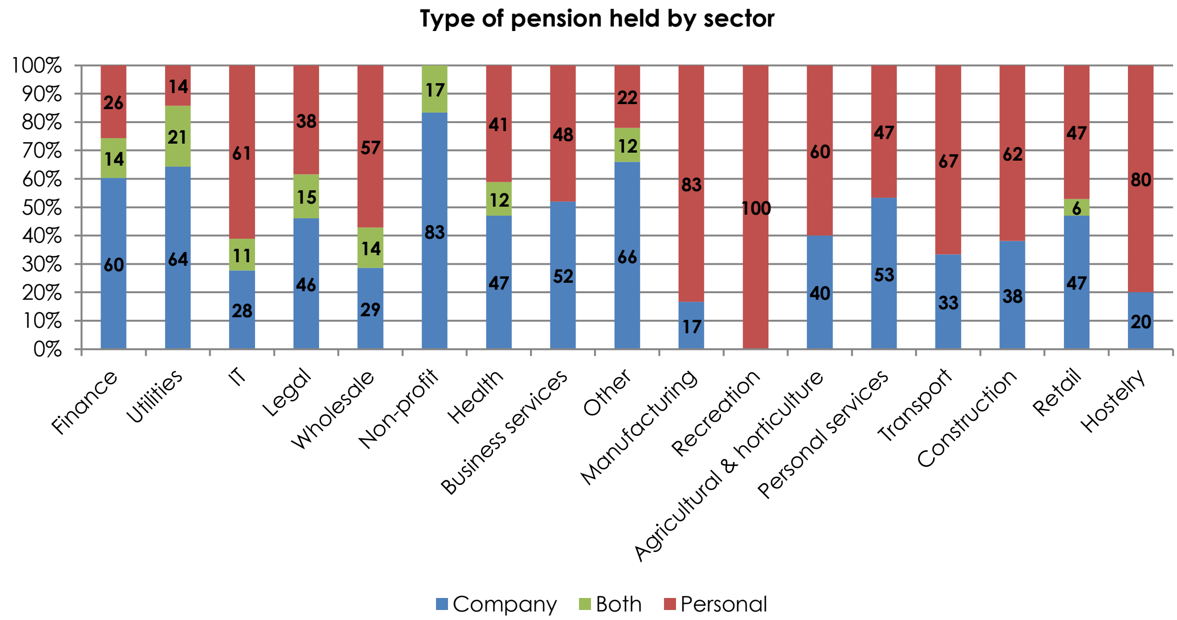


Figure 17

There is greater likelihood for an individual to be contributing to a company pension if working in the finance, utilities, and non-profit sectors. Those employed in the recreation, manufacturing, hostelry and IT sectors were far more likely to be currently contributing to a personal pension.

Pension type

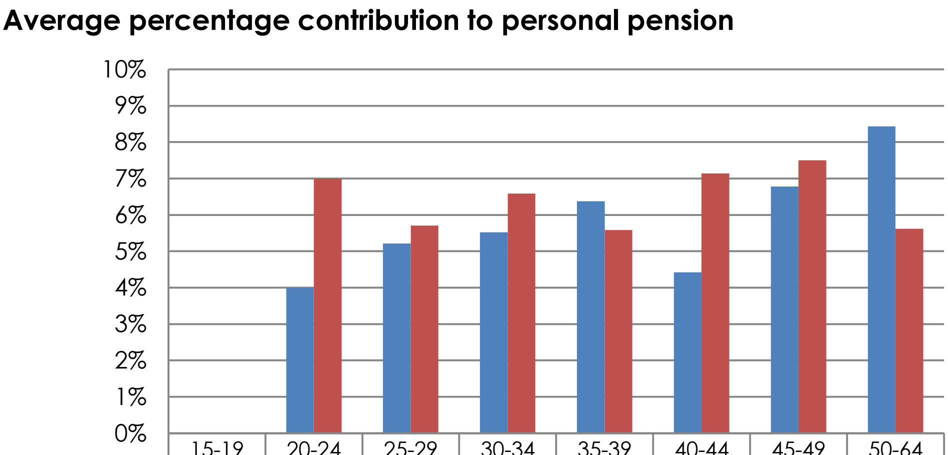
The current pension type held by those who were currently contributing to a scheme is displayed in Table 2. Younger age groups were more likely to hold a company pension than a private pension in comparison to older respondents (Table 2).

	Pension type %		
Age group	**Company**	**Personal**	**Both**
15-24	75	14	11
25-34	60	34	6
35-49	48	42	10
50-64	37	49	14
Total average	**51**	**39**	**10**

Table 2

Personal pensions

Contributions to personal pensions as a percentage of gross annual salary averaged at approximately 6.7% per pension (Figure 18). However the amounts paid in varied from 2% to 30%. Company contributions to personal pensions averaged at approximately 6% where relevant.

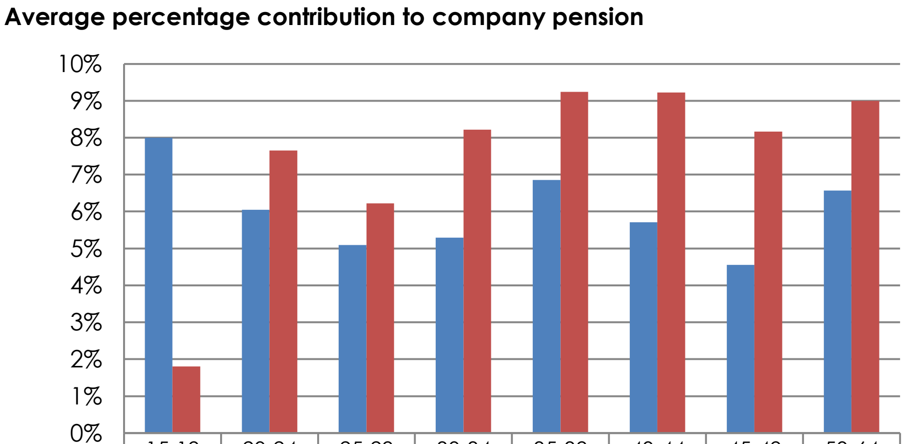


	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-64
Average personal contribution	0%	4%	5%	6%	6%	4%	7%	8%
Average company contribution	0%	7%	6%	7%	6%	7%	8%	6%

Figure 18

Company Pensions

On average, 22% of company pensions held were non-contributory for the individual. The average contribution by individuals that did contribute to their pension was 5.9% of their gross annual income, with company contributions attaining a mean of 8.3%. Contributions by both individuals and companies ranged from 2% to 18% (where contributions were applicable).



	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-64
Average personal contribution	8%	6%	5%	5%	7%	6%	5%	7%
Average company contribution	2%	8%	6%	8%	9%	9%	8%	9%

Figure 19

The average personal contribution to company pensions is 5.9% of their gross annual income. The average personal contribution percentage is within the 5% to 7% range from the age of 20 years up to 64 years, slightly higher in the 15 to 19 years age group. Company contributions were greatest at the ages of 35 to 44 years and 50 to 64 years at 9% of the gross annual wage on average. Total contributions (both company and personal) were greatest in the 35 to 39 year age group, followed by the 40 to 44 and the 50 to 64 year age groups.

	Average personal contribution	Average company contribution
Personal pension	6.6%	6.2%
Company pension	5.9%	8.3%

Table 3

Duration of contribution

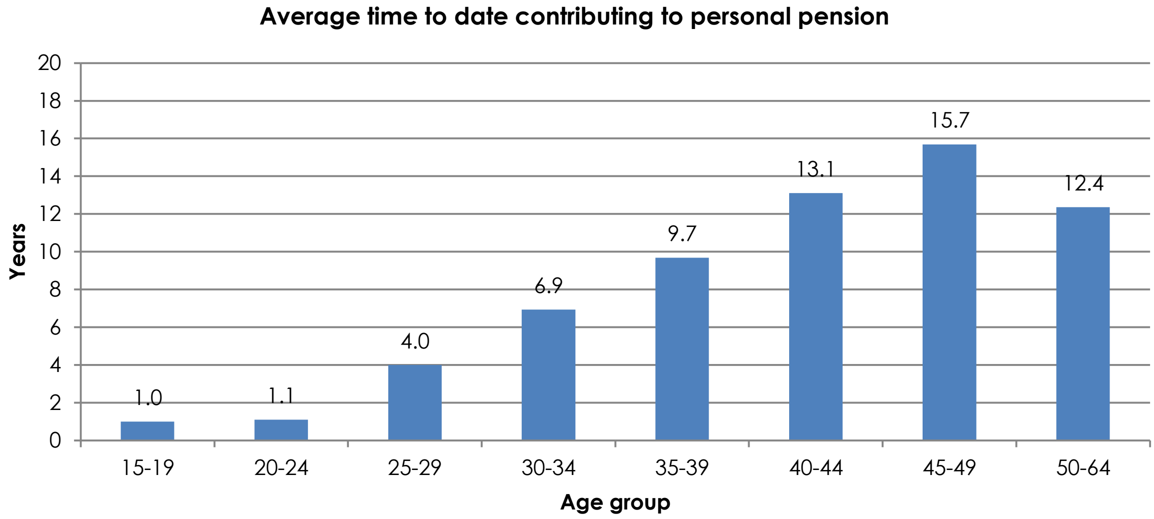


Figure 20

With regard to those that knew the details of their personal pension contributions, the average length of time that people had contributed to personal pensions was 12.5 years (Figure 20). The older age groups who would have had potentially more time in employment were more likely to have been contributing for longer periods. However, in the 50 to 64 year age groups, this average duration of contributions had reduced in comparison to the 45 to 49 age group. A greater number of individuals in this 50 to 64 year age group had started a private pension scheme more recently than respondents in the 45 to 49 years age group. Possible explanations and reasons provided included that many had already finished contributing to a pension scheme, their schemes were now frozen, and some individuals have started new ones or may hold other alternative investments.

The average time contributing to a company pension demonstrated a similar trend to that observed in personal pensions (Figure 21). However, the average duration was less for all age groups apart from the under 25s.

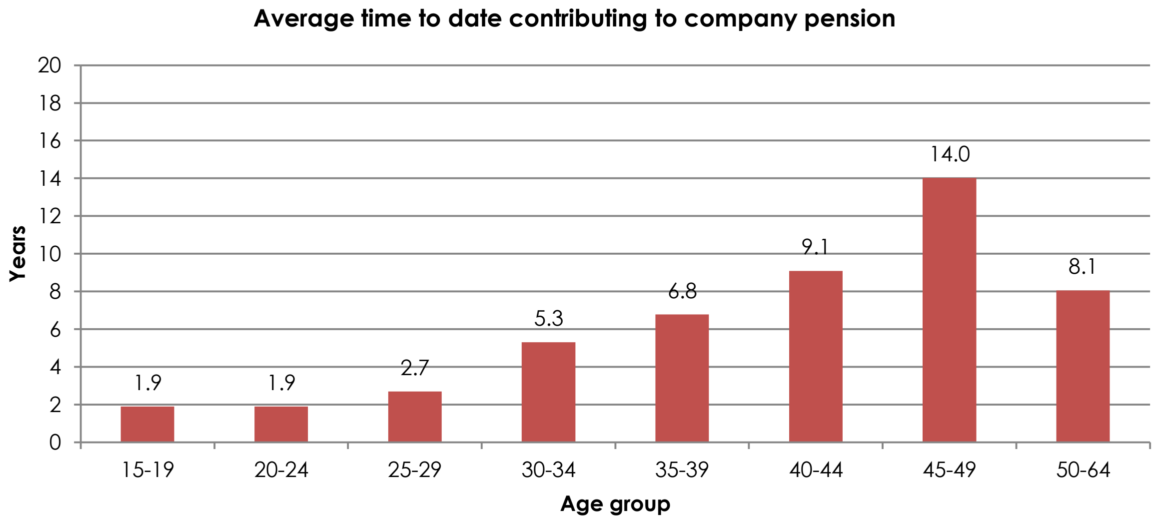
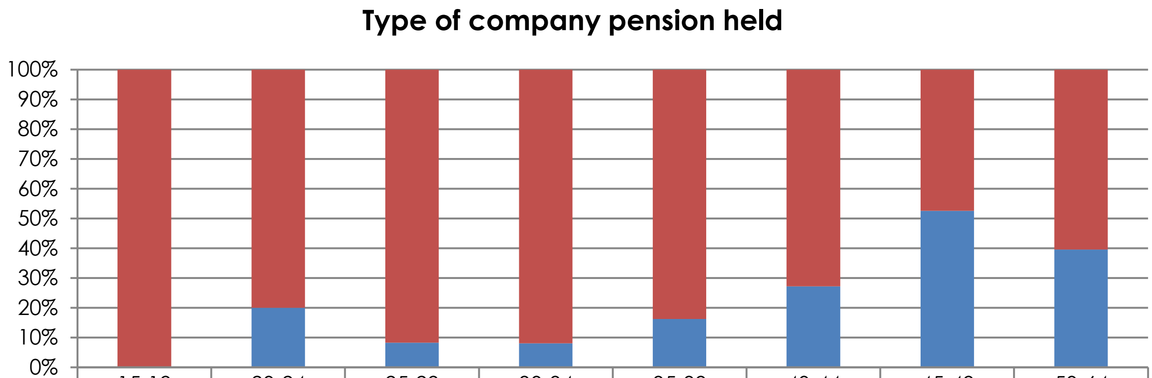


Figure 21

Defined benefits or defined contributions



	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-64
DC	100	80	92	92	84	73	47	60
DB	0	20	8	8	16	27	53	40

Age group

Figure 22

The type of company pension held was also influenced by age group. The proportion of those receiving a defined benefits (DB) company pension was greatest in the 45 to 49 age group. Younger age groups were more likely to have a defined contributions (DC) pension. The lower proportion of DC pensions in the 50 to 64 years age group (than the 45 to 49 age group) could be due to the more recently started pension (Figure 21) which may affect the type of company pension held (Figure 22).

Personal Contributions to Company Pension

11% of respondents voluntarily contribute more than the standard rate towards their company pension. 53% contribute at a standard rate whilst 31% did not know whether their contributions are standard. Just over 5% of these company pensions were non-contributory. Respondents in the 25 to 34 and the 50 to 64 age groups demonstrate a greater tendency to pay more than the standard rate towards their company pension (Figure 23). Reasons given by respondents in the 35 to 49 age group indicated they would like to pay more but are waiting for children to grow up or pay off more towards their mortgage.

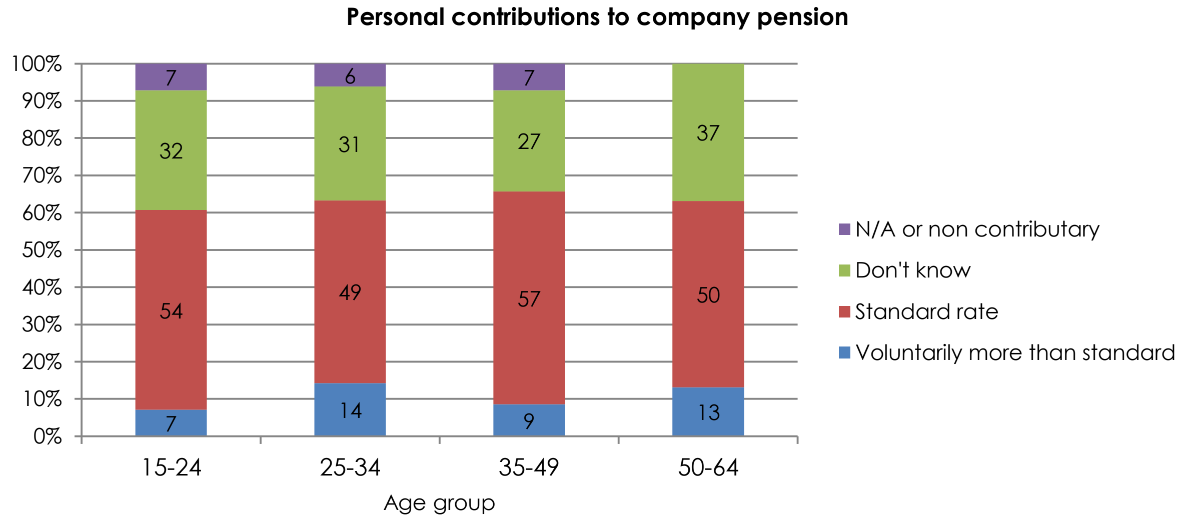


Figure 23

Current pension contributors

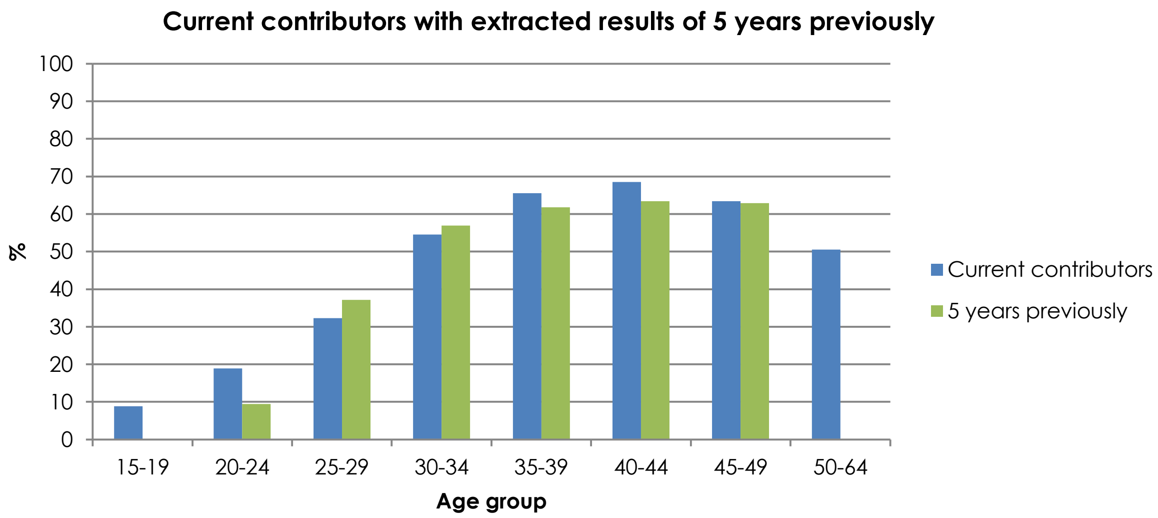


Figure 24

If the number of respondents currently contributing is analysed by age group and aged by 5 years, the data indicates that the percentage of individuals over the age of 25 currently contributing to a pension is very similar to 5 years previously (Figure 24). This analysis included the responses of current non-contributors who may have since ceased payment to a scheme. The younger age groups had pensions that were generally of less than 5 years in duration to date. Therefore the proportion appears depleted in these age groups.

Previous company schemes

Almost a quarter (24%) of respondents who were currently contributing to a pension did have previous schemes they had paid into. Of those who were not currently contributing to a pension, 16% had previous schemes and of these, representation was highest in the 35 and over age groups (Figure 25).

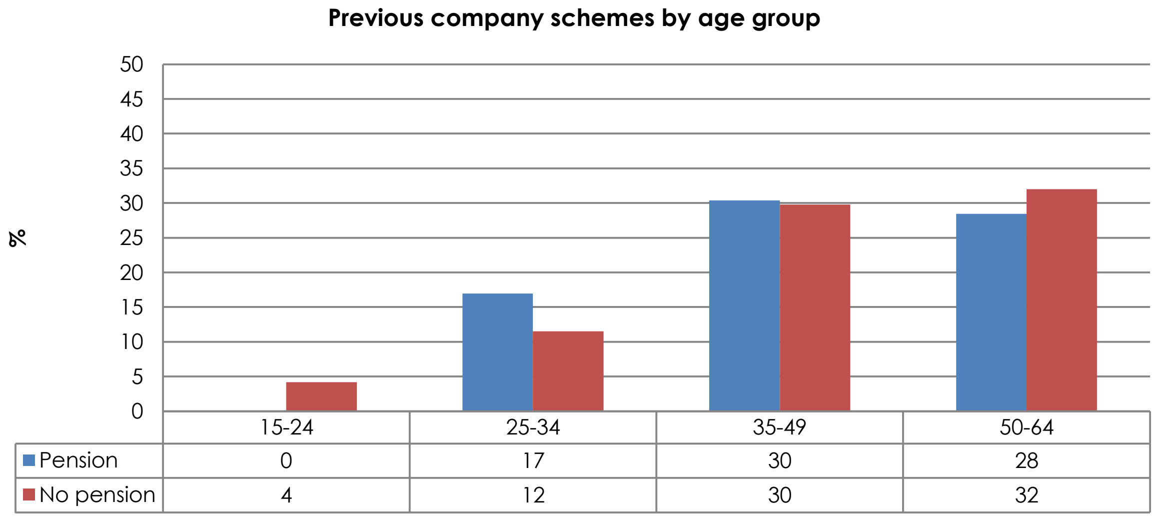


Figure 25

Reasons for not currently contributing

For the 55% who do not currently contribute to a pension, the reasons given for not having any arrangements at the present time include (in descending order):

- No company scheme (26%)
- Can't afford payments (24%)
- Other (24%)
- Never got round to it (18%)
- Too young (16%)
- Will use spouses pension (7%)

The further breakdown of these responses by age group are as follows (Table 4):

Age group	No company scheme %	Will use spouse's pension %	Too young %	Can't afford payments %	Never got round to it %
15-19	10	0	71	18	13
20-24	30	1	24	23	22
25-29	29	0	13	29	27
30-34	33	2	0	29	24
35-39	23	15	0	35	23
40-44	18	18	0	36	14
45-49	35	19	0	27	4
50-64	28	19	0	15	6

Table 4

The reasons given by younger age groups were primarily linked to their age and affordability of payments. An average of 26% across all age groups indicated the fact that there was no company scheme as a reason. This was matched with regard to an average score by affordability of the payments.

The likelihood of using a spouse's pension increased with age group particularly – more amongst female respondents than male.

16% of current non-contributors had previously been contributing to a scheme. Details are contained in Appendix 2.

Partners and Pensions

When asked whether the respondent's partner had a pension, 16% did not have a spouse or partner and, therefore, results are analysed on only those who had a partner.

With regard to those who were currently contributing to a pension themselves, the trend was that their partner was more likely to currently have a pension as well (49% in comparison to the 28% of current non-contributors to pensions (Table 5).

	Partners with pension	
Response	**Current contributors %**	**Non-contributors %**
Yes	49	28
Don't know	8	13
No	43	59

Table 5

However, noticeably of the 49% of those who knew that their partners had a pension, the older the respondent - the more likely they were to know the details of or have a partner with a pension. For example, 60% of 50 to 64 year olds were aware that their partner had a pension, 52% of 35 to 49 year olds, 23% of 25 to 34 year olds and 6% of 15 to 24 year olds.

This was replicated in the current non-contributors to pensions, with a similar trend observed but with less awareness recorded of partners' pensions. 53% of 50 to 64 year olds knew that their partner had a pension, in comparison to 37% of 35 to 49 year olds, 17% of 25 to 34 year olds and 5% of 15 to 24 year olds (Table 6).

	Partners with pension (proportion of age group)	
Age group	**Current contributors %**	**Non-contributors %**
15 to 24 years	6	5
25 to 34 years	23	17
35 to 49 years	52	37
50 to 64 years	60	53

Table 6

With regard to the details of their partner's pension, their partner's contributions, the partner's employer's contribution and the expected benefits, a high proportion of respondents did not know any of the details (Table 7).

	'Don't know' responses	
Topic	**Current contributors %**	**Non-contributors %**
Partner's contribution	68	74
Partner's employer contribution	68	53
Expected benefits	76	76

Table 7

Where respondents were aware of payments to a pension, this awareness was usually based upon a cash sum rather than a percentage of the partner's gross annual wage. Awareness, as noted before was greatest in the older age groups.

Age for retirement

	Set an age for retirement	
Response	**Current contributors %**	**Non-contributors %**
Yes	37	21
No	63	79

Table 8

Over a third of respondents (37%) who were currently putting money into a pension scheme had decided on a target age for retirement. The average was 62.3 years, but had peaks at 50, 55, 60 and 65 years. 65 was the most frequent age named. The average age for retirement for respondents with no current payments into a scheme was 63 years (Figure 26).

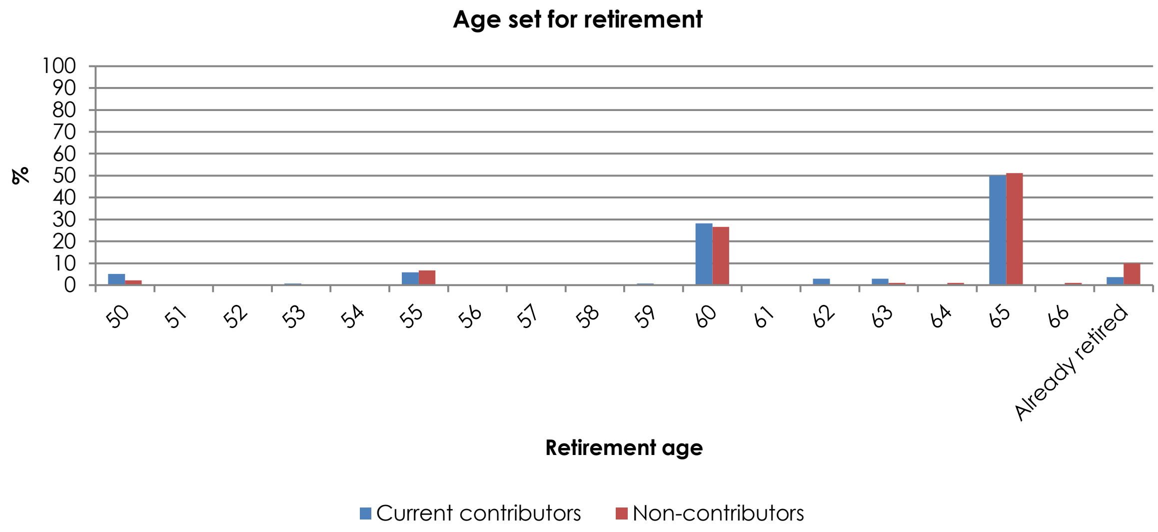
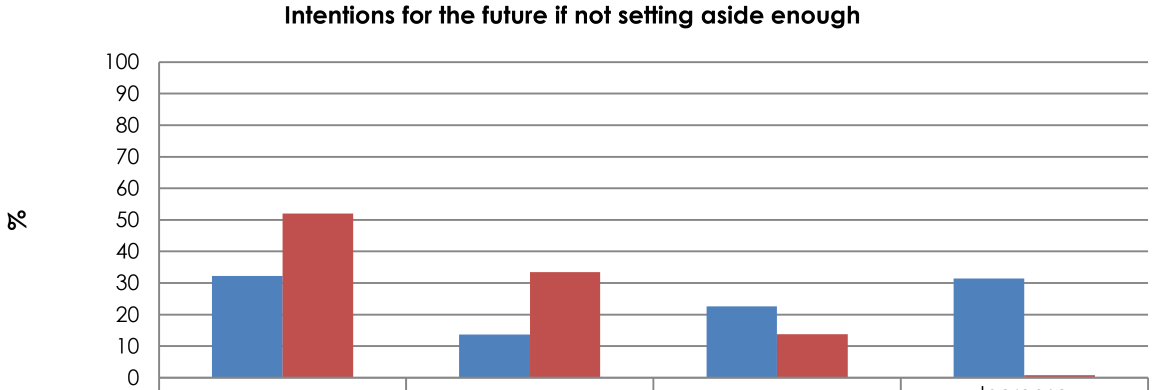


Figure 26

Future intentions



	Nothing	Begin contributing to new pension	Retire later than currently planned	Increase contributions to current pension
Pension	32.3	13.7	22.6	31.5
No Pension	52.0	33.5	13.8	0.8

Figure 27

For those who stated that they did not currently believe that they were setting aside sufficient sums for their retirement, the most frequent answers from those who were contributing to a pension was to either do 'nothing' (32%) or to increase contributions to their current pensions (32%) (Figure 27). For the non-contributors to current pensions, 52% stated 'nothing', whilst the next most frequently indicated intention was to begin contributing to a new pension.

In addition to the options covered in Figure 27 above, there was a fair proportion that indicated 'other' in response their intentions, many appear to be relying on downsizing houses in future, aiming to capitalise on housing prices. Further comments are available in Appendix 2.

Appendix 1

PRIVATE SECTOR PENSION SURVEY

Island Analysis has been contracted by the States of Guernsey Policy Council to carry out research into private sector pension provision.

Answers to the following questions are required from individuals currently working in the ***private sector****. All surveys are conducted in accordance with the Market Research Society (MRS) guidelines, answers are confidential.*

General Information – please place a tick next to all that apply

Gender	
Male	
Female	

Age Group	
15-19	
20-24	
25-29	
30-34	
35-39	
40-44	
45-49	
50-64	

Please indicate your residential status	
Home-owner (owned)	
Home-owner (mortgage)	
Private let	
States let	
Reside with parents/family	
Other, please specify: …………………………………………………………	

Please indicate your housing status	
Locally qualified	
Housing license holder (please indicate number of years of license) ………………	

Please indicate your employment status	
Employed	
Self-employed	
Unemployed	
Student	
Retired	
Other, please specify: ……………………………………………	

What is your approximate gross annual salary?			
Less than £20,000		£60,001 - £70,000	
£20,001 - £30,000		£70,001 - £80,000	
£30,001 - £40,000		£80,001 - £90,000	
£40,001 - £50,000		£90,000+	
£50,001 - £60,000		Prefer not to answer N/A	

In which economic sector do you work?			
Agriculture & Horticulture		Manufacturing	
Business Services		Non-profit	
Construction		Personal services	
Finance		Recreation	
Health		Retail	
Hostelry		Transport	
IT		Wholesale	
Legal		Utilities	
		Other, please specify: ………………………………………………………	

About your pension

1. Do you and/or your employer currently contribute to a personal or company pension scheme?

Yes	No

If yes, please go to Question 3

2. What are your reasons for having no current pension arrangements:

No company scheme	Too young	Never got round to it
Will use spouse's pension	Can't afford payments	Other, please specify: ………………………………………………

Please go to Question 4

3. Is this a personal scheme or a company scheme?

Personal	Company	Both

If a PERSONAL scheme:

3(a)	**How much do <u>you</u> contribute per month? (i.e. % of salary or £s)**	**% or £**
3(b)	**How much does <u>your employer</u> contribute to this scheme? (i.e. % of salary or £s)**	**% or £**
3(c)	**How long have you been in this scheme?**	**…………years**
3(d)	**Do you know the expected benefits are? (i.e. % of final salary or £s)**	**% or £**

If a COMPANY scheme:

3(e)	**Is this a defined benefit (DB) or defined contribution (DC) scheme? ***	**☐ DB ☐ DC**
3(f)	**How much do <u>you</u> contribute per month? (i.e. % of salary or £s)**	**% or £**
3(g)	**Is this the standard rate or do you voluntarily contribute more than the minimum?** ………	
3(h)	**How much does <u>your employer</u> contribute to this scheme? (i.e. % of salary or £s)**	**% or £**
3(i)	**How long have you been in this scheme?**	**…………years**
3(j)	**Do you know the expected benefits are? (i.e. % of final salary or £s)**	**% or £**

**Defined contribution is where contributions are set and benefits depend on the value at retirement, defined benefit is where retirement benefits are set in advance (usually as a proportion of final salary). Defined benefit schemes are no longer common in the private sector.*

4. Do you have any other pension arrangements such as previous company schemes?

Yes (please provide details below)	No

………

………

5. Does your spouse or partner have any private pension arrangements?

Yes	No	Don't know

If Yes, do you know any of the details of your partner's pension?

If Yes, do you know;				Don't know
5(a)	How much do they contribute per month? (ie % of salary or £s)	%	£	☐
5(b)	Does their employer contribute to this scheme? (ie % of salary or £s)	%	£	☐
5(c)	How long have they been in this scheme?	…………years		☐
5(d)	Do you know the expected benefits? (ie % of final salary or £s)	%	£	☐

6. Have you set an age for retirement? (please specify)

Yes (please specify age: ………………………)	No

7. Do you think that you are presently setting aside sufficient sums for your retirement?

Yes	No	Don't know

8. If no, what do you intend to do?

Nothing	Retire later than currently planned	Increase contributions to current pension	Begin contributing to new pension	Other (please specify):

Additional Comments

Thank you for taking the time to participate in the survey. If you have any further comments with respect to pension provision in Guernsey which was not explicitly asked above please state them below.

……

……

Appendix 2

Current contributors' comments on what to do in the future

Under 25 years

- Lack of information
- Don't know enough/ lack of info/adverts
- I don't know too much about it other than it gets taken out of my wages and I had to agree to it when I started work as a condition of my contract.
- I think I'm in a good scheme

25 to 34 years

- All that they can afford, can't do anything else yet. Living Open Market and paying this amount is all she can afford.
- Lack of information and clearer guidelines
- lack of info & guidance should be mentioned at earlier age. Didn't worry until recently - thought states pension would be enough
- Start contributing again after a contribution break to buy house
- Unsure of husband's pension arrangement of the top of her head. Thinks they've set aside enough!
- When company promotes, will think about increasing contributions.
- Aiming to save more once the children have grown up and left home
- Will work as much and late as I can
- Cannot afford to increase payments at moment x4
- Property investment

35 to 49 years

- Downsize property to release equity x2
- Give more to pensioners (staff pension)
- I assume the state will not provide for me in my old age
- Increase pension contributions once finished paying into Children's college funds
- My employer and myself contribute half and half into my company pension. i do not know how much. I voluntarily contribute more, maybe 2%.
- Not clear on arrival re transferring pensions
- Not happy that I now have to work to 67
- Will only increase contributions when get a payrise
- Review my pension after I've saved enough to buy a house.
- Struggling at the moment. Can't afford to increase payments until roughly 2013
- will increase contributions when re employed, no drive to inform people about needs
- Work part time
- Would like to put more aside but can't afford it. Too many other responsibilities to pay for.
- You just pay and hope for the best x2
- Saving and using own assets x2
- Begin contributing/ think about it once children have grown up x 2
- Can't afford anything yet
- Panic and worry about it later

50 to 64 years

- Sell property and downsize/ move to fund retirement x8
- All pensions are subject to alter if the returns drop?
- Gets a States social pension too.
- I can retire early
- Recommend and encourage everyone to have health and then pension provision arrangements.
- Suggest a low-cost provider is encouraged to provide pension plans for companies and individuals locally.
- Too old to start new pension, am saving what cash I can
- Investments
- Savings plan and hoping policies on mortgage will help.

Non-contributors plans for the future

Under 25 years

- Marry rich man
- Hope to get job with company pension - wants a role in Finance Sector x1
- Don't know
- Start in a few years
- Waiting for pay increase
- Finished University in August but cannot find permanent work - odd jobs that does not include pension scheme.
- Rely on inheritance x2

25 to 34 years

- Put more aside into savings account x2
- Start when move back to home country x2
- Nothing at the moment, have to find a job first.
- Plans to get full-time job that has company scheme - hasn't thought about personal pension
- Begin contributing when can afford it x2
- Find a job and then start contributing to pension in a few years' time - hopefully the job will have a pension scheme
- Not thought about it, too young x2
- Bought much larger house than necessary will sell later and live off this
- Win the lottery
- Rely on inheritance

35 to 49 years

- Hoping children will help out.
- start new one up when return to work
- Invest in property
- Wait for inheritance
- Start business
- Sell property (downsize) x3
- Spend less and save
- Begin contributing to a new pension when permanent/ start work again x2

50 to 64 years

- Panic
- Carry on working as long as I can
- Rely on husband
- Sell some assets
- Use my personal savings

Reasons for current non-contributors not having a pension

Under 25

- From other Commonwealth country x1
- Currently arranging to start pension
- Don't know how to get one
- I chose not to contribute to my company's scheme
- Voluntary worker x2
- Never thought about it
- On benefits so can't contribute to a pension
- Don't qualify for company scheme/ (need to work for certain period/threshold age) x4
- Student x4
- Temporary worker x3
- Unemployed/no job x3

25 to 34 years

- From other Commonwealth country x3
- Don't qualify for company scheme/ (need to work for certain period/achieve threshold age) x4
- Going to be in partnership
- Other investments x3
- Have RATS fund
- Using property as own pension plan x4
- In the middle of starting a pension
- Other savings arrangements x2
- Never thought about it
- Not allowed on benefit x2
- Not here long enough
- Self-employed
- Unemployed/no job x4

35 to 49 years

- Already receiving a military pension
- Temporary worker
- Don't believe in retirement/pension x2
- Previous frozen pension.
- Don't qualify for company scheme/ (need to work for certain period/achieve threshold age) x1
- Partner has a good scheme with company.
- On probation, but when probation period over cash alternative as company does not have a pension scheme
- Not allowed on benefits/sickness benefit x2
- Payments ceased on retirement
- Putting into savings/other investments instead x3

- Redeemed an old scheme, soon to re-invest
- Used to have one at my work but gave up. Don't have a personal one
- Using property as own pension plan, or relying on downsizing house x4
- Waste of time
- Will use RATS I pay into when working

50 to 64 years

- Alternative savings plan is better option/better returns invested elsewhere x2
- Contributions finished at 60/ Already finished contributing x2
- Do not need to x2
- Don't do enough hours to qualify
- Drawing pension already x6
- Have RATS
- Invested in scheme several years ago and the value of funds fell 30% year on year, 50% in the first year. No point investing into a diminishing return.
- Lump sum from previous company pension scheme invested in RATS
- Health reasons/ medically retired x2
- Not allowed on benefits
- Own other investments/savings/private means x3
- Paid well, had to select own private pension scheme/investments.
- Self-employed x3
- Stopped pension contributions 10 years ago.
- Suspended
- Waiting for States Personal Pension to start

Further comments

- The pension obligations of employers in Guernsey severely inadequate. In other countries such as Australia it is a mandatory amount (9%) and this is contributed to a pension fund in addition to base salary for EVERY employee. The percentage that companies locally offer is hardly a drop in the ocean of what is necessary and the States should impose bigger obligations on companies to mandatorily contribute to pension funds.

- Guernsey needs to consider auto enrolment as a compulsory pension solution to ensure that all residents are able to support themselves in retirement. The benefits to our society are immense as the more retired people who receive pensions higher than the State Pension, the more they have to spend locally and the more they will pay in the way of income tax. As the retirement population is growing, this has to be one way forward.

- The current states pension is not enough.

- Financial adviser didn't think it was worth increasing pension contributions in today's climate. The anticipated pension is lower now than when it started so probably better to put into high interest bank a/c's if funds available.

- My three pensions matured at 60, I cashed them as there had been no return for the previous 5 years. The money is in a RAT in Guernsey. I intend downsizing as I have a valuable property. My wife has a pension from the UK.

- I believe that the mind-set amongst the younger generation has moved against saving. Spending/living for today is too prevalent. Relying on a state retirement pension is foolhardy, as life longevity will force available sums to be cut. Public sector pension arrangements are outrageously unaffordable. This all points to the need to set up a fully funded Guernsey-wide pension arrangement to ensure that those not already in adequate company schemes pay a compulsory minimum into a state-sponsored pension scheme. Otherwise future social security payments to the old in lieu of pensions will prove too costly. Someone should take a look at the Singapore state pension arrangements and fund - an interesting island comparison.
- I think you covered most of the bases. I would add that I feel totally unprepared financially for retirement and that my immediate problem is to earn more NOW in order to live the lifestyle I desire to live. There are an awful lot of people in my position and it's a lack of pension provision time bomb just waiting to happen!
- The uncertainty of "end result" i.e. sums available in retirement is biggest concern.
- Unfortunately we are being hit by very low interest rates at present which will affect our pensions. As an older person with my wife, our future is dependent upon our health.
- Used to be in company defined benefits scheme which was shut to all members in 2010
- With pension provision falling increasingly on the individual, States should look to increase tax breaks.

February 2012

Appendix 5b: Outline of mandate given to the UK Government Actuary's Department

A5b.1 As part of this review the UK Government Actuary's Department (GAD) was commissioned to update its projections and examine the impact of various potential policy changes on the sustainability of the funds.

A5b.2 The request to the GAD included the following:

- An update of underlying population projections to reflect most recent available data
- A downward revision of assumptions of real earnings growth from 2% per annum to 1.5% per annum
- A central long-term assumption of net immigration of 200 people per annum consistent with historical trends[2]
- Assumed annual rate of uprating of:
  - Prices (RPIX) only
  - Prices +0.5%[3]
  - Price +0.5% for a ten-year period; prices only thereafter
- Assumed pension age of:
  - 67 by 2031 (as per current approved policy)
  - 70 by 2049

A5b.3 After discussion with the GAD, which felt that the projections resulting from the central assumptions above were optimistic in the light of very recent experience, the report (provided in **Appendix 5c and d**) also includes projections which revise the fund income down to 90% as well as projections based on the assumptions above. The GAD states that these projections proved a better match to the actual experience of the fund between 2009 and 2013. While the adjustment is necessarily crude, it would, broadly speaking, represent a scenario where economic conditions continue the limited growth that has been seen over this period.

A5b.4 It must be noted that economic conditions for the past four years have been particularly weak, and projecting on this basis is equivalent to assuming that the economy (and the

[2] Note that the figures for the year ending March 2013 showed net emigration of 464 people, however data for 2014 are not yet available and there are insufficient data to determine whether this represents any more than short-term phenomena reflecting weak economic conditions.

[3] Previous Actuarial reviews assumed an increase of 1% above RPIX, half way between the increase in prices and the assumed increase in earnings. This was revised down to reflect the lower assumption of earnings growth. Under the assumptions used this is equivalent to 1/3rd of the real increase in earnings.

labour market in particular) will continue to stagnate. While this is a fairly pessimistic assumption, the downside risks exist and should not be ignored.

A5b.5 The two sets of projections (labelled 90% and 100% by the GAD and referred to as downside and upside cases in this report) should, therefore, be viewed as representing the range of possibilities, with the actual outcome likely to fall somewhere between the two. The difference between the two sets of projections over a sustained period is very large.

A5b.6 It should also be noted that the speed at which reserves are depleted is heavily dependent on the migration assumptions used, with lower levels of immigration, which imply a smaller working age population to pay contributions, resulting in a faster depletion of reserves.

A5b.7 The reports from the GAD on the GIF are included as **Appendix 5c, 5d and 6.** Note that these projections were not available at the time of the publication of the Principles and Issues Document (**Appendix 1**) and therefore the projections presented in these reports differ.

Government Actuary's Department

Appendix 5c: GAD assessment of proposed policy options for Guernsey Insurance Fund

MEMO

TO: **Ellen Pragnell, Ed Ashton**

COPIED TO: **Dermot Grenham, Corrado Coppa, Guernsey Policy Costings 2014**

FROM: **Joanne McDaid**

REF: DATE: 20 June 2014

SUBJECT: Assessment of the impact of proposed policy changes on the Guernsey Insurance Fund – including alternative contribution scenario

1. Introduction

1.1. We were asked by Ellen Pragnell of the Guernsey Social Security Department to provide projections showing the impact of proposed policy changes on the Guernsey Insurance Fund ("the Fund"). Details of the work that we would carry out were set out in Appendix A to the Letter of Engagement, dated 6 February 2014.

1.2. The Fund is financed broadly on the pay-as-you-go principle, with contribution income in a year intended to cover expenditure in the year. This means contribution rates and the future progress of the Fund may change significantly over time owing to changes in the benefit structure, population or economic activity. The long-term objective is to maintain a Fund balance approximately equal to two years' outgo, while keeping the contribution rate relatively stable.

1.3. The legislation governing the Guernsey Insurance Fund requires regular reviews of the financial condition of the Fund and the adequacy of the contributions payable. The last such review, carried out by GAD, was as at 31 December 2009. This assessment of the impact of proposed policy changes does not constitute a full review of the Fund. In particular, recent experience relating to workforce participation and benefit awards has not been reviewed and therefore the assumptions in respect of these have not been updated.

2. The policy options

2.1. The Guernsey Social Security Department ("the Department") asked us to provide projections for the following scenarios:

> current benefit structure

> increasing pensionable age to 70 between 2032 and 2049 following the already agreed increases in pensionable age to 67 between 2020 and 2031

> decreasing the upper earnings and income limits in January 2015 to £85,000, from the 2014 limit of £132,444, with a compensatory increase in the States Grant.

2.2. For each scenario, and for the two changes combined, we were asked to show projections assuming:

> up-rating of benefits in line with prices, rather than the current up-rating policy of half-way between prices and earnings

> a proposed short-term up-rating policy of 0.5% above price inflation for 10 years, and in line with prices thereafter

> a proposed long-term up-rating policy of 0.5% above price inflation throughout the projection period.

2.3. The Department requested that the projections were based on assumed real earnings growth of 1.5%, re-rating of contribution limits in line with prices and revised population projections.

3. Assumptions

3.1. We provided a paper on 15 April 2014 setting out our proposed assumptions to underlie this assessment of the impact of proposed policy changes. A copy of this paper is included at Appendix A.

3.2. As requested, the projections are based on a real earnings growth assumption of 1.5% and net immigration of 200 a year. We have retained the other economic assumptions adopted for the 2009 Review, as well as the labour market and benefit-specific assumptions adopted for that review.

3.3. We aligned modelled contribution income and benefit expenditure with actual experience, as recorded in the accounts. Generally the adjustments required were small. However, actual contribution income has been lower in recent years than projected by our models. This may reflect smaller proportions of the population contributing to the scheme and lower earnings increases in recent years. Therefore, we made an explicit adjustment of 0.9 to bring the figures in line with accounts, that is, the projections provided are based on 90% of modelled output.

3.4. The Guernsey Social Security Department requested additional projections reflecting 100% of modelled contributions, that is, with no adjustment made to align the projections with recent experience. This provides for a significant increase in projected contribution income in 2014 relative to that received in 2013, with associated higher projected amounts in all future years.

3.5. Other than the adjustment, or absence thereof, in respect of contributions, the same assumptions were used for all scenarios.

4. Population projections

4.1. We have produced updated population projections based on population data as at 31 March 2013, as provided by the Guernsey Social Security Department, and the mortality, fertility and migration assumptions set out in Appendix A.

4.2. Appendix B sets out the results of these projections. We have provided the Guernsey Social Security Department with spreadsheets showing the population projection for each year from 2013 to 2070 by age and sex.

5. Methodology

5.1. We have used the same projection methodology as described in our report on the 2009 actuarial review.

6. Results

6.1. The projected impact of the proposed policy changes on the future progress of the Fund is assessed in terms of projected fund ratios and changes in the expected level of the States Grant. That is, results are provided as the projected average balance of the Fund expressed as a multiple of expenditure on benefits and expenses during the year and as the projected level of the States Grant over the period from 2013 to 2070.

6.2. We have also produced projections of break-even contribution rates as we understand that the Department may find these helpful in considering policy changes.

6.3. The additional projections reflecting 100% of modelled contributions are only provided in terms of projected fund ratios.

6.4. The charts and tables on the following pages set out the results of our projections. There are limitations with considering policy changes based on a review update, whereby only some assumptions have been reviewed and revised, rather than a full review. As such, we recommend that results are considered in relative terms rather than absolute terms, eg ‘compared to the proposed short-term up-rating policy, the proposed long-term policy brings forward the fund exhaustion date by 3 years’, rather than ‘from 2044 to 2041’.

6.5. The Table 1 below provides a summary of the different scenarios provided and the assumptions underlying each of these.

Table 1: Details of assumptions underlying scenarios projected

Scenario	Pension Age	Up-rating of benefit rates and contribution limits	Upper earnings and income limits
Base case	Agreed increase to 67 by 2031	In line with prices throughout the projection period	2014 limit of £132,444 increased in line with prices
Short-term Uprating Policy	Agreed increase to 67 by 2031	0.5% above price inflation for 10 years, and in line with prices thereafter	2014 limit of £132,444 increased in line with prices
Long-term Uprating Policy	Agreed increase to 67 by 2031	0.5% above price inflation throughout the projection period	2014 limit of £132,444 increased in line with prices
SPA & Price Up-rating	Agreed increase to 67 by 2031 and proposed increase to 70 by 2049	In line with prices throughout the projection period	2014 limit of £132,444 increased in line with prices
SPA & Short-term Uprating Policy	Agreed increase to 67 by 2031 and proposed increase to 70 by 2049	0.5% above price inflation for 10 years, and in line with prices thereafter	2014 limit of £132,444 increased in line with prices
SPA & Long-term Uprating Policy	Agreed increase to 67 by 2031 and proposed increase to 70 by 2049	0.5% above price inflation throughout the projection period	2014 limit of £132,444 increased in line with prices
UEL & Price Uprating	Agreed increase to 67 by 2031	In line with prices throughout the projection period	2015 limit of £85,000 increased in line with prices
UEL & SPA – Price Uprating	Agreed increase to 67 by 2031 and proposed increase to 70 by 2049	In line with prices throughout the projection period	2015 limit of £85,000 increased in line with prices

6.6. Please note that chart axes are appropriate to the relevant projections and therefore the scales are not necessarily consistent between charts.

Figure 1: Projected fund ratios allowing for proposed up-rating scenarios based on 90% modelled contributions

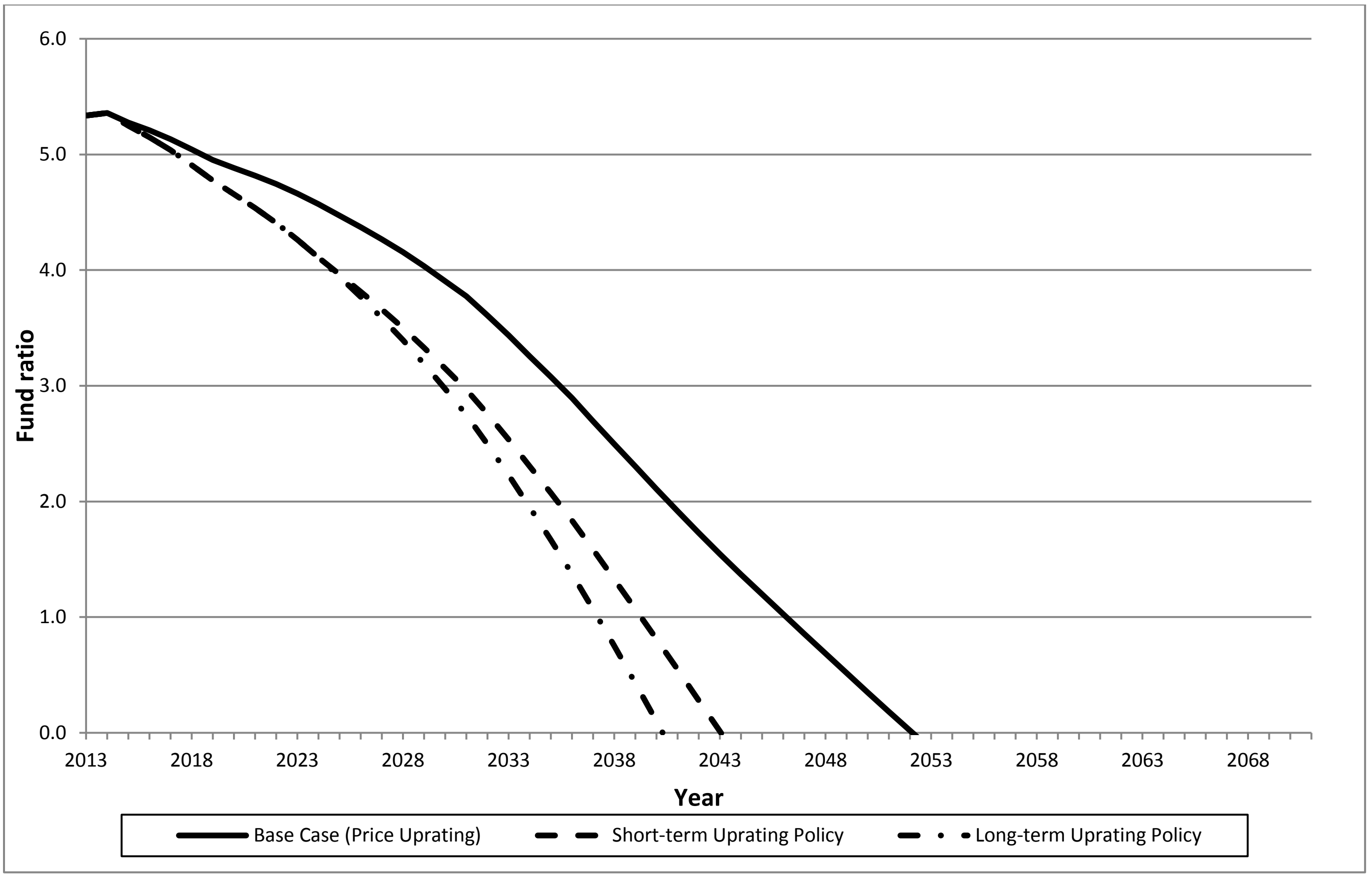


Figure 2: Projected fund ratios for proposed increases in SPA based on 90% modelled contributions

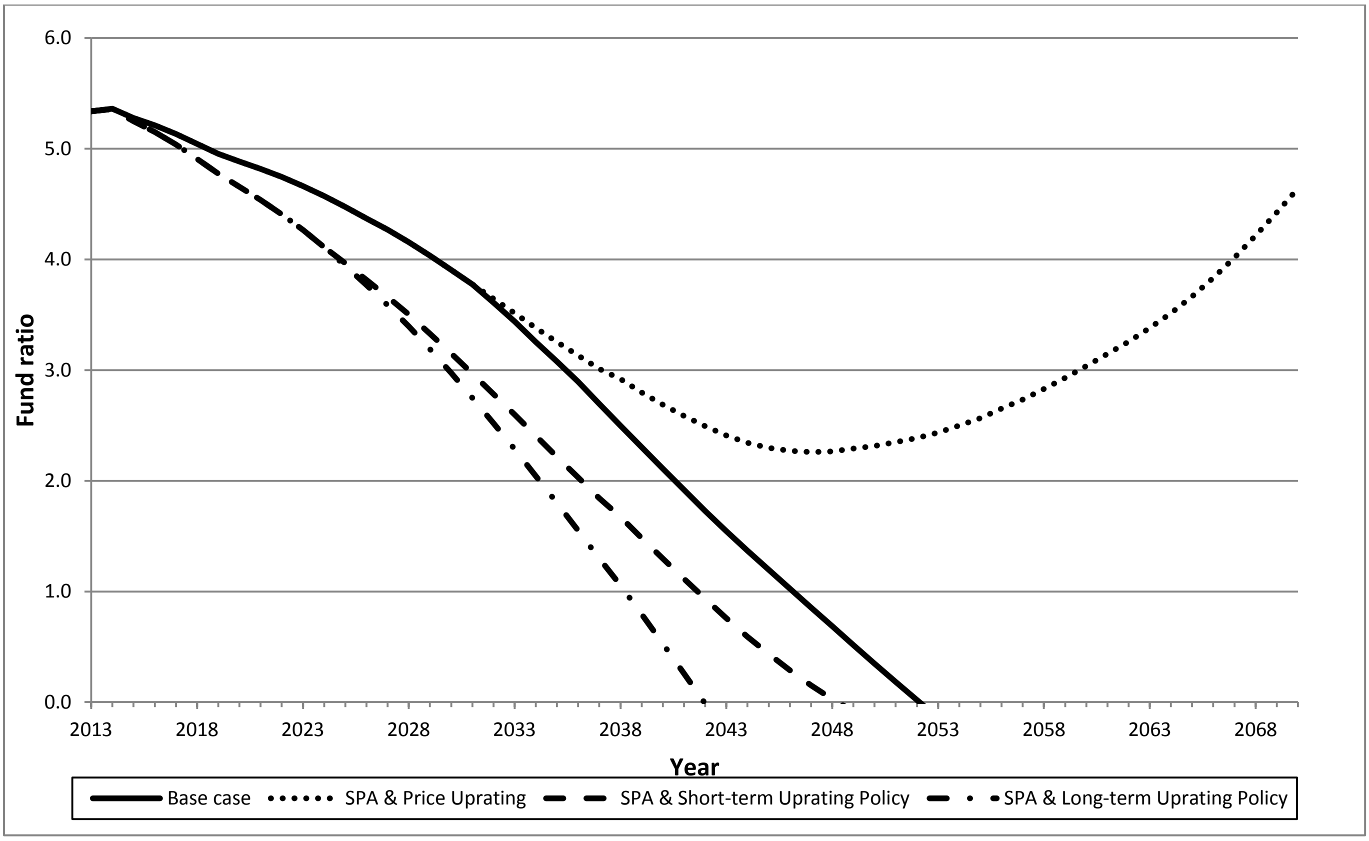


Figure 3: Projected fund ratios allowing for proposed up-rating scenarios based on 100% modelled contributions

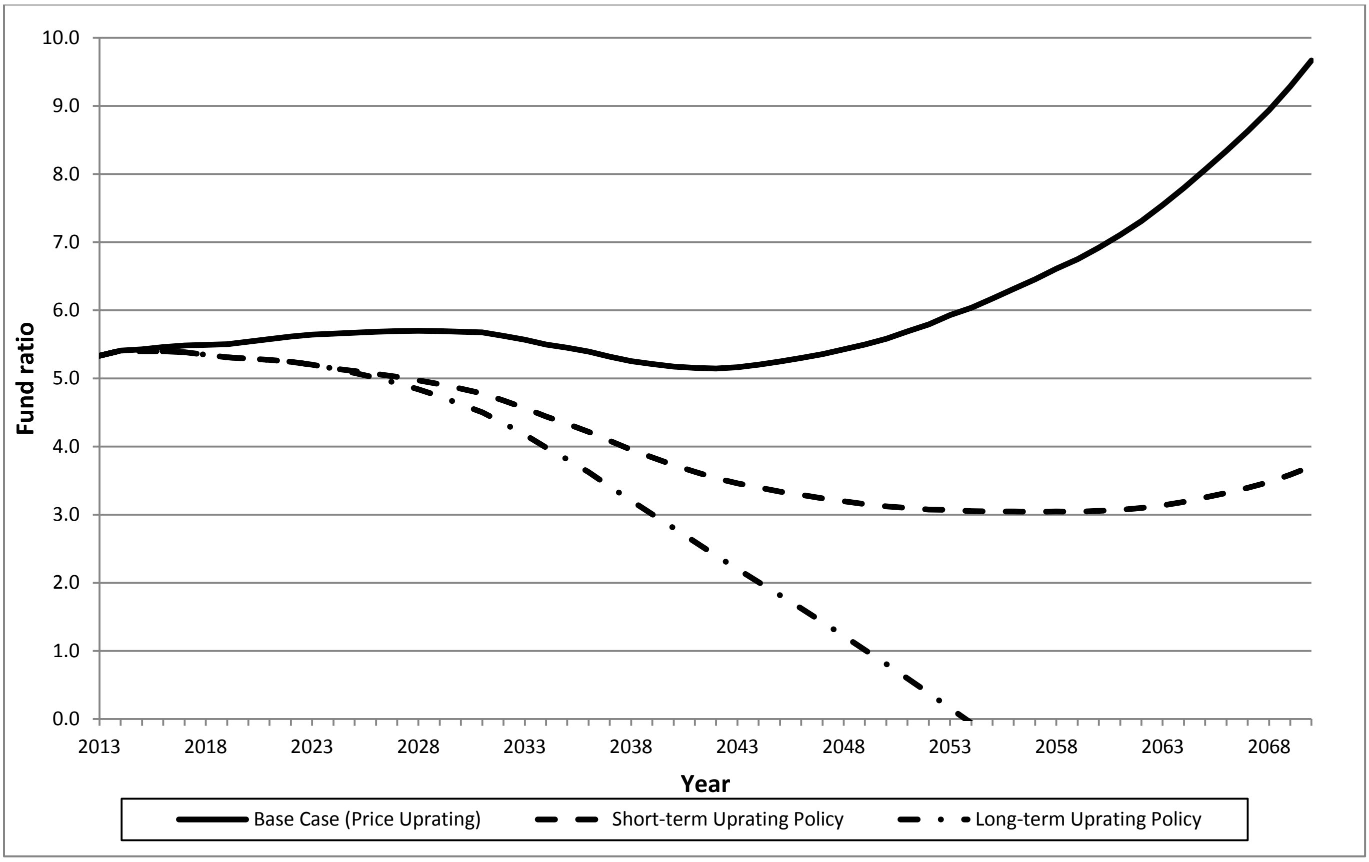
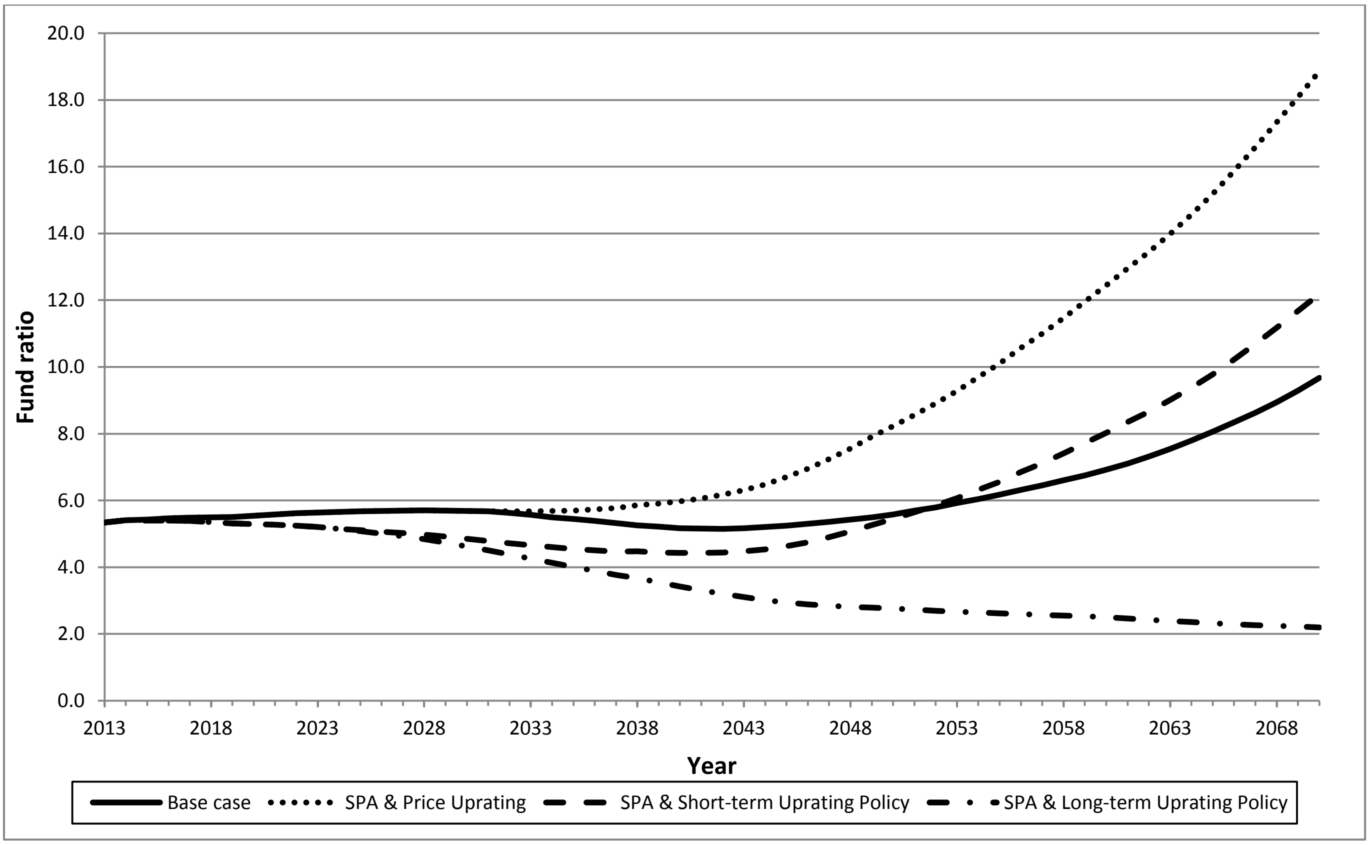


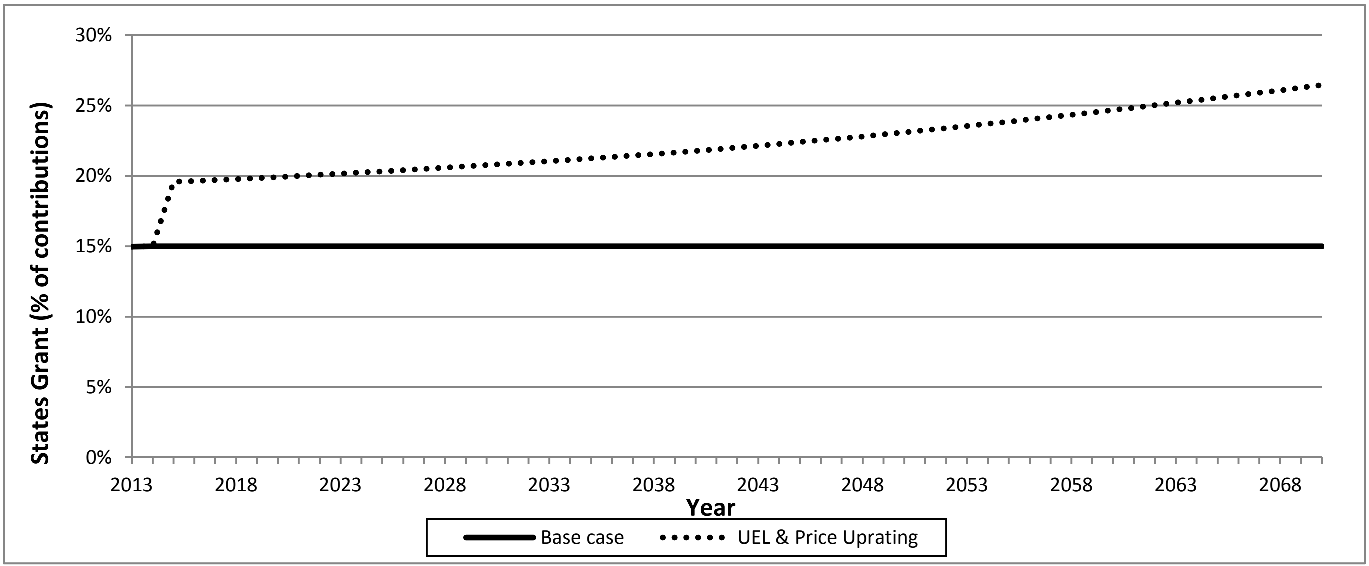
Figure 4: Projected fund ratios for proposed increases in SPA based on 100% modelled contributions



6.7. The proposed decrease in the upper earnings and income limits in January 2015 to £85,000, from the 2014 limit of £132,444, with a compensatory increase in the States Grant has no impact on the projected progression of the Fund as total income will remain unchanged. As a result, the effect of the proposed policy changes together, in terms of the projected progression of the Fund, is the same as that allowing for the proposed changes to SPA.

6.8. However, the proposed decrease in the upper earnings and income limits with a compensatory increase in the States Grant is projected to increase the percentage of contributions required as a States Grant as shown in Figure 3 below. Different up-rating policies have no effect on the States Grant percentage required as the up-rating approach only impacts benefit expenditure and not contribution income. As such, Figure 3 below only shows the impact of the change in the UEL together with up-rating in line with prices.

Figure 5: Projected States Grant percentage to compensate for the decrease in upper earnings and income limits based on 90% modelled contributions



6.9. The proposed increases in SPA is projected to increase employee contribution income and therefore is projected to affect the percentage of contributions required as a States Grant, as shown in Figure 4 below. Compared to Figure 3, differences only arise from 2032 onwards and they are very small, up to 1.1%, as only a small proportion of the additional contributions generated by the increase in SPA are expected to in respect of earnings above the UEL.

Figure 6: Projected States Grant percentage based on combined effect of the proposed changes based on 90% modelled contributions

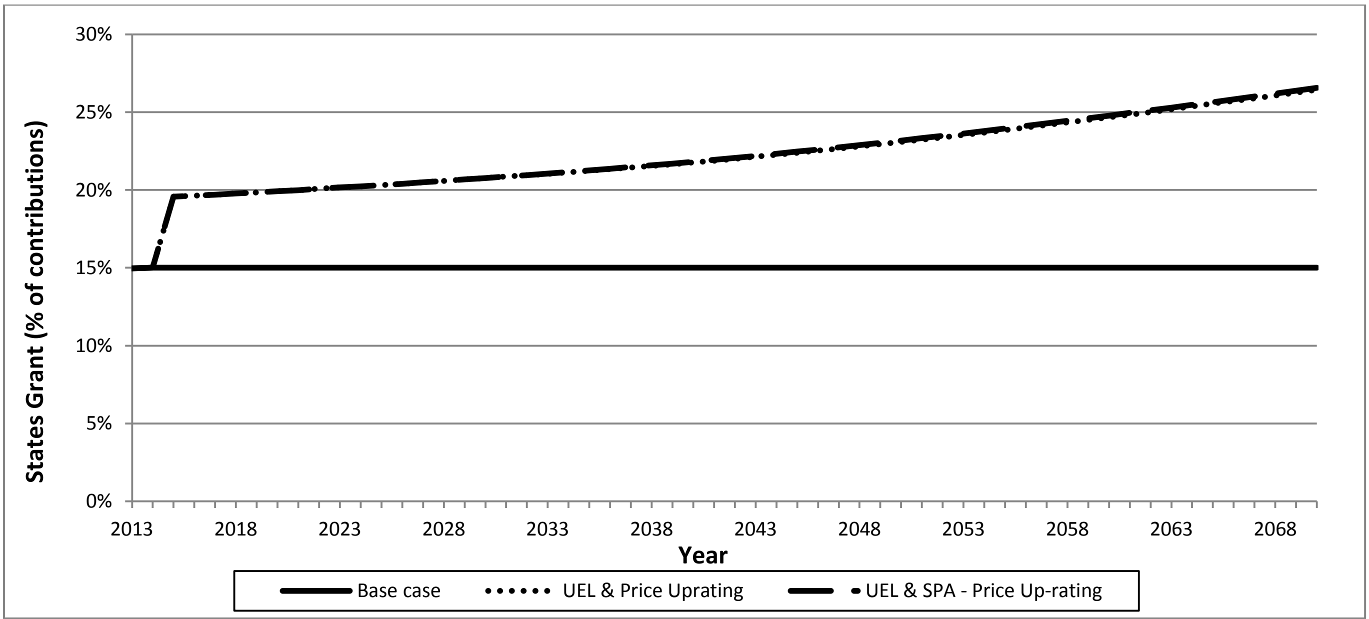


Figure 7: Projected break-even contribution rate allowing for proposed up-rating scenarios based on 90% modelled contributions

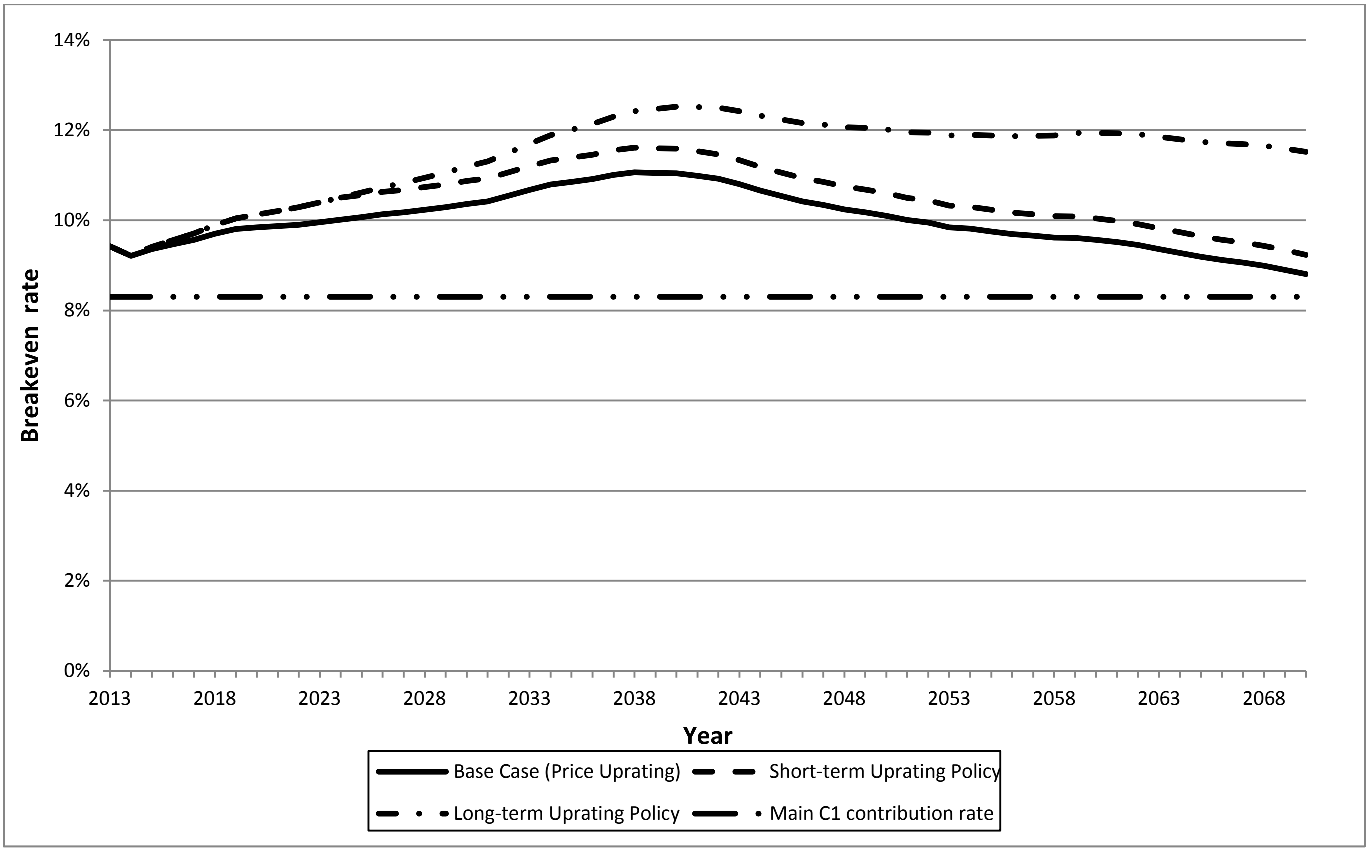
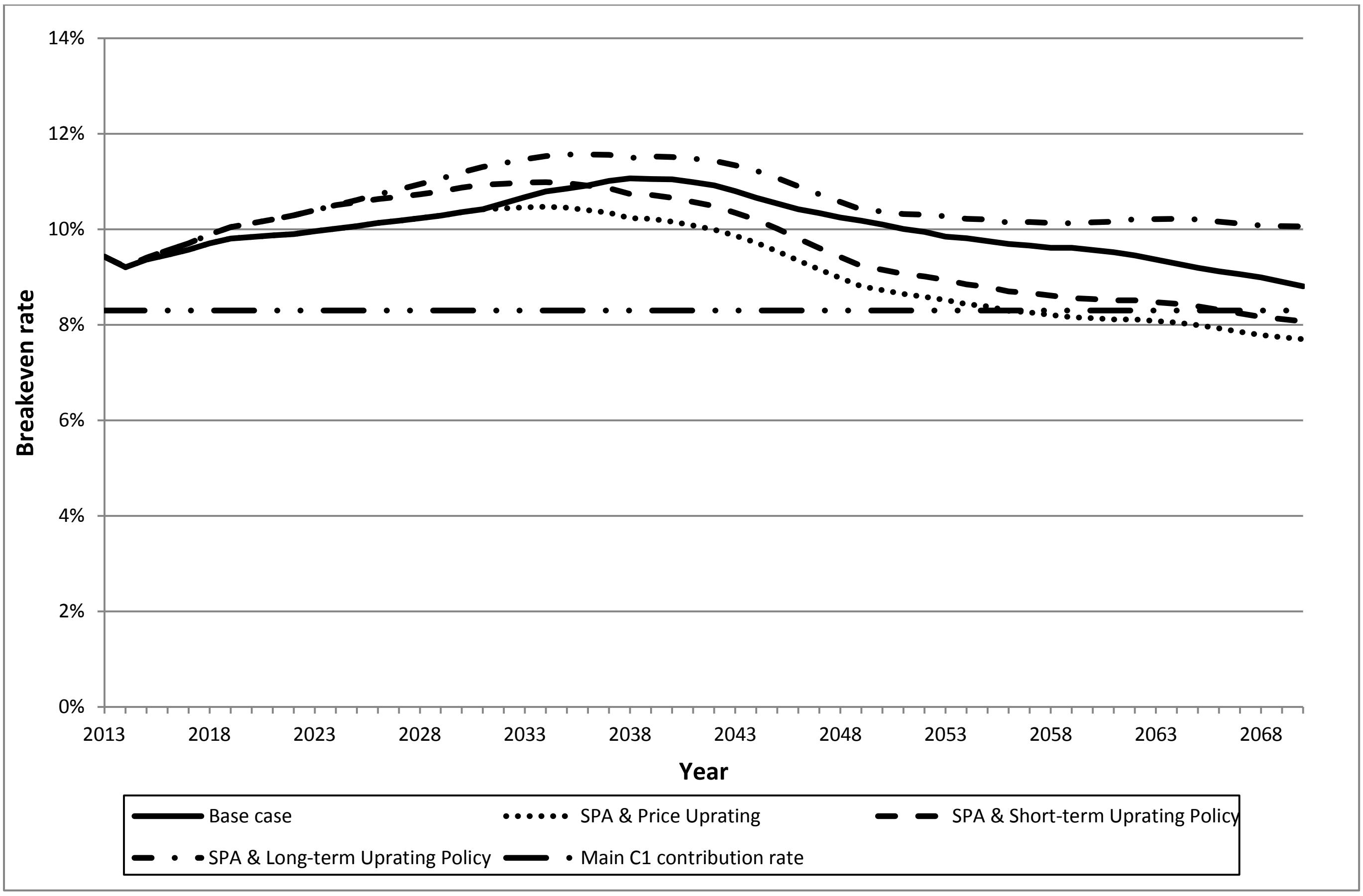


Figure 8: Projected break-even contribution rate allowing for proposed increases in SPA based on 90% modelled contributions



6.10. The proposed decrease in the upper earnings and income limits with a compensatory increase in the States Grant has no impact on the projected break-even contribution rate as total income remains unchanged. As a result, the effect of the proposed policy changes together, in terms of the projected break-even contribution rate, is the same as that allowing for the proposed changes to SPA.

6.11. The tables below details the results provided in each chart at 10-year intervals.

Table 2: Projected fund ratios allowing for proposed up-rating scenarios based on 90% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	5.3	4.9	3.9	2.1	0.3	0.0	0.0
Base case with ST Uprating	5.3	4.7	3.2	0.8	0.0	0.0	0.0
Base case with LT Uprating	5.3	4.7	3.0	0.1	0.0	0.0	0.0

Table 3: Projected fund ratios allowing for proposed increases in SPA based on 90% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	5.3	4.9	3.9	2.1	0.3	0.0	0.0
SPA with Prices Uprating	5.3	4.9	3.9	2.7	2.3	3.0	4.6
SPA with ST Uprating	5.3	4.7	3.2	1.3	0.0	0.0	0.0
SPA with LT Uprating	5.3	4.7	3.0	0.5	0.0	0.0	0.0

Table 4: Projected fund ratios allowing for proposed up-rating scenarios based on 100% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	5.3	5.5	5.7	5.2	5.6	6.9	9.7
Base case with ST Uprating	5.3	5.3	4.8	3.7	3.1	3.1	3.7
Base case with LT Uprating	5.3	5.3	4.6	2.8	0.8	0.0	0.0

Table 5: Projected fund ratios allowing for proposed increases in SPA based on 100% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	5.3	5.5	5.7	5.2	5.6	6.9	9.7
SPA with Prices Uprating	5.3	5.5	5.7	6.0	8.2	12.4	18.9
SPA with ST Uprating	5.3	5.3	4.8	4.4	5.4	8.0	12.2
SPA with LT Uprating	5.3	5.3	4.6	3.4	2.8	2.5	2.2

Table 6: Projected States Grant percentage to compensate for the decrease in upper earnings and income limits based on 90% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
UEL with Prices Uprating	15.0%	19.9%	20.8%	21.8%	23.1%	24.7%	26.4%

Table 7: Projected States Grant percentage based on combined effect of the proposed changes based on 90% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
UEL & SPA with Prices Uprating	15.0%	19.9%	20.8%	21.8%	23.2%	24.8%	26.6%

Table 8: Projected break-even contribution rate allowing for proposed up-rating scenarios based on 90% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	9.4%	9.8%	10.4%	11.0%	10.1%	9.6%	8.8%
Base case with ST Uprating	9.4%	10.1%	10.9%	11.6%	10.6%	10.0%	9.2%
Base case with LT Uprating	9.4%	10.1%	11.2%	12.5%	12.0%	11.9%	11.5%

Table 9: Projected break-even contribution rate allowing for proposed increases in SPA based on 90% modelled contributions

Year	2013	2020	2030	2040	2050	2060	2070
Base case	9.4%	9.8%	10.4%	11.0%	10.1%	9.6%	8.8%
SPA with Prices Uprating	9.4%	9.8%	10.4%	10.2%	8.7%	8.1%	7.7%
SPA with ST Uprating	9.4%	10.1%	10.9%	10.7%	9.2%	8.5%	8.1%
SPA with LT Uprating	9.4%	10.1%	11.2%	11.5%	10.4%	10.1%	10.1%

7. Limitations

7.1. This report has been prepared for the Minister and Members of the Guernsey Social Security Department. We understand that the information in this report may be made available to others. However GAD does not accept any liability to third parties in relation to this report.

7.2. This assessment of the impact of proposed policy changes does not constitute a full review of the Fund. A full review of the Fund could produce projections that are materially different from those provided in this memo. Therefore there should not be too much reliance placed on absolute figures, for example, the date the Fund is projected to be exhausted. Other than the additional projections, which reflect 100% of modelled contributions, all the projections have been produced based on the same underlying assumptions enabling results to be considered in relative terms.

7.3. The additional projections reflecting 100% of modelled contributions, with no adjustment made to align the projections with recent experience, have been provided at the request of the Guernsey Social Security Department.

7.4. This review relies on the accuracy of data and information provided by the Guernsey Social Security Department. GAD does not accept responsibility for advice based on wrong or incomplete data or information provided.

7.5. The advice provided must be taken in context. Advice is intended to be read and used as a whole and not in parts. GAD does not accept responsibility for advice that is altered or used selectively.

7.6. Clarification should be sought if there is any doubt about the intention or scope of advice provided in this report. GAD is not responsible for any decision taken by the Social Security Department, except to the extent that the decision has been made in accordance with specific advice provided.

7.7. All references to Guernsey in this report are to be taken to include also the islands of Alderney, Herm and Jethou.

Appendix A – Assumptions

A1. Introduction

A1.1 This memo has been prepared for the Guernsey Social Security Department. It sets out the mortality and fertility assumptions we propose are used to produce updated population projections, which will underlie the assessment of the impact of proposed policy changes to the Guernsey Insurance Fund. As the assessment is to consider the impact of changes, the absolute value of some assumptions will not be particularly material.

A1.2 This memo also comments on the reasonableness of the intended migration and earnings assumptions, as well as the reasonableness of retaining the other economic assumptions adopted for the 2009 Review of the Guernsey Insurance Fund. The intention is to also retain the labour market and benefit-specific assumptions adopted for the 2009 Review.

A2. Summary

A2.1 The table below provides an overview of the demographic and economic assumptions we propose to adopt for the assessment of the impact of proposed policy changes to the Guernsey Insurance Fund, together with those adopted for the 2009 Review. Further details are set out in the remaining sections of this note.

Table A1: Demographic assumptions

	2009 review	**Assessment of impact of proposed policy changes**
Fertility and mortality projections	ONS 2008-based projections for England and Wales adjusted by constant age-related multipliers to reflect Guernsey's mortality and fertility experience from 2007 to 2009	ONS 2012-based projections for England and Wales adjusted by constant age-related multipliers to reflect Guernsey's mortality experience from 2008 to 2013 and fertility experience from 2009 to 2013
Migration	Migration set to be sufficient to maintain the total population constant at the April 2007 level *Variants:* *Constant net migration of zero* *Constant net immigration of 200 a year*	Constant net immigration of 200 a year

Table A2: Economic assumptions

	2009 review	Assessment of impact of proposed policy changes
Price inflation	3% a year	3% a year
Earnings increases	2% a year net of price inflation *Variant: 1.5% a year net of price inflation*	1.5% a year net of price inflation
Investment return	3.5% a year net of price inflation	3.5% a year net of price inflation
Up-rating of benefits and earnings limits	Results provided showing up-rating in line with: • price inflation • earnings increases • halfway between the two	Results to be provided showing up-rating of benefits in line with: • price inflation • the proposed short-term policy of 0.5% above price inflation for 10 years commencing January 2015, and in line with price inflation thereafter • the proposed long-term policy of 0.5% above price inflation throughout the projection period Earnings limits up-rated in line with price inflation

A2.2 We propose that the same labour market and benefit-specific assumptions are adopted as for the 2009 Review of the Guernsey Insurance Fund. Given the nature of the assessment being carried out, contributor data and beneficiary data were not requested. As noted in the 2009 Review report, the proportions of the working-age population paying contributions were fairly constant in the years prior to that review. We have reviewed the updated population data and noted that the size and profile of the population by age and sex has remained reasonably stable in recent years. Similarly, the average numbers unemployed in recent years has been broadly in line with that assumed for the 2009 Review. As such, we consider it reasonable to adopt the same assumptions, with adjustments applied to reflect the proposed increases in pension age.

A2.3 Details of the assumptions adopted for the 2009 review are provided in section A6 of this note.

A3. Demographic assumptions

Fertility and mortality

A3.1 The Guernsey Social Security Department provided Guernsey population data, including details of births and deaths, for each of the years ending 31 March 2010 to 2013 inclusive. Data for earlier years had been provided for the 2009 Review.

A3.2 The relatively small population size and the relatively few years of data mean that it is not appropriate to project population birth and death rates solely from this information. Instead, we propose adapting the 2012-based principal population projections prepared by the Office for National Statistics (ONS) for England and Wales by applying age and sex-related factors to obtain assumed Guernsey fertility and mortality rates. These age and sex-related factors are derived by comparing actual experience for Guernsey for the calendar years 2008 to 2012 inclusive for mortality (2009 to 2012 for fertility) with England and Wales rates for the same period.

A3.3 We propose that the same mortality assumptions apply for all beneficiaries, both those resident in Guernsey and those who are not resident in Guernsey, and that future improvements in life expectancy in Guernsey are assumed to be consistent with the 2012-based principal projections prepared by ONS for England and Wales.

A3.4 This analysis has indicated lighter mortality in Guernsey relative to England and Wales, with the differential being greater for females, and lower fertility rates in Guernsey at younger ages.

A3.5 The tables below illustrate our proposed assumptions for life expectancy and fertility as at 2012 for Guernsey, together with the corresponding figures based on the assumptions adopted for the 2009 Review and those for England and Wales based on the ONS projections. For life expectancy, we have shown figures for 60-year-olds, in 2012, as well as future 60-year-olds, in 2032, to illustrate the effect of assumed future improvements in longevity.

A3.6 The tables show that:

> assumed life expectancies have fallen since the 2009 Review but remain higher in Guernsey than in England and Wales. That is, the differential between the Guernsey and England and Wales experience has narrowed since the previous review.

> assumed fertility has increased at older ages but is lower in Guernsey compared to England and Wales at younger ages. Lower fertility in Guernsey was also observed at for the 2009 Review.

Table A3: Life expectancy for males and females aged 60 last birthday in mid-2012 and mid-2032

		2009 review	2014 Policy Costings	England & Wales (ONS 2012-based Population Projections)
Males – Age 60 in	2012	27.5	25.8	25.6
	2032	29.4	28.2	28.0
Females – Age 60 in	2012	29.9	29.3	28.5
	2032	31.8	31.5	30.8

Table A4: Age specific fertility rates: number of births per 1,000 women in 2012

Mother's Age	2009 Review	2014 Policy Costings	England & Wales (ONS 2012-based Population Projections)
15	3.0	2.6	2.6
20	43.2	35.9	51.2
25	74.8	69.3	92.3
30	103.7	109.9	115.7
35	76.7	90.1	90.1
40	23.8	27.6	27.6
45	1.6	2.0	2.0

Migration

A3.7 The Guernsey Social Security Department has advised that the central migration assumption to be used for this assessment should be 200 net immigration a year. The Department has also provided details of immigration and emigration by age and sex for each of the years ending 31 March 2010 to 2013 inclusive.

A3.8 The data show variability in the net migration figures for individual years, ranging from net emigration of 460 in 2012-13 to net immigration of 331 in 2010-11, averaging close to a net zero position in recent years. However in the period from 2007 to 2009, net immigration averaged around 450 a year.

A3.9 The migration data provided show that net migration is very variable at all ages. However it indicates that migration is most significant at ages between the early 20s and mid-30s, which is consistent with the experience prior to the 2009 Review.

A3.10 In the absence of robust data to the contrary, we propose retaining the same distribution of migration by age and sex as adopted for the 2009 Review. This distribution provided for net immigration concentrated around the 20s and 30s age groups, and small amounts of net emigration at child ages and pension ages as shown in Table A5 below.

Table A5: Number of Immigrants assuming 200 Net Immigration

Age	Males	Females	Total
Under 15	-2	10	8
15-24	62	34	96
25-34	46	18	64
35-44	22	4	26
45-54	8	2	10
55-64	0	-4	-4
65-74	-2	2	0
75+	0	0	0

A4. Economic assumptions

A4.1 The 2009 Review assumed:

> a rate of RPIX price inflation of 3% a year

> a real rate of earnings growth of 2% a year net of RPIX price inflation

> a rate of real investment return of 3.5% a year net of RPIX price inflation.

A4.2 The Guernsey Social Security Department has requested that an assumed real rate of earnings growth of 1.5% a year net of RPIX price inflation is used for this assessment, with the other assumptions remaining unchanged. Our understanding is that the request for other rates to be unchanged relates to rates in real terms.

A4.3 This suggests that nominal earnings would be expected to be in region of 4.5% a year and that nominal investment returns would be expected to be in the region of 6.5% a year.

A4.4 Earnings growth in recent years has been quite variable, averaging around 5% nominal in the period 2006-2008, but with a sharp fall in 2009, followed by modest increases of around 3% nominal during 2011 and 2012. Given the recent economic climate, we think that a long-term assumption of nominal earnings growth of 4.5% a year is not unreasonable.

A4.5 We have also considered price inflation in recent years, to check this nominal earnings assumption is consistent with an assumed real rate of earnings growth of 1.5% a year net of price inflation. In the years prior to the 2009 Review, RPIX price inflation was generally in the region of 3% a year. However, it was considerably above this from late 2007 through to early 2009, reaching a peak of 6.4% in September 2008. Since then, price inflation has reverted to around 3%, although rates were closer to 2% during 2013. As such, it does not seem unreasonable to retain a long-term assumption for price inflation of 3% a year.

A4.6 Investment returns have also been quite variable in recent years, with negative returns emerging in 2008 and 2011, and quite high returns earned in 2009 and 2010. Considering average returns over a number of years, an assumption of real investment returns of 3.5% a year net of RPIX price inflation does not seem unreasonable.

A5. Alignment with Accounts

A5.1 We will align modelled expenditure for each benefit in 2012-13 with actual expenditure as recorded in the accounts to determine any adjustment is required to allow for differences between using a model and assumptions, and actual expenditure. We propose that any adjustment required is assumed to apply for all future years.

A6. Assumptions used for the 2009 review

A6.1 The tables below provide an overview of the labour market and benefit-specific assumptions adopted for the 2009 Review of the Guernsey Insurance Fund which we propose are retained for this assessment.

Table A6: Labour market assumptions

	2009 Review
Labour market participation	Constant subject to unemployment assumption
Unemployment	Constant at 250

Table A7: Old age pension

	2009 Review
Proportions of the population assumed to be in receipt of pension in future years	Based on recent experience, 152% of both males and females aged 65-69 assumed to receive a pension. This is more than 100% as it allows for non-resident recipients. This assumption is assumed to apply to all new cohorts expected in future. Lower proportions are assumed for older cohorts already in payment at the review date, in line with observed experience Within this, age profiles specifically required for widows on late husband's insurance and married females on husband's insurance based on the 2003 review's age profiles (rebased to the 2009 review date) and projected to develop over time in line with Great Britain '2008 marital status projections' Approach to post-2004 alterations modified, allowing for married females on husband's insurance group to remain fairly stable until 2014 and then taper off
Proportion of standard rate expected to be paid on average	Simplified approach based on experience, with an equalisation adjustment for females

Table A8: Sickness benefit, invalidity benefit and industrial injury benefit

	2009 Review
Expected future number of claims in payment per insured	Sickness benefit: 1 claim in payment per 3 insureds Invalidity benefit: 1 claim in payment per 33 insureds Industrial injury benefit: 1 claim in payment per 60 insureds
Combination of average proportion of standard full benefit rate payable and expected duration of payment per claim in payment (in equivalent days)	Sickness benefit: 14.5 days Invalidity benefit: 255.0 days Industrial injury benefit: 24.5 days

Table A9: Bereavement benefits

	2009 Review
Proportions of the population assumed to be widowed in future years	2001 Guernsey and Alderney census statistics, projected from 2001 to each (future) year in line with Great Britain '2008 marital status projections' For example, 0.8% of males aged 45 were widowers in 2001 and by 2030 this is now projected to be 0.3%
Proportion of widows and widowers assumed to be receiving each type of bereavement benefit in future years	Percentage at each age for each benefit type based on an average of the relevant claim data for 2008 and 2009 As there were only a handful of earlier legacy cases remaining, we are proposing to group them with their equivalent post-2004 successor benefits, rather than explicitly build in an allowance for their continued run-off For example, percentage of widowers aged 45 who were expected to be in receipt of WPA, BP and BA respectively in 2030 are now 19.5%, 9.8% and 6.5% at 2030, respectively
Proportion of standard rate expected to be paid on average	Based on previous experience of the benefit type concerned, or closest equivalent – age & sex-specific rates For example, average expected proportion of standard rate paid to a male aged 45 in 2030 was 80.3% for WPA, 77.4% for BP and 77.4% for BA

Table A10: Travelling allowance grant

	2009 Review
Proportion of population giving rise to a grant	1 grant per 50 males 1 grant per 50 females
Annual increase in cost per grant	In line with up-rating of other benefits

Table A11: Unemployment benefit

	2009 Review
Number unemployed	250 people
The proportion of potential full unemployment benefit received on average by the unemployed	(Equivalent of) 70%

Table A12: Maternity benefit

	2009 Review
Proportion of births giving rise to a Maternity Grant	1 maternity grant per 8.3 births
Proportion of births giving rise to a new Maternity Allowance award	1 new maternity allowance award per 1.1 births
Average duration of Maternity Allowance	14.3 weeks

Table A13: Industrial disablement benefit

	2009 Review
Proportion of insured population giving rise to new awards	(Roughly) 1 new award per 3,375 insureds
Proportion of standard full benefit payable in the average case	38%
Future average termination rate	1 termination per 15 claims in payment

Table A14: Death grant

	2009 Review
Proportion of deaths giving rise to a grant	3 grants per 4 deaths
Proportion of standard full benefit payable in the average case	96.5%

Table A15: Minor benefits

	2009 Review
Coverage	Industrial Medical Benefit (the other two no longer exist)
Expenditure on future Industrial Medical Benefit claims	Expenditure in the review year, adjusted by any change in the number insured in each future projection year in comparison with the number of insured present in the year of the review
Future increases in claim amounts	In line with prices/earnings/halfway between the two

Table A16: Administration costs

	2009 Review
Assumed future increases	Salary-related costs assumed to increase in line with earnings and other costs assumed to increase in line with prices

Appendix B – Population projections

B1. Introduction

B1.1 This appendix sets out details of the projected future population of Guernsey, which will underlie the assessment of the impact of proposed policy changes to the Guernsey Insurance Fund. It also provides projections for a number of variant migration scenarios.

B2. Projection methodology & assumptions

B2.1 These projections of the population of Guernsey are based on population data as at 31 March 2013, as provided by the Guernsey Social Security Department, and allow for the interaction of demographic assumptions including mortality, fertility and migration. Demographic assumptions are inevitably subject to a considerable degree of uncertainty, particularly for the more distant future. The projections we have prepared are not predictions, rather they are based on a set of specific assumptions. We have relied on the accuracy of data and information provided by the Guernsey Social Security Department. GAD does not accept responsibility for advice based on wrong or incomplete data or information provided.

B2.2 The mortality and fertility assumptions underlying the population projections provided are based on the ONS 2012-based projections for England and Wales adjusted by constant age-related multipliers to reflect Guernsey's mortality experience from 2008 to 2013 and Guernsey's fertility experience from 2009 to 2013. Details of the assumptions used are provided in Tables A3 and A4 of Appendix A.

B2.3 Migration to and from Guernsey is particularly difficult to project. At the request of the Social Security Department, we have produced population projections for a number of variant migration scenarios to illustrate the sensitivity of the population projections to different migration experience.

B2.4 The central migration assumption we have been asked to use is to assume 200 more immigrants than emigrants in each year, that is, constant net immigration of 200 a year. The variant migration assumptions are:

- Zero migration
- net immigration of 100 a year
- net immigration of 300 a year

B2.5 The zero migration scenario assumes zero immigration and zero emigration. It does not assume that immigration is matched by equal emigration. This means the population profile is not affected by differences in the distribution of immigrants and emigrants by age and sex.

B2.6 These scenarios have been chosen to demonstrate the effect migration has on the projected population profile and should not be regarded as predictions of future levels of migration.

B2.7 The assumed distribution of migrants by age and sex reflects recent Guernsey experience. In particular, net immigration is concentrated around the 20s and 30s age groups, with small amounts of net emigration at some child and pension ages. Details of the assumed distribution is provided in Table A5 of Appendix A.

B3. **Projection results**

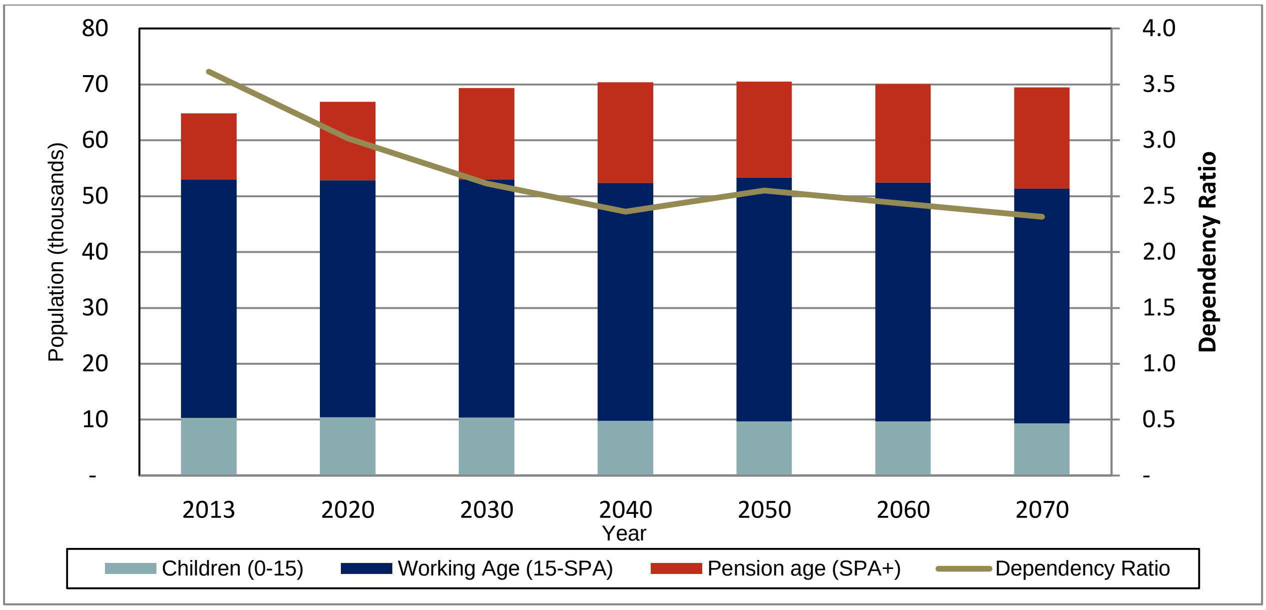
B3.1 The charts provided show the population of Guernsey in 2013 and the projected future population at 10-year intervals for each of the four migration scenarios. The projections are based on population data as at 31 March 2013.

B3.2 The charts sub-divide the population into children (0-15 years), those of working age and pensioners (above pension age). The projections reflect the planned increase in the pension age from 65 to 67 between 2020 and 2031 and the proposed increase in pension age from 67 to 70 between 2032 and 2049, provides for both a larger working-age population and a smaller pensioner population than would otherwise be the case. The impact of the increases in pension age between 2020 and 2040 are not readily observable in the charts due to the large cohorts reaching pension age during this period. In all scenarios, the dependency ratio is projected to decline during this period.

B3.3 The same mortality and fertility assumptions underlie all four scenarios. In particular, in all cases, the total fertility rate is 1.65, which is below the replacement rate of 2.1. The same migrant age/sex distribution is also assumed for all scenarios. The concentration of immigration around the 20s and 30s age groups means that scenarios assuming higher migration project more women of child-bearing age and therefore the projected number of children is also higher, although there is no change in the assumed fertility rate.

B3.4 The starting point for all scenarios is the population as at 31 March 2013 which provides for a ratio of the working-age population to the pensioner population of 3.6.

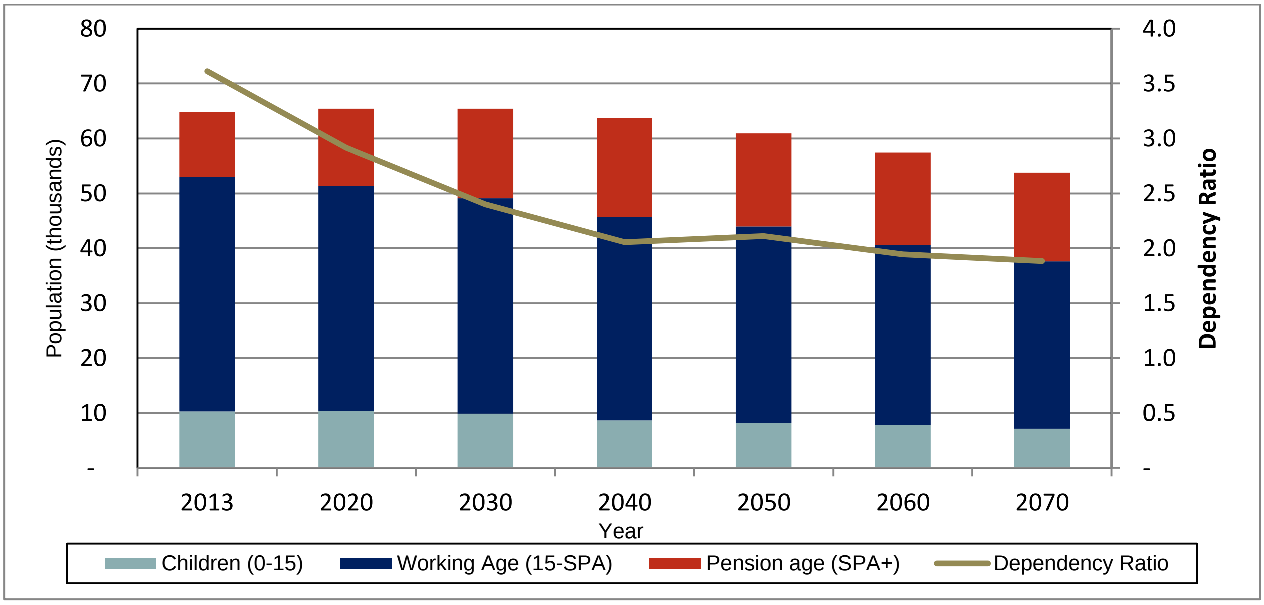
Figure B1: Projection of Guernsey population assuming 200 net immigration



B3.5 Based on the central migration assumption of 200 net immigration a year, the total population and the working-age population are projected to remain reasonably stable over the long-term. Once the proposed increases in pension age are fully implemented in 2050, the working-age population is projected to decline and the pensioner population is projected to increase.

B3.6 Under this scenario, the ratio of the working-age population to the pensioner population is projected to be around 2.3 in 2070.

Figure B2: Projection of Guernsey population assuming zero migration



B3.7 This scenario assumes zero immigration and zero emigration, that is, it does not assume that immigration is matched by equal emigration. This means the population profile is not distorted by differences in the distribution of immigrants and emigrants by age and sex.

B3.8 In this scenario, the total population is projected to be reasonably stable over the short-term but to decline from about 2030, with the working-age population projected to reduce throughout the projection period. The decline in the working-age population reflects both the absence of immigrant workers and also the relatively low total fertility rate. In turn, the absence of immigrant women of child-bearing age further reduces the number of children in future years.

B3.9 Over the short-term the pensioner population is projected to increase, however, it is projected to decline from the 2040s as the pension age continues to increase-and as the smaller working-age population in earlier years flows through to pensioner ages. As the working-age population is decreasing throughout the projections period, this provides for decreases in the dependency ratio before stabilising at around 1.9 from the mid-2060 onwards.

Figure B3: Projection of Guernsey population assuming 100 net immigration

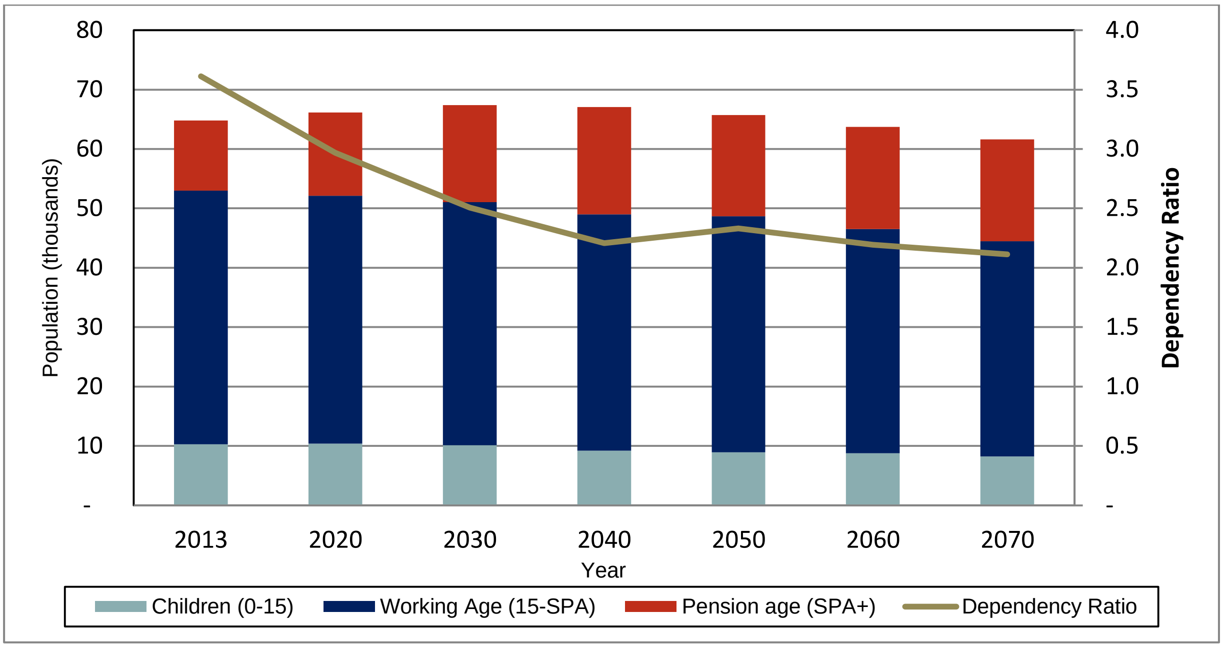
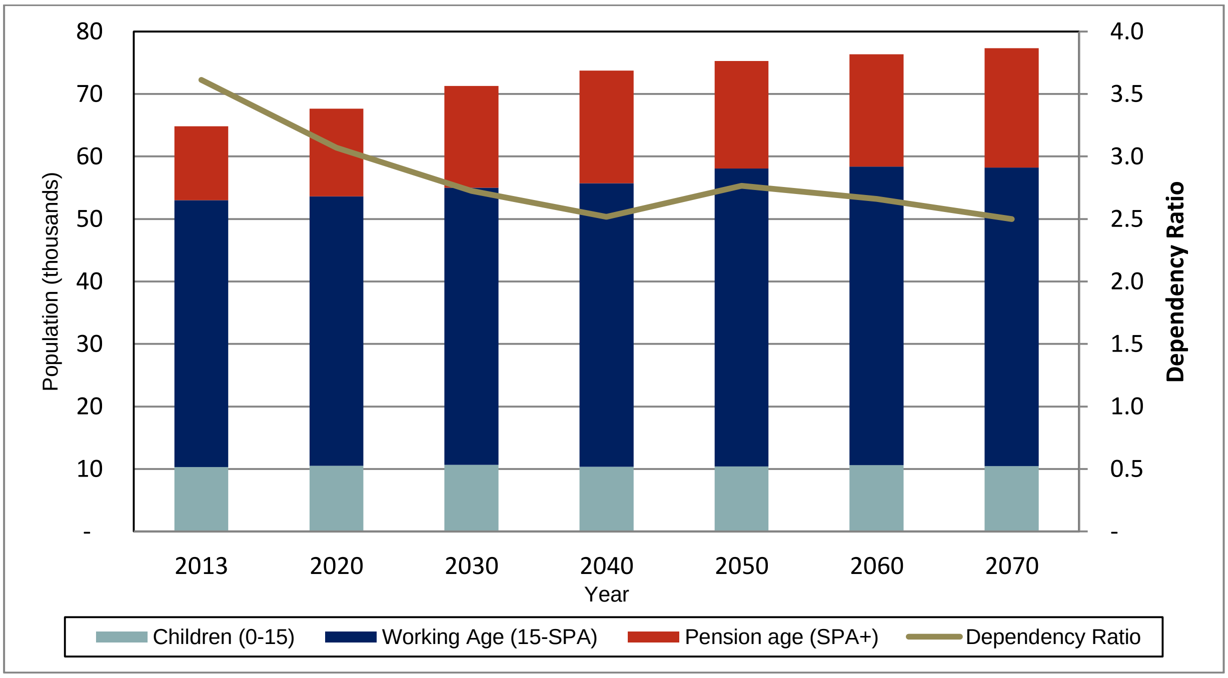


Figure B4: Projection of Guernsey population assuming 300 net immigration



B3.10 The 100 net immigration scenario provides the mid-point between the zero migration scenario and the central 200 net immigration scenario, with the 300 net immigration scenario providing an extrapolation of the central scenario.

B3.11 Similar to the zero migration scenario, under the 100 net immigration scenario the total population is projected to decline from the early 2030s, with the working-age population projected to reduce throughout the projection period, albeit to a lesser extent than that projected under the zero migration scenario. Similarly, the pensioner population is projected to increase over the short-term, but to decline from the 2040s as the pension age continues to increases and as the smaller working-age population in earlier years flows through to pensioner ages. Under this scenario, the ratio of the working-age population to the pensioner population is projected to be around 2.1 in 2070.

B3.12 In contrast, assuming 300 net immigration provides for projected increases in the total population and the working-age population, although the working-age population is projected to become reasonably stable once the proposed pension age increases are fully implemented from 2050. The concentration of immigration around the 20s and 30s age groups means higher projections of women of child-bearing age, which in turn increases the projection number of children and the projected working-age population and pensioner population in later years.

B3.13 Under this scenario, the ratio of the working-age population to the pensioner population is projected to be around 2.5 in 2070.

B3.14 Table B1 below provides a summary of the projected dependency ratios for each migration scenario, together with those projected on the 200 net immigration scenario for the 2009 Review.

Table B1: Projected dependency ratios

Year	2013	2020	2030	2040	2050	2060	2070
200 net immigration	3.6	3.0	2.6	2.4	2.5	2.4	2.3
Zero migration	3.6	2.9	2.4	2.1	2.1	1.9	1.9
100 net immigration	3.6	3.0	2.5	2.2	2.3	2.2	2.1
300 net immigration	3.6	3.1	2.7	2.5	2.8	2.7	2.5
2009 Review (200 net immigration)	3.5	2.9	2.6	2.1	2.0	1.8	1.8

B3.15 The higher projected dependency ratios for the 200 net immigration scenario, relative to those projected for the 2009 Review, reflect a more favourable starting position in 2013, from that projected, together with the proposed additional increases in pension age, the small increase in the assumed total fertility rate from 1.6 to 1.65 and the higher assumed mortality rates adopted for the current projections.

Government Actuary's Department

Appendix 5d: GAD assessment of alternative contribution scenarios for the Guernsey Insurance Fund

MEMO

TO: **Ellen Pragnell, Ed Ashton**

COPIED TO: **Dermot Grenham, Corrado Coppa, Guernsey Policy Costings 2014**

FROM: **Joanne McDaid**

REF: **DATE: 01 July 2014**

SUBJECT: Guernsey Insurance Fund – Constant Contribution Rate required to achieve a fund balance equal to two times annual expenditure at the end of the projection period

1. Introduction

1.1. This memo has been produced in response to a request made during our conference call on 6 June 2014. It provides estimates of the constant contribution rate required from January 2015, such that the projected average Fund balance of the Guernsey Insurance Fund in 2070 is equal to twice the projected expenditure on benefits and expenses during the year.

1.2. Estimates are provided based on the current pension age arrangements and the proposed pension age increases, for projections reflecting both 90% and 100% of modelled contributions, and for two different uprating policies.

2. Background

2.1. Our memo of 20 June 2014 provided projections showing the impact of proposed policy changes on the Guernsey Insurance Fund ("the Fund"). The projected fund ratios provided in that memo were based on the current combined Class 1 contribution rate from employer and employee of 8.3% of relevant band earnings.

2.2. This note provides estimates of the constant contribution rate required such that the projected average Fund balance of the Guernsey Insurance Fund in 2070 is equal to twice the projected expenditure on benefits and expenses during the year for eight different scenarios. The assumptions underlying these projections are detailed in our memo of 20 June 2014. This memo should be read in conjunction with the 20 June memo.

2.3. Analogous to the projection of break-even contribution rates, the estimated constant contribution rates provided in this memo have been assessed in terms of the combined Class 1 contribution rate from employers and employees. It is assumed that contribution rates for self-employed and non-employed contributors would be changed pro rata to the Class 1 rate.

3. Results

3.1. Table 1 overleaf shows the estimated constant contribution rates required from January 2015 for four different scenarios, based on up-rating of benefits in line with prices. Table 2 shows the corresponding constant rates based on up-rating of benefits in line with the long-term up-rating policy of 0.5% above price inflation throughout the projection period.

3.2. In both tables, the estimates provided are based on:

> The current pension age arrangements, including the agreed increases in pension age to 67 between 2020 and 2031

> Proposed pension age increases to age 70 between 2032 and 2049, following the agreed increases between 2020 and 2031.

In each case, estimates are provided based on:

- 90% of modelled contributions
- 100% of modelled contributions.

Table 1: Constant contribution rate calculated assuming up-rating in line with prices

Pension age	Adjustment to modelled contributions	
	90%	**100%**
Current pension age arrangements	8.7%	7.8%
Proposed pension age changes	8.1%	7.3%

Table 2: Constant contribution rate calculated assuming up-rating in line with the proposed long-term policy of prices plus 0.5%

Pension age	Adjustment to modelled contributions	
	90%	**100%**
Current pension age arrangements	9.9%	8.9%
Proposed pension age changes	9.2%	8.3%

3.3. Figures 1 to 4 on the following pages show the projected fund ratios based on the constant contribution rates for the four price up-rating scenarios detailed in Table 1. It can be observed that the projected fund ratios shown in Figures 2 and 4 are virtually identical to those provided in Figures 1 and 3 respectively. That is, using 100% of modelled contribution provides for lower constant contribution rates but the projected profile of the fund ratios is unchanged. Specifically, the contribution rates derived for the scenarios using unadjusted modelled contribution are broadly 90% of those derived for the scenarios based on 90% of modelled contributions.

3.4. There are very slight differences between the scenarios as the adjustment to modelled contributions is applied from 2014 onwards whereas the constant contribution rates are derived as those required from January 2015. Given these very small differences, corresponding charts based on the long-term up-rating scenario are only provided in respect of the projections based on 90% of modelled contributions.

3.5. Please note that chart axes are appropriate to the relevant projections and therefore the scales are not necessarily consistent between charts.

Figure 1: Projected fund ratios based on a Class 1 contribution rate of 8.7% and 90% of modelled contributions

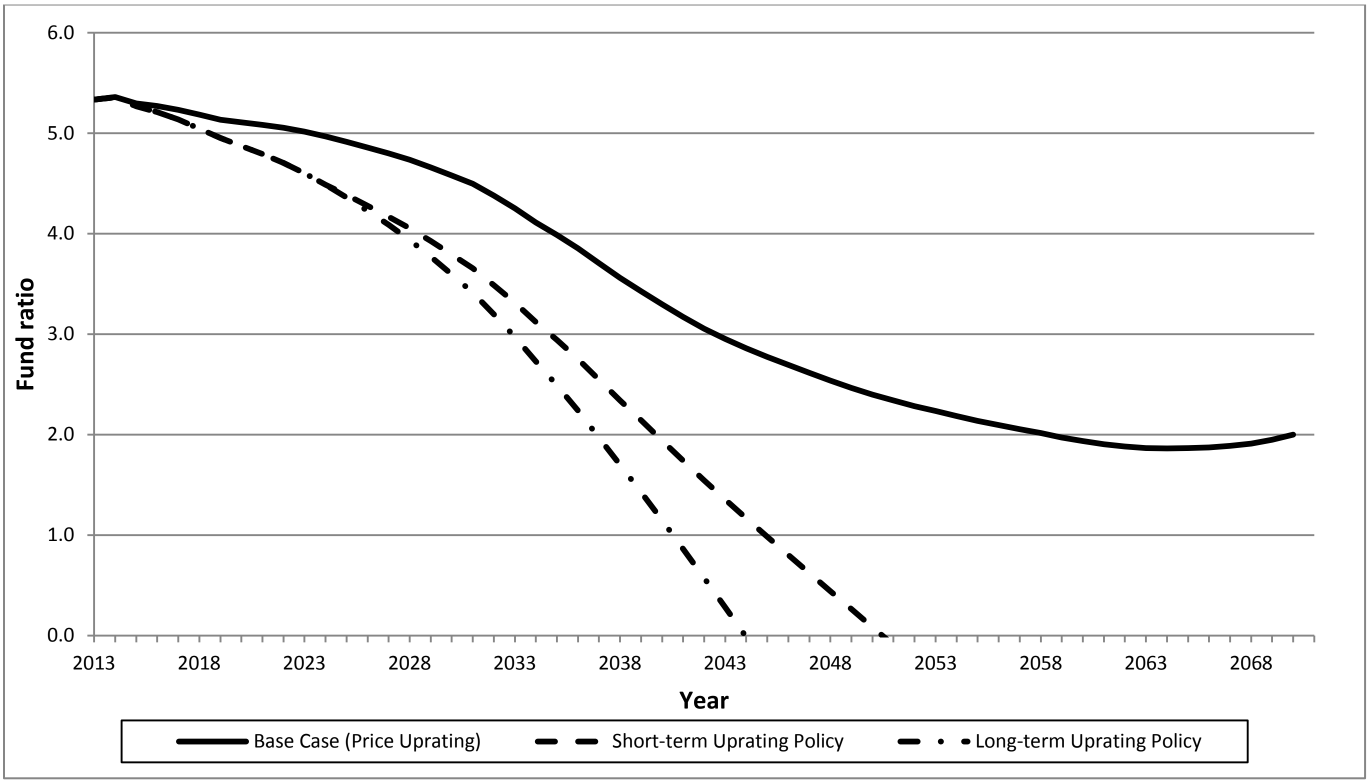


Figure 2: Projected fund ratios based on a Class 1 contribution rate of 7.8% and 100% of modelled contributions

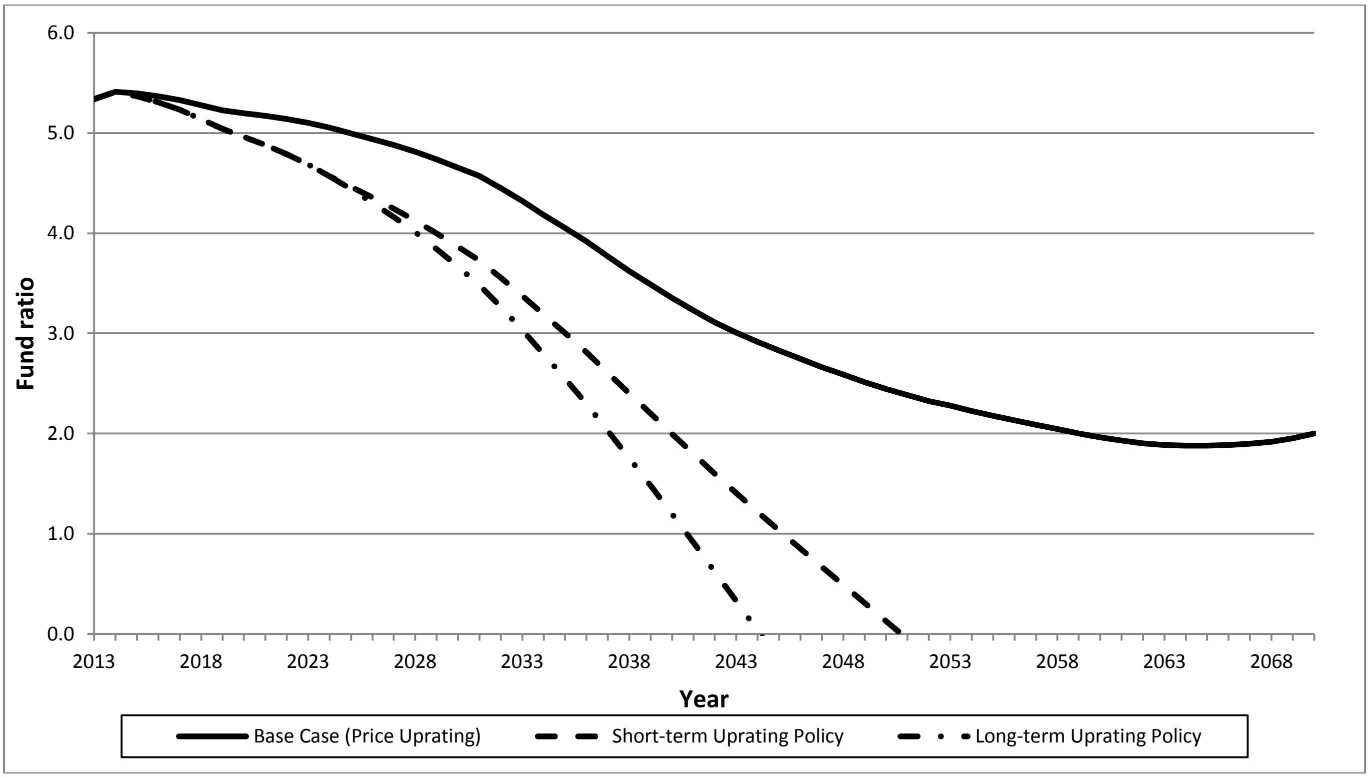


Figure 3: Projected fund ratios based on a Class 1 contribution rate of 8.1% and 90% of modelled contributions, allowing proposed increases in pension age

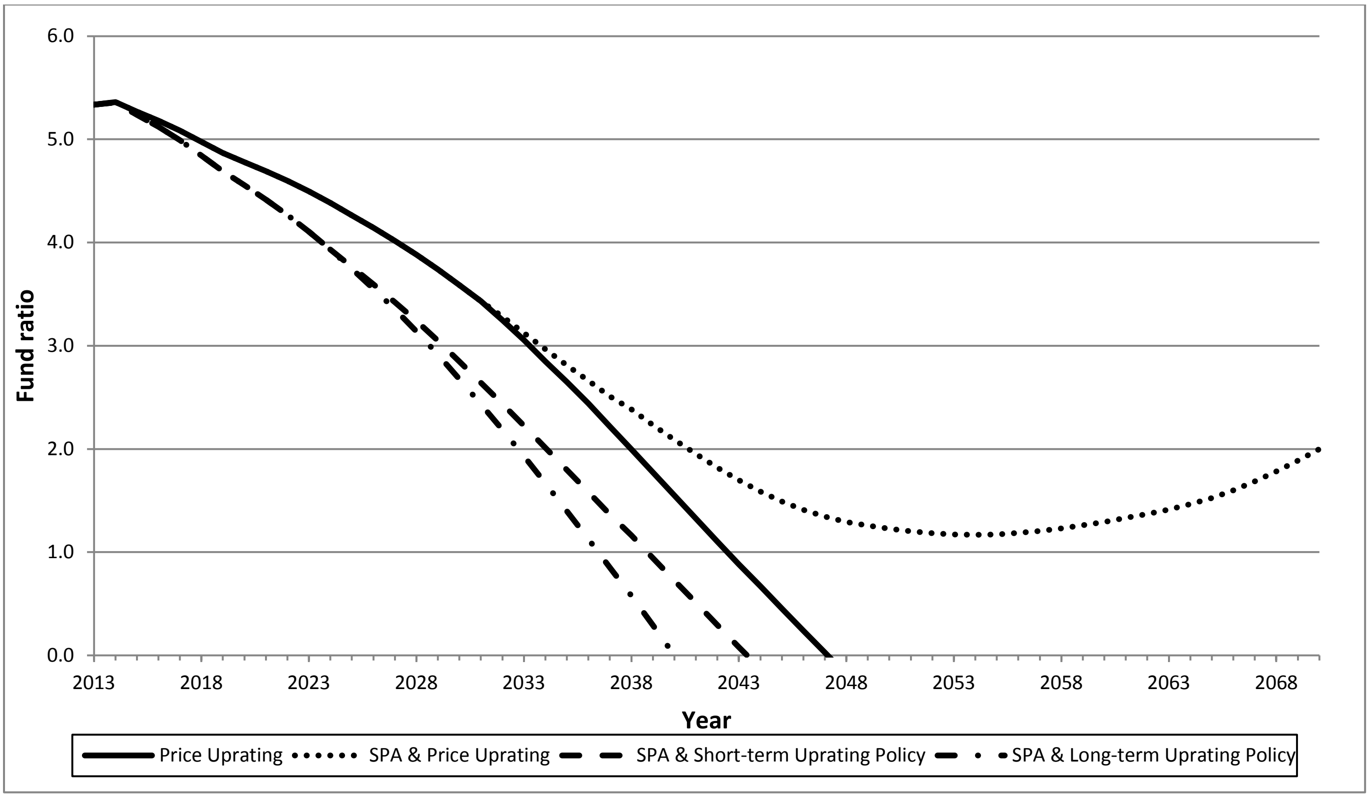


Figure 4: Projected fund ratios based on a Class 1 contribution rate of 7.3% and 100% of modelled contributions, allowing proposed increases in pension age

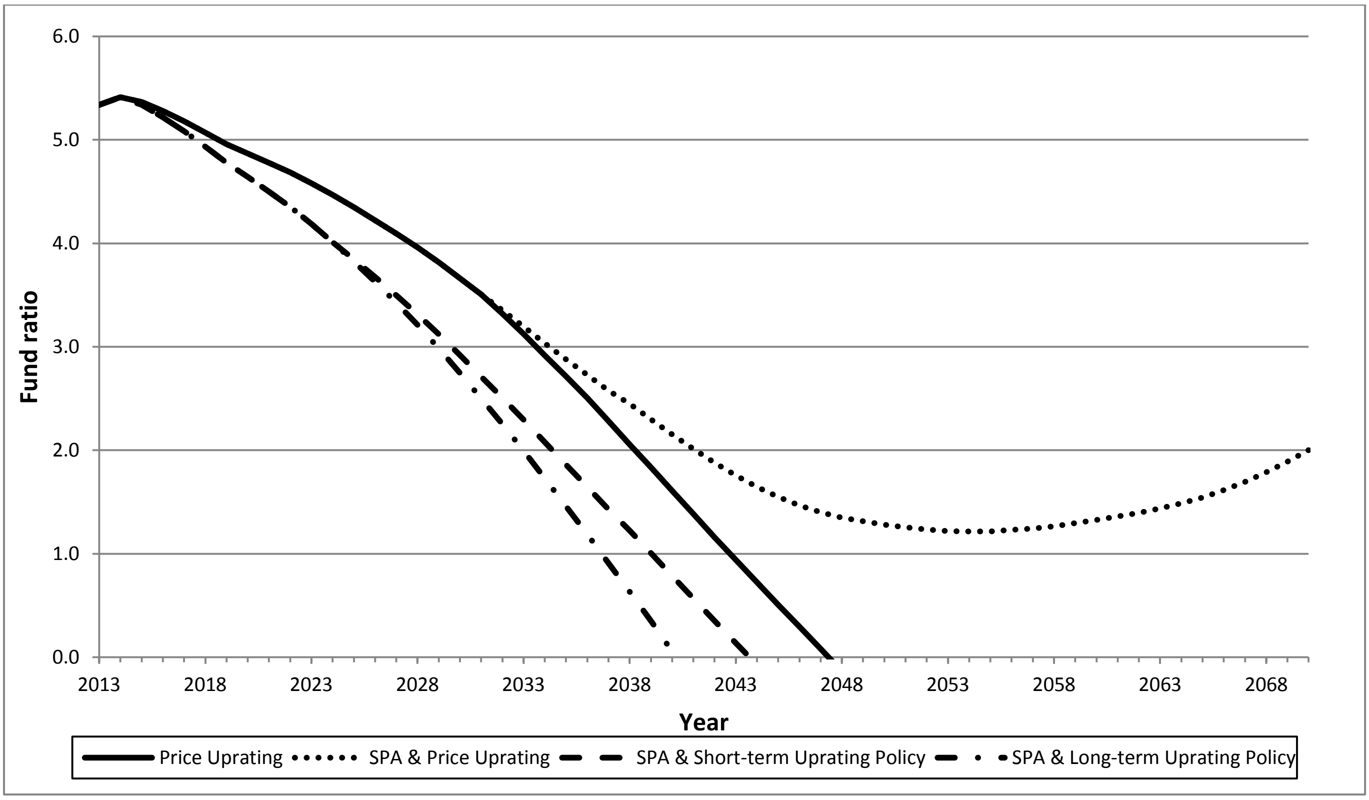


Figure 5: Projected fund ratios based on a Class 1 contribution rate of 9.9% and 90% of modelled contributions

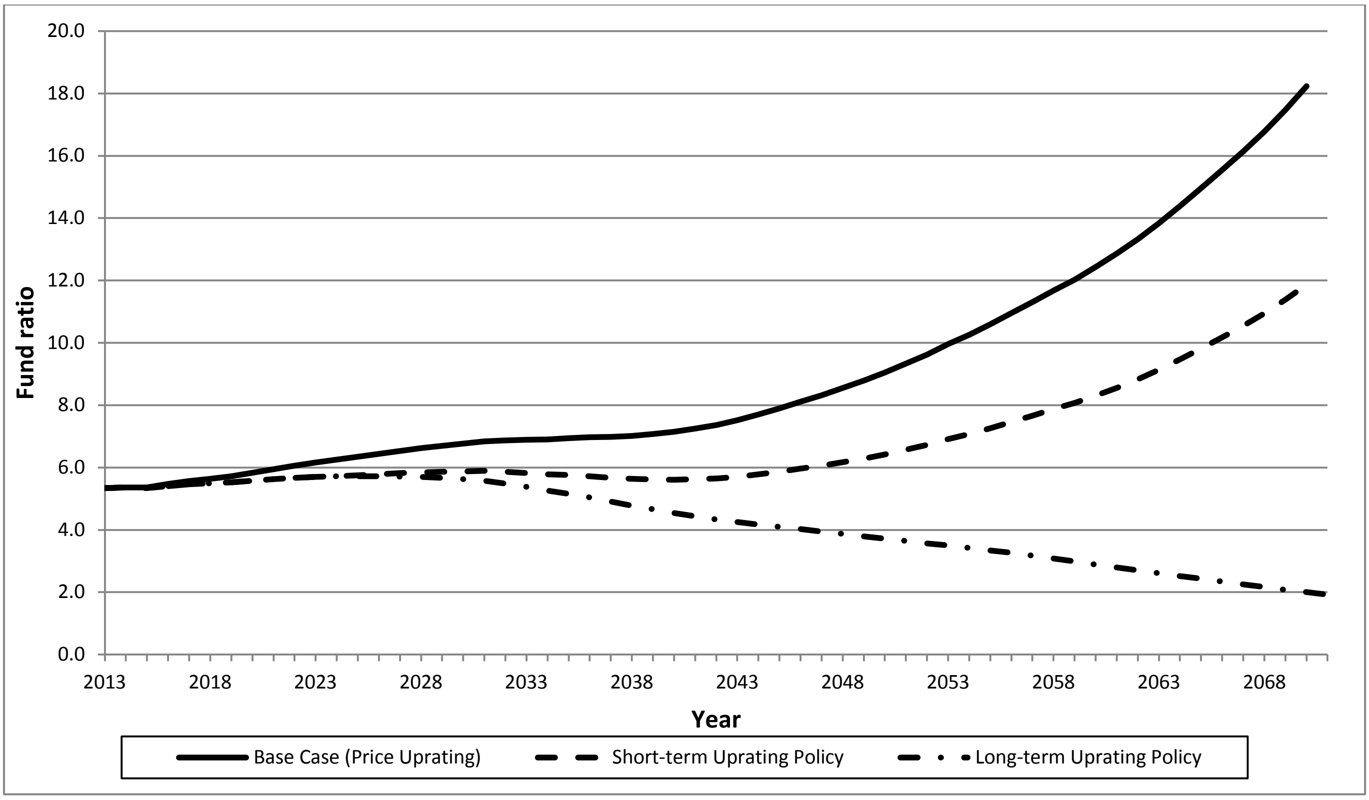
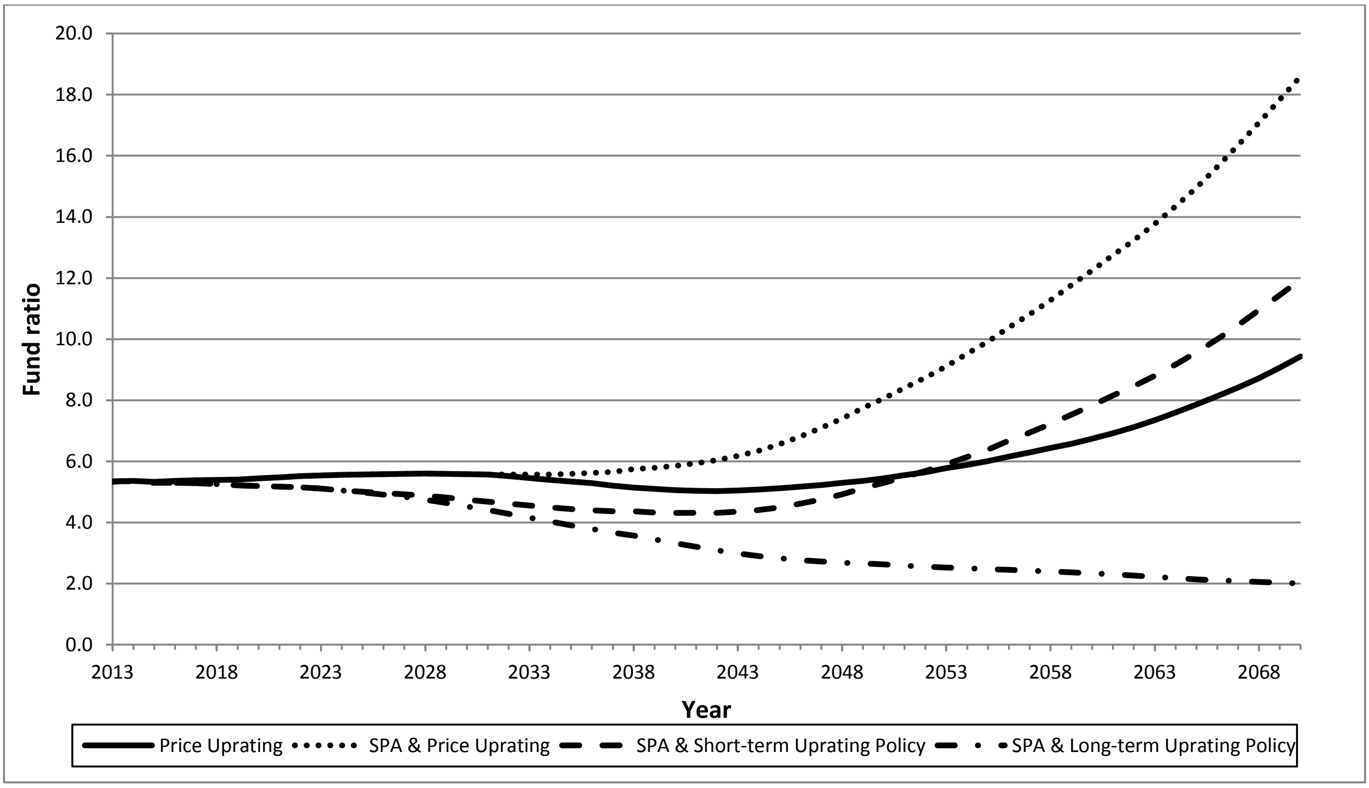


Figure 6: Projected fund ratios based on a Class 1 contribution rate of 9.2% and 90% of modelled contributions, allowing proposed increases in pension age



4. Limitations

4.1. This memo has been prepared for the Minister and Members of the Guernsey Social Security Department. We understand that the information in this report may be made available to others. However GAD does not accept any liability to third parties in relation to this report.

4.2. This assessment of the impact of proposed policy changes which underlies the projections provided in this memo does not constitute a full review of the Fund. A full review of the Fund could produce projections that are materially different from those provided in this memo. Details of the assumptions underlying these projections are provided in our memo of 20 June 2014.

4.3. These projections rely on the accuracy of data and information provided by the Guernsey Social Security Department. GAD does not accept responsibility for advice based on wrong or incomplete data or information provided.

4.4. Advice provided must be taken in context. Advice is intended to be read and used as a whole and not in parts. GAD does not accept responsibility for advice that is altered or used selectively.

4.5. Clarification should be sought if there is any doubt about the intention or scope of advice provided in this report. GAD is not responsible for any decision taken by the Social Security Department, except to the extent that the decision has been made in accordance with specific advice provided.

4.6. All references to Guernsey in this memo are to be taken to include also the islands of Alderney, Herm and Jethou.

Appendix 5e: The impact of changing old-age pension uprating relative to inflation and earnings

A5e.1 The actuarial projections show the impact on the funds of changing the assumed annual uprating (see table A5.1 and **Appendix 5d**). The impact of reducing the assumptions of uprating is considerable. Even using the downside (90% of modelled income) projections, a reduction in the assumed annual rate of uprating of just 1/3rd of the assumed increase in earnings (assumed to be RPIX +0.5%) could add 10 years to the lifespan of the fund.

A5e.2 Using the upside (or 100% of modelled income) projections suggests that the fund could be made fully sustainable, with no increase in contributions, if the uprating assumption were reduced to prices only for all or part of the projected period.

A5e.3 The projections indicate that, assuming economic conditions improve, the States could maintain the uprating policy above RPIX for a period of up to ten years (reducing to RPIX subsequently) and maintain the value of the GIF above the equivalent of two years of expenditure with no additional measures required.

A5e.4 If economic conditions do not improve, a reduction in the uprating policy to prices only would not, alone, be sufficient to stabilise the GIF. However, applied in combination with an increase in pension age the improvement in the fund stability is greater.

Table A5.1: Estimated minimum level of reserve held by Guernsey Insurance Funds

	Minimum number of years of expenditure held in reserve	
	Upside model (At 100% income)	**Downside model (At 90% income)**
Prices (RPIX) only	Sustainable: Minimum 5 years expenditure held in 2042	Exhausted by 2052
1/3rd of real increase in median earnings (Prices +0.5%)	Exhausted by 2053	Exhausted by 2040
1/3rd of real increase in median earnings (Prices +0.5%) for 10 years, prices only there after	Sustainable: Minimum 3 years expenditure held in 2058	Exhausted by 2043

Table A5.2: Estimated employee/employer contribution rates required to stabilise Guernsey Insurance Funds

	Estimated required contribution rates	
	Upside model (At 100% income)	**Downside model (At 90% income)**
Prices only	7.8%	8.7%
1/3rd of real increase in median earnings (Prices +0.5%)	8.9%	9.9%
1/3rd of real increase in median earnings (Prices +0.5%) for 10 years, prices only there after	7.8%-8.3%	8.7%-9.9%
Current employee/employer contribution rate to GIF: 8.3%		

A5e.5 There are consequences to reducing the assumed annual increase in pensions. Reducing the annual uprating of pensions to prices (RPIX) only would maintain the real value of the pension in monetary terms. This means that after adjusting for inflation, it would be worth, in monetary terms, the same in twenty years as it is today and, in theory, a pensioner would be able to buy the same amount of goods.

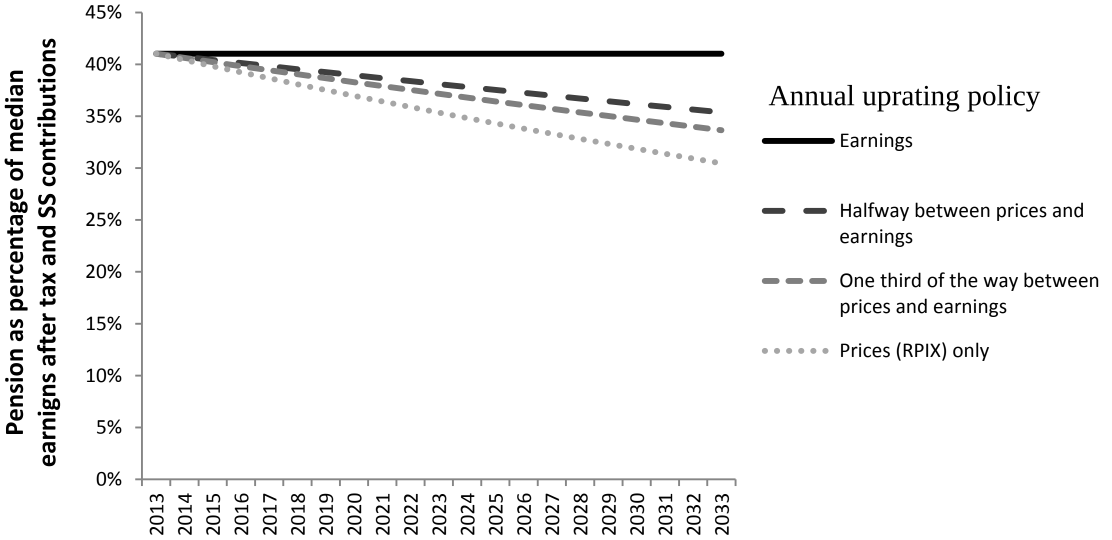
A5e.6 However, typically, earnings among those employed increase faster than inflation[4] (as has been assumed in these projections). If this is the case, then increasing pensions at a rate lower than the increase in earnings means that the value of the old-age pension relative to earnings (the replacement rate) will decrease (see figure A5.3).

A5e.7 The implication of this is that more pensioners could be poor relative to the income of the population as a whole. At present, about 16% of pensioner households in Guernsey rely on their Guernsey old-age pension for more than 75% of their total income (before receipt of benefits). A reduction in the value of the old-age pension relative to earnings could result in an increased in the percentage of pensioners who have recourse to Supplementary Benefit to supplement their income, particularly if welfare benefit rates are increased at a faster rate than the old-age pension.

[4] This has not been the case in the last four years. Between 2009 and 2013 median earnings have reduced in real terms.

Figure A5.3: Projected replacement rate of a full old-age pension (after tax and Social Insurance)

Assuming 1.5% annual increase in median earnings



A5e.8 At present, approximately 15% of pensioner households claim Supplementary Benefit or a social housing rent rebate. Projecting how this might increase is difficult, especially as it is unclear at this time what level of private provision people retiring in the next forty years can expect. However, as a rough indication, between 1% and 3% of pensioner households are within 5% of the requirement rates for Supplementary Benefit and therefore could be considered most at risk. A further 1% to 2% are within 5% and 10% of requirement rates and could be considered at some risk.

A5e.9 If the risk of an increase in the proportion of Supplementary Benefit were to manifest there would be a cost implication. Again, how much this might be is difficult to establish but outside estimates suggest that, if uprating were restricted to RPIX only, this could reach a maximum of £0.5m per annum in twenty years.

A5e.10 While this is a substantial sum, it is significantly less than the cost to the GIF of continuing to increase pensions by more than RPIX each year, which would require an increase in contributions of between 0.6% and 1.3% to make the fund sustainable. In monetary terms this increase would extract a further £7m to £14m per annum from the workforce (or employers) if applied today.

A5e.11 The old-age pension was designed to be a platform for retirement income of sufficient value to encourage thrift during working lives and to allow the majority of people to finance their retirement through a pension, personal savings and other income. The impact of a gradual reduction in the replacement rate over time could be mitigated by increasing the amount of private pension provision made by individuals. This would increase the total replacement rate of an individual's total income in retirement; reducing the dependence on the old-age pension. This issue is covered in more detail in Section 5.2.

A5e.12 While the benefit of reducing the assumed rate of annual uprating to RPIX only is clear and the public consultation suggested broad support for reducing the increase to inflation only (42% in favour versus 29% not in favour), given the weakness that is known to exist in the provision of personal and workplace pensions, the Joint Board does not feel it would be appropriate to reduce the assumed rate of uprating to this level at this time.

Appendix 5f: The impact of further increasing the pension age

A5f.1 When the old-age pension was first introduced in Guernsey in the 1920s the pension age was set at 70. At the time this was *higher* than average life expectancy. Subsequently, when the current pension law was drafted in 1965 the pension age was reduced to 65.

A5f.2 In 2009, the Social Security Department presented a report containing proposals to improve the sustainability of the Guernsey Insurance Fund [GIF] (Billet d'État XXI, July 2009). The States agreed to increase the pension age from 65 to 67 between 2020 and 2031.

A5f.3 If this is compared to average life expectancy projections, the average number of years an individual can be expected to live beyond the age of 65 is expected to have increased by 10 or 11 years between 1965 and 2031. As a result people are spending, on average, a greater proportion of their lives in retirement and a smaller proportion of their lives contributing towards their old age pension.

A5f.4 This means that individuals are receiving the majority of the benefit of increased life expectancy by way of an increased number of years in retirement. Meanwhile comparatively little of this improvement is being relayed into the economy in the form of an increase in the number of years each person is economically active and the GIF is carrying the increasing cost of having to pay out pensions for a greater number of years.

A5f.5 The States need to consider how to redress the balance between additional years in retirement for the individual and the benefit received by the economy and the government, by increasing the number of years in which people are likely to be economically active.

A5f.6 Many countries have chosen to increase the age at which people can claim their old-age pension over the last three years. To cover but a few examples:

- Australia: agreed an increase in the pension age to 70 by the year 2035 was confirmed in the 2014 federal budget published in May 2014.
- UK: stated their intention to link the UK pension age to life expectancy, which would see the pension age reach 68 by the mid-2030s and 69 in the 2040s in April 2013. The expectation is that the pension age will continue to increase to 70 in the 2060s.
- Ireland: announced an increase in the pension age to 68 by 2028, in 2011.

- Netherlands: agreed to increase their pension age to 67 by 2023.
- Norway: introduced a flexible pension age allowing people to begin claiming between 62 and 75.
- The Isle of Man: published proposals to increase the State Pension age to 74 by the early 2070s in November 2014.

A5f.7 Increasing the pension age effectively increases the average number of years a claimant is paying in to the Social Security funds and reduces the number of years they claim from them. This both reduces expenditure and increases contribution income.

A5f.8 Actuarial projections indicate that, assuming an annual uprating of 0.5% (1/3rd of the assumed increase in median earnings), an increase in the pension age to 70 by 2049 would reduce the required contribution increase to between 0% and 0.9%. If combined with an assumption of an uprating policy of RPIX only, an increase in the retirement age as stated could make the fund sustainable even using the downside projections.

Table A5.4: Estimated minimum level of reserves held by the Guernsey Insurance Funds
-assuming annual uprating of **RPIX +0.5%**

	Minimum number of years of expenditure held in reserve	
	Upside model (At 100% income)	**Downside model (At 90% income)**
Current increase in pension age (to 67 by 2031)	Exhausted by 2053	Exhausted by 2040
Pension age increased to 70 by 2049	Sustainable: Minimum 2 years'' expenditure held in 2071	Exhausted by 2042

Table A5.5: Estimated minimum level of reserves held by the Guernsey Insurance Funds
-assuming annual uprating of **RPIX only**

	Minimum number of years of expenditure held in reserve	
	Upside model (At 100% income)	**Downside model (At 90% income)**
Current increase in pension age (to 67 by 2031)	Sustainable: Minimum 5 years' expenditure held in 2042	Exhausted by 2052
Pension Age increased to 70 by 2049	Sustainable: Minimum 5 years' expenditure held in 2015	Sustainable: Minimum 2 years' expenditure held in 2047

Table A5.6: Estimated employee/employer contribution rate required to stabilise the Guernsey Insurance Funds

-assuming annual uprating of **RPIX +0.5%**

	Estimated required contribution rates	
	Upside model (At 100% income)	**Downside model (At 90% income)**
Current increase in pension age (to 67 by 2031)	8.9%	9.9%
Pension Age increased to 70 by 2049	8.3%	9.2%
Current employee/employer contribution rate to GIF: 8.3%		

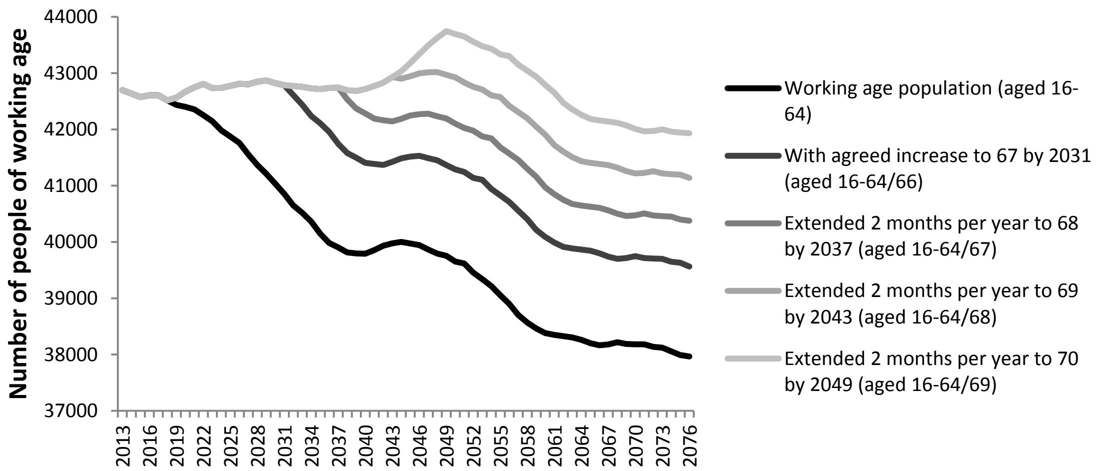
Table A5.7: Estimated employee/employer contribution rate required to stabilise the Guernsey Insurance Funds

-assuming annual uprating of **RPIX only**

	Estimated required contribution rates	
	Upside model (At 100% income)	**Downside model (At 90% income)**
Current increase in pension age (to 67 by 2031)	7.8%	8.7%
Pension Age increased to 70 by 2049	7.3%	8.1%
Current employee/employer contribution rate to GIF: 8.3%		

A5f.9 Beyond improving the financial sustainability of the GIF, there are further benefits to increasing the pension age. As explained in the Principles and Issues document (section 9), even assuming net immigration of 200 people per year, Guernsey faces a declining working age population. Increasing the pension age would extend the working age population, increasing the pool of employees available. Given that many people choose to retire early it is unlikely that the full improvement in the working age population will be translated into an increase in the number of people employed, but this could represent a partial solution to the declining work force.

Figure A5.8: Projected working age population adjusted for changes in retirement age.



A5f.10 This could be of considerable economic and fiscal benefit to Guernsey. If it is assumed that participation rates for those captured by the increase in pension age are the same as currently seen in those aged 60 to 65, this could add up to 3% to States revenues (at current prices that is equivalent to about £14m). However, it would be several decades before the benefit of this became apparent in public finances.

A5f.11 Table A5.9 below shows the comparative impact on the fund ratio of the increase in pension age and the assumed annual uprating on the projected reserves. The recommended policy combination is underlined.

Table A5.9: Estimated minimum level of reserves held by the Guernsey Insurance Funds

		Minimum number of years of expenditure held in reserve	
Uprating Policy	**Pension Age**	**Upside model (At 100% income)**	**Downside model (At 90% income)**
RPIX (prices) only	**Pension age increased to 67 by 2031**	Sustainable: Minimum 5 years' expenditure held in 2042	Exhausted by 2052
	Pension age increased to 70 by 2049	Sustainable: Minimum 5 years' expenditure held in 2015 (i.e. the reserves will increase from their current level)	Sustainable: Minimum 2 years' expenditure held in reserve 2047
1/3rd of real increase in median earnings (RPIX +0.5%) until 2025, prices only thereafter	**Pension age increased to 67 by 2031**	Sustainable: Minimum 3 years' expenditure held in reserve 2058	Exhausted by 2043
	Pension age increased to 70 by 2049	Sustainable: Minimum 4 years' expenditure held in 2040	Exhausted by 2048
1/3rd of real increase in median earnings (Prices +0.5%)	**Pension age increased to 67 by 2031**	Exhausted by 2053	Exhausted by 2040
	Pension age increased to 70 by 2049	Sustainable: Minimum 2 years' expenditure held in reserve 2070	Exhausted by 2042

Table A5.10: Estimated employee/employer contribution rates required to stabilise the Guernsey Insurance Fund

Current contribution rate = 8.3%

		Contribution rate	
Uprating Policy	**Pension Age**	**Upside model (At 100% income)**	**Downside model (At 90% income)**
RPIX (prices) only	**Pension age increased to 67 by 2031**	7.8%	8.7%
	Pension age increased to 70 by 2049	7.3%	8.1%
1/3rd of real increase in median earnings (RPIX +0.5%) until 2025, Prices only thereafter	**Pension age increased to 67 by 2031**	7.8% - 8.3%	8.7%-9.2%
	Pension age increased to 70 by 2049	7.8% - 8.3%	8.7%-9.2%
1/3rd of real increase in median earnings (Prices +0.5%)	**Pension age increased to 67 by 2031**	8.9%	9.9%
	Pension age increased to 70 by 2049	8.3%	9.2%

A5f.12 On balance, the public consultation indicated general support for an increase in the pension age with 50% of respondents broadly in favour of an increase compared to 22% who were broadly not in favour. If this recommendation is accepted, Guernsey would be among the earliest jurisdictions to confirm an increase in the pension age to 70 although it is likely others jurisdictions will follow.

A5f.13 The Joint Board considered the possibility of accelerating this increase. If the current agreed policy[5] were amended, increasing the pension age at three months a year (as opposed to two) from 2020, the pension age in Guernsey could reach 70 by 2039. However, the Joint Board do not feel it is appropriate to change the policy already agreed upon, which would impact (although by a comparatively small amount) the retirement age of those currently in their late 50s.

[5] to increase the pension age at a rate of two months a year between from 2020 to reach 67 in 2031.

Appendix 5g: Support for older workers

A5g.1 To achieve maximum benefit from an increase in the pension age, the States will need to promote workforce participation among those approaching retirement. Catering for an older workforce may require employers in Guernsey to adapt their practices.

A5g.2 Many people already choose not to work to the official pension age, choosing instead to retire early. It is to be expected that, if the pension age were increased, the percentage of people who would choose not to continue to work to the pension age would increase. As is currently the case, unless they have medical reasons not to work, those who choose to retire early would be responsible for their own self-support.

A5g.3 As people age, typically their level of health and fitness declines and the proportion of people who struggle to perform their daily tasks could increase if the pension age were extended. This could lead to an increase in claims for incapacity benefit. Those with physically or mentally demanding jobs are likely to be most affected.

A5g.4 However, with improved life expectancy has come improved levels of health and fitness. The typical level of fitness of a 65 year old today is considerably higher than a 65 year old in 1965. The average 65 year old in 2049 may be fitter still. The perception of age needs to be adapted to the changing reality.

A5g.5 The Joint Board recommends that Social Security Department be instructed to lead a project, in consultation with all other affected departments with the objective of enacting recommendations to "Support longer working lives by providing access to life-long learning, adapting work places for a more diverse workforce, developing employment opportunities for older workers and supporting active and healthy ageing.

Appendix 5h: Means testing pensions

A5h.1 The option of means-testing the old age pension, and restricting access to lower income households only, was raised in the initial consultation paper. Reponses to the idea of means-testing of pensions were among the strongest received: 69% of respondents did not support the suggestion; while only 16% responded in favour. The general feeling was that pensions are a part of the contractual arrangement between the States and contributors and many felt that to withdraw that entitlement would be a breach of trust.

A5h.2 As highlighted in the Principles and Issues report, other countries have moved to means-tested systems. Australia introduced a scheme like this in 1992 making the government-paid old-age pension a means-tested safety net and placing the majority of the burden for providing for pensions in retirement on compulsory workplace pensions, with a compulsory employer's contribution of 9%.

A5h.3 The time required to transition to a means-tested system, while avoiding disadvantaging those who have planned their retirement around the receipt of an old-age pension would be very long. In the very long-term a means-testing of the old-age pension could very significantly reduce expenditure, however the transition time required would mean that the benefit of this would occur too late to stabilise the GIF through the period of imbalance.

A5h.4 **It is the opinion of the Joint Board that, given the public feeling against this idea and the current poor coverage of private and workplace pensions in Guernsey, this should not be attempted. Furthermore, there are several other identified issues with means-tested pension systems which the Joint Board feels make it unsuitable for Guernsey in the near future, including:**

- **It may discourage personal provision as a private or workplace pension.**
- **As a means tested benefit, claiming the old-age pension may become stigmatised.**
- **Means testing can be administratively complex and would increase the administration cost of the system.**
- **The evidence suggests that uptake and/or accessibility of workplace or private pension schemes in Guernsey is poor and in their absence there is a risk of increased pensioner poverty.**

Appendix 5i: Voluntary deferral of pension claims

A5i.1 Many countries, including the UK and Canada, offer the option to delay the age at which a pension can be claimed, in return for a slight enhancement of the amount received. Typically the benefit of deferral is shared between the individual deferring their claim and the government, which receives additional contributions from the person deferring their claim and makes fewer payments.

A5i.2 The benefit the individual would receive from deferral varies by country, but pension payments might be expected to be increased by approximately 5% for each year a pension claim is deferred. At the current level of payments that is equivalent to just under £10 a week.

A5i.3 In most places, only a small proportion of people opt to defer their pension and the administration is more complicated than Guernsey's current system. Financially, the benefits of a voluntary deferred pension scheme are unlikely to be large enough to make a significant improvement in the issue of financing old-age pension provision, particularly when balanced against increased administration costs. It could, however, be a useful way of encouraging people to stay in work longer.

A5i.4 While the Joint Board is not recommending this at this time, it is an area that the Social Security Department may wish to return to in the future.

Government Actuary's Department

Appendix 6: GAD assessment of alternative contribution scenarios for the Long-Term Care Fund

MEMO

TO: **Ellen Pragnell, Ed Ashton**

COPIED TO: **Dermot Grenham, Corrado Coppa, Guernsey Policy Costings 2014**

FROM: **Joanne McDaid**

REF: **DATE: 18 July 2014**

SUBJECT: Guernsey Long-term Care Fund – Constant Contribution Rate required to achieve a fund balance equal to one year's expenditure at the end of the projection period

1. Introduction

1.1 This memo has been produced in response to the request made in your email of 10 July 2014. It provides estimates of the constant contribution rate required from January 2015, such that the projected average Fund balance of the Long-term Care Fund ("the Fund") in 2070 is equal to the projected expenditure on benefits and expenses during that year.

1.2 Estimates are provided based on the current pension age arrangements and 90% of modelled contributions, for projections reflecting both 85% and 100% of modelled expenditure on permanent nursing benefits, and for three different uprating policies. Estimates are based on updated population projections and a revised assumption for real earnings growth of 1.5% a year.

2. Background

2.1 In February 2014, the Guernsey Social Security Department ("the Department") asked us to provide projections showing the impact of proposed policy changes on the Guernsey Insurance Fund. The Department asked that these projections reflect updated population projections and a revised real earnings growth assumption of 1.5% a year. The results of those projections were provided in our memo of 20 June 2014. Subsequently, the Department requested estimates of the constant contribution rate required to achieve a fund balance for the Guernsey Insurance Fund equal to two times annual expenditure at the end of the projection period (2070) for a number of scenarios, based on the same underlying assumptions. The results of those projections were provided in our memo of 1 July 2014.

2.2 This memo provides similar estimates for the Long-term Care Fund to those provided in the 1 July memo. That is, estimates of the constant contribution rate required to achieve a specified fund balance at the end of the projection period for six different scenarios, based on updated population and real earnings growth assumptions. For the Long-term Care Fund the specified fund balance at the end of the projection period is a fund balance equal to one-year's projected expenditure on benefits and expenses at the end of the projection period.

2.3 Similar to the projections in the memos in respect of the Guernsey Insurance Fund, the estimated constant contribution rates provided in this memo have been assessed in terms of the Class 1 contribution rate paid by employees. It is assumed that contribution rates for self-employed and non-employed contributors would be changed pro rata to the Class 1 rate.

3. Assumptions

3.1 The assumptions underlying the estimates provided in this note are the same as those in the most recent review of the Long-term Care Fund, updated to reflect:

- Actual population numbers in the years 2009 to 2013 inclusive
- Actual benefit rates and earnings limits during this period

- The introduction of the Elderly Mentally Infirm benefit from January 2011, adopting an assumption that 20% of residential care beneficiaries receive this supplement
- Updated population projections based on population data as at 31 March 2013, as provided by the Guernsey Social Security Department, and the mortality, fertility and migration assumptions set out in Appendix A. These reflect net immigration of 200 a year, rather than the assumption of variable migration set to be sufficient to maintain the total population constant at the April 2007 level as adopted for the 2009 Review
- A real earnings growth assumption of 1.5% a year, rather than 2% a year as adopted for the 2009 Review.

3.2 Appendix B sets out the results of the updated population projections. We have already provided the Guernsey Social Security Department with a spreadsheet showing the population projection for each year from 2013 to 2070 by age and sex.

3.3 We aligned modelled contribution income and benefit expenditure with actual experience, as recorded in the accounts. This has shown that actual contribution income has been lower in recent years than projected by our models – potentially reflecting smaller proportions of the population contributing to the scheme and lower earnings increases in recent years – and that expenditure on permanent nursing benefits in recent years has also been lower than that projected by our models. We have made an explicit adjustment of 0.9 to the modelled contribution figures and an adjustment of 0.85 to the modelled permanent nursing benefit expenditure figures to bring these in line with the accounts, that is, the projections provided are based on 90% and 85% of modelled contribution income and benefit expenditure respectively.

3.4 The Guernsey Social Security Department requested additional projections reflecting 100% of modelled expenditure on permanent nursing benefits that is, with no adjustment made to align the projections with recent experience. This request was made as there was some reservation that recent experience reflected shortages in availability of care facilities rather than lower care needs. This provides for an increase in projected benefit expenditure in 2014, the first projection year, relative to that received in 2013, the last year of actual experience, with associated higher projected amounts in all future years.

3.5 The 2009 Review provided projections based on up-rating of benefit and earnings limits in line with prices or earnings or halfway between the two. The projections provided in this note assume up-rating of earnings limits in line with prices in all cases, with up-rating of benefits reflecting the scenario being modelled.

4 Methodology

4.1 We have used the same projection methodology as described in our report on the 2009 actuarial review.

5 Results

5.1 Table 1 overleaf shows the estimated constant contribution rates required from January 2015 for six different scenarios, reflecting three different benefit up-rating scenarios:

- in line with prices
- in line with a proposed long-term up-rating policy of 0.5% above price inflation throughout the projection period
- in line with earnings.

5.2 In each case, estimates are provided based on:

- 85% of modelled expenditure on permanent nursing benefits
- 100% of modelled expenditure on permanent nursing benefits.

5.3 As agreed with the Guernsey Social Security Department, we have not produced estimates based on 100% of modelled contribution income as the constant contribution rate based on this scenario can be fairly robustly estimated as 90% of the constant contribution based on 90% of modelled contributions. This is shown and discussed in our memo of 1 July 2014 in respect of the Guernsey Insurance Fund.

5.4 The estimates provided are based on the current pension age arrangements, including the agreed increases in pension age to 67 between 2020 and 2031. They do not allow for the proposed pension age increases to age 70 between 2032 and 2049. This potential change would be expected to increase contribution income but it would not be expected to impact expenditure from the Long-term Care Fund.

Table 1: Constant contribution rate calculated assuming 90% of modelled contribution income

Adjustment to modelled permanent nursing benefit expenditure	Assumed up-rating policy		
	Prices	Proposed long-term policy of prices plus 0.5%	Earnings
85%	1.9%	2.2%	3.0%
100%	2.0%	2.4%	3.2%

5.5 Figures 1 to 3 on the following pages show the projected fund ratios based on the constant contribution rates for the three up-rating scenarios based on 85% of modelled permanent nursing benefit expenditure.

5.6 Figures 4 to 6 show the projected fund ratios based on the constant contribution rates for the three up-rating scenarios based on 100% of modelled permanent nursing benefit expenditure.

5.7 The projected fund ratios shown in Figures 4, 5 and 6 are quite similar to those provided in Figures 1, 2 and 3 respectively. That is, allowing for 100% of modelled permanent nursing benefit expenditure requires higher constant contribution rates but because the fund balance at the end of the projection period and the assumed up-rating policy are the same, the projected profile of the fund ratios is very similar. The relationship in respect of the adjustment made to modelled benefit expenditure isn't as close as the corresponding relationship noted in paragraph 5.3 in respect of the adjustment made to contribution income due to the adjustment being in respect of one element of benefit expenditure.

5.8 Please note that chart axes are appropriate to the relevant projections and therefore the scales are not necessarily consistent between charts.

Figure 1: Projected fund ratios based on a Class 1 contribution rate of 1.9% and 85% of modelled permanent nursing benefit expenditure

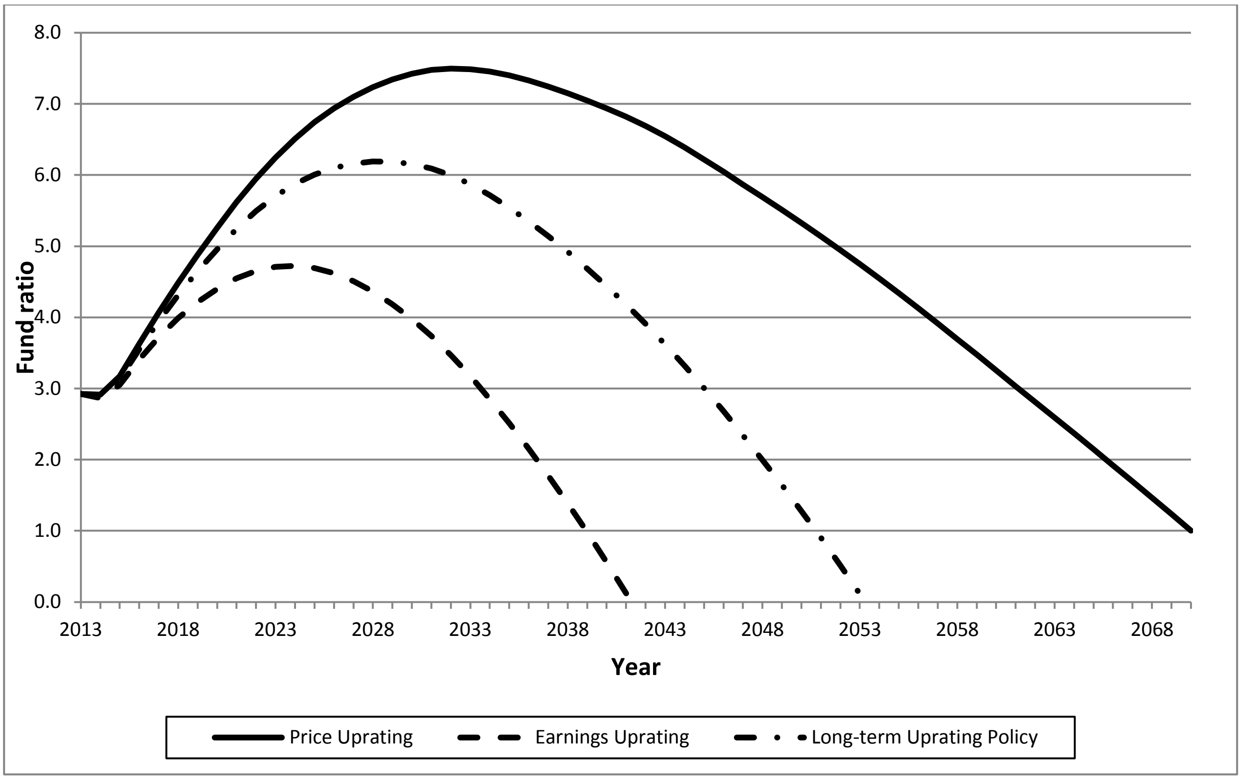


Figure 2: Projected fund ratios based on a Class 1 contribution rate of 2.2% and 85% of modelled permanent nursing benefit expenditure

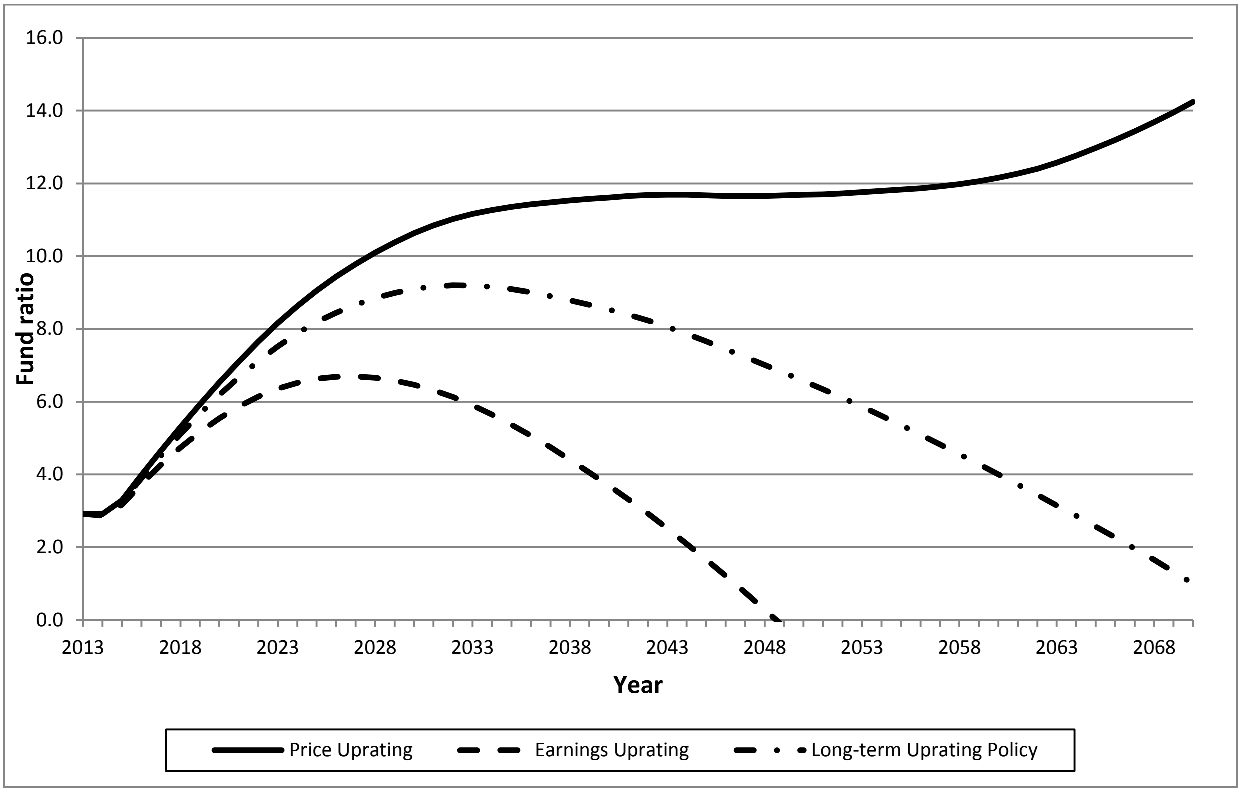


Figure 3: Projected fund ratios based on a Class 1 contribution rate of 3.0% and 85% of modelled permanent nursing benefit expenditure

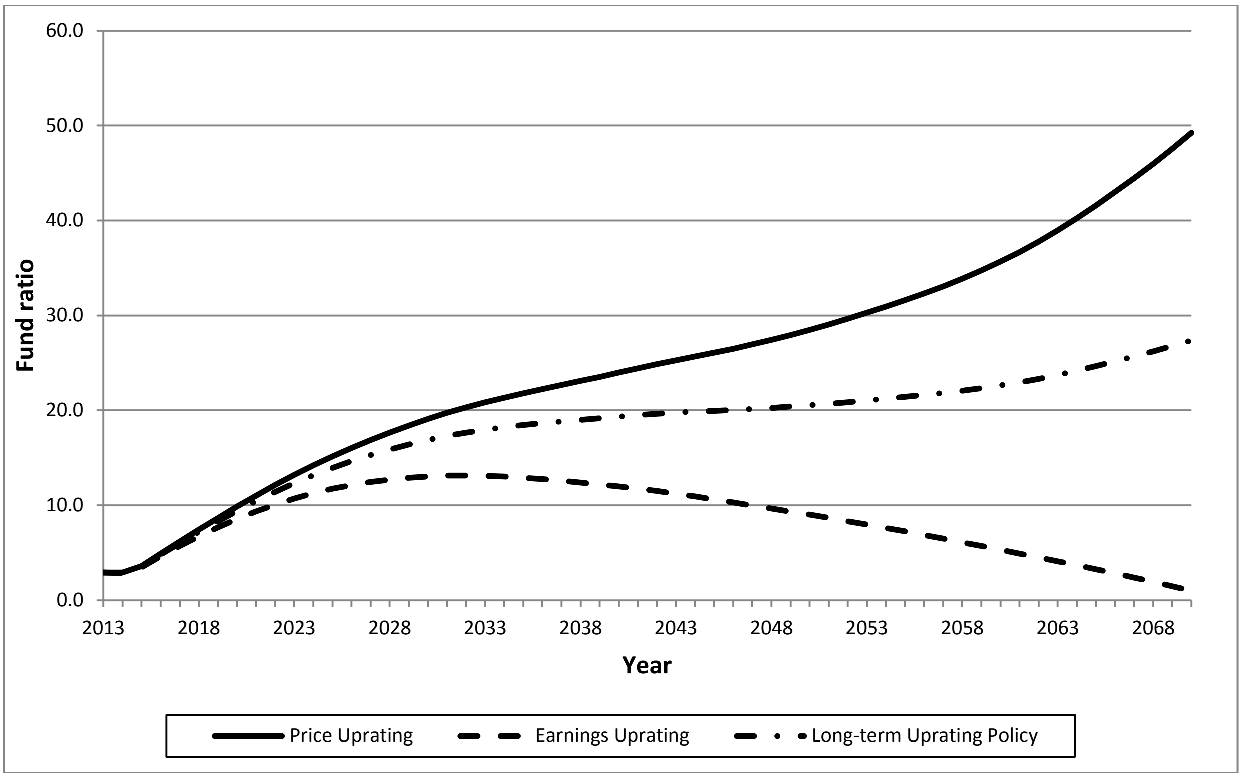


Figure 4: Projected fund ratios based on a Class 1 contribution rate of 2.0% and 100% of modelled permanent nursing benefit expenditure

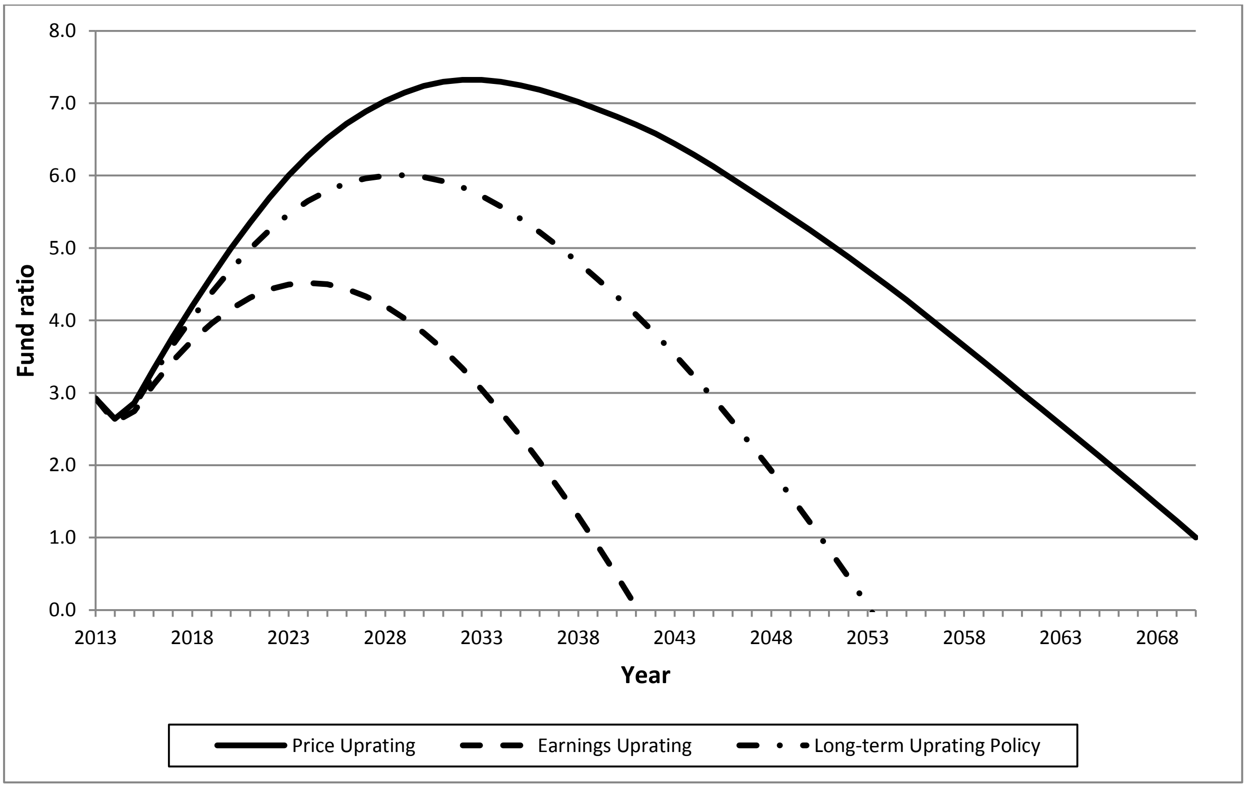


Figure 5: Projected fund ratios based on a Class 1 contribution rate of 2.4% and 100% of modelled permanent nursing benefit expenditure

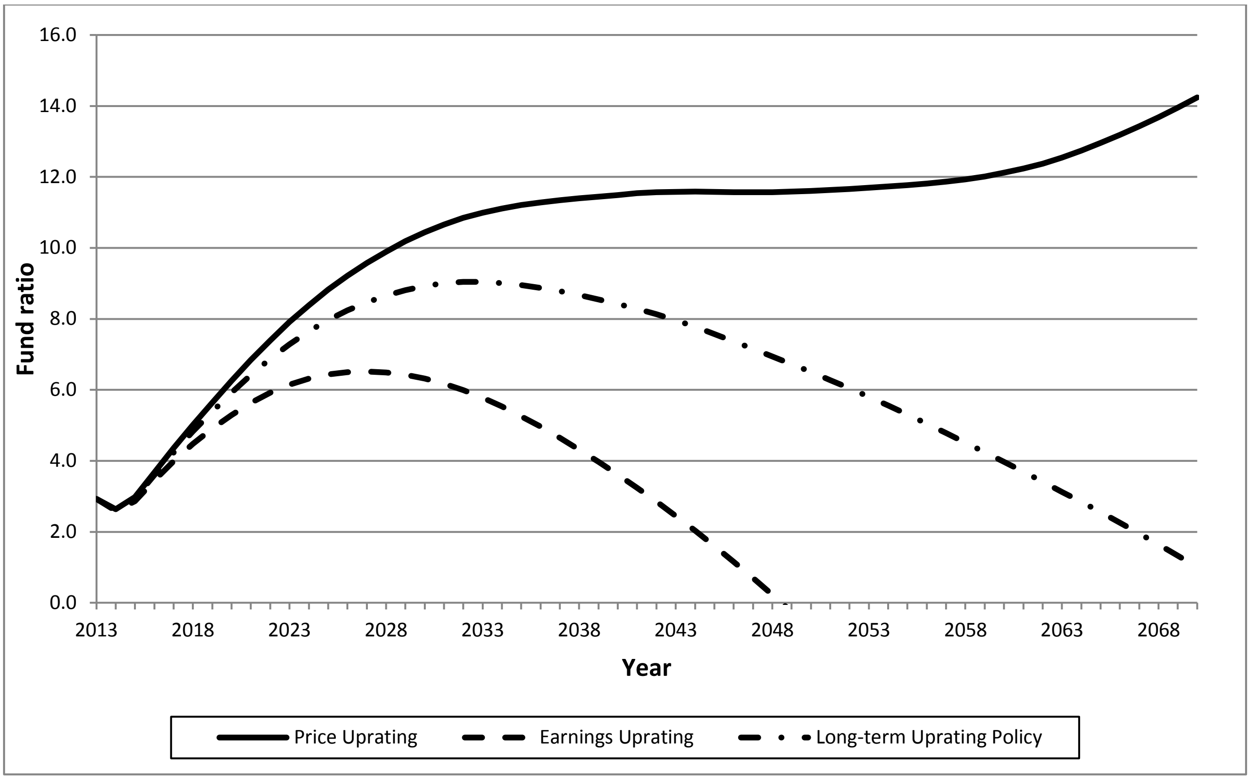
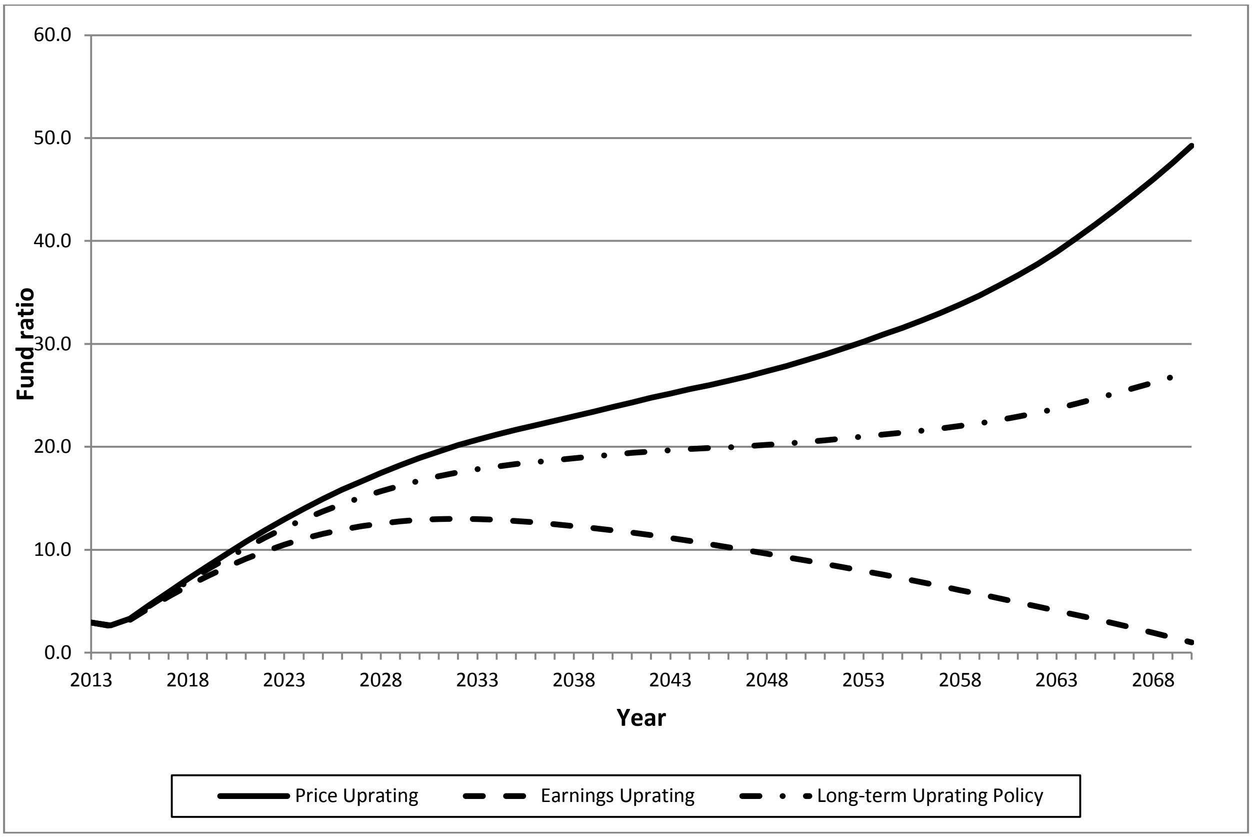


Figure 6: Projected fund ratios based on a Class 1 contribution rate of 3.2% and 100% of modelled permanent nursing benefit expenditure



6 Limitations

6.1 This memo has been prepared for the Minister and Members of the Guernsey Social Security Department. We understand that the information in this report may be made available to others. However GAD does not accept any liability to third parties in relation to this report.

6.2 The updates underlying the projections provided in this memo do not constitute a full review of the Long-term Care Fund. A full review of the Fund could suggest assumptions and produce projections that are materially different from those provided in this memo.

6.3 The projections reflecting 100% of modelled expenditure of permanent nursing benefits, with no adjustment made to align the projections with recent experience, have been provided at the request of the Guernsey Social Security Department.

6.4 These projections rely on the accuracy of data and information provided by the Guernsey Social Security Department. GAD does not accept responsibility for advice based on wrong or incomplete data or information provided.

6.5 Advice provided must be taken in context. Advice is intended to be read and used as a whole and not in parts. GAD does not accept responsibility for advice that is altered or used selectively.

6.6 Clarification should be sought if there is any doubt about the intention or scope of advice provided in this report. GAD is not responsible for any decision taken by the Social Security Department, except to the extent that the decision has been made in accordance with specific advice provided.

6.7 All references to Guernsey in this memo are to be taken to include also the islands of Alderney, Herm and Jethou.

Appendix A – Assumptions

A1. Introduction

A1.1 This appendix sets out the mortality and fertility assumptions used to produce updated population projections, which underlie the projections for the Long-term Care Fund provided in this note.

A1.2 This memo provides details of the migration and earnings assumptions adopted, as requested by the Guernsey Social Security Department, as well details of the other assumptions which are unchanged from those adopted for the 2009 Review of the Long-term Care Fund.

A2. Summary

A2.1 The table below provides an overview of the demographic and economic assumptions adopted for these updated Long-term Care Fund projections, together with those adopted for the 2009 Review. Further details are set out in the remaining sections of this appendix.

Table A1: Demographic assumptions

	2009 review	**Assessment of impact of proposed policy changes**
Fertility and mortality projections	ONS 2008-based projections for England and Wales adjusted by constant age-related multipliers to reflect Guernsey's mortality and fertility experience from 2007 to 2009	ONS 2012-based projections for England and Wales adjusted by constant age-related multipliers to reflect Guernsey's mortality experience from 2008 to 2013 and fertility experience from 2009 to 2013
Migration	Migration set to be sufficient to maintain the total population constant at the April 2007 level *Variants:* *Constant net migration of zero* *Constant net immigration of 200 a year*	Constant net immigration of 200 a year

Table A2: Economic assumptions

	2009 review	**Assessment of impact of proposed policy changes**
Price inflation	3% a year	3% a year
Earnings increases	2% a year net of price inflation *Variant: 1.5% a year net of price inflation*	1.5% a year net of price inflation
Investment return	3.5% a year net of price inflation	3.5% a year net of price inflation
Up-rating of benefits and earnings limits	Results provided showing up-rating in line with: • price inflation • earnings increases • halfway between the two	Results to be provided showing up-rating of benefits in line with: • price inflation • the proposed long-term policy of 0.5% above price inflation throughout the projection period • earnings increases Earnings limits up-rated in line with price inflation

A2.2 The same labour market and benefit-specific assumptions are adopted as for the 2009 Review of the Long-term Care Fund. Given the nature of the update being provided, contributor data and beneficiary data were not requested. As noted in the 2009 Review report, the proportions of the working-age population paying contributions were fairly constant in the years prior to that review. We have reviewed the updated population data and noted that the size and profile of the population by age and sex has remained reasonably stable in recent years. Similarly, the average numbers unemployed in recent years has been broadly in line with that assumed for the 2009 Review. As such, we consider it reasonable to adopt the same assumptions.

A2.3 Details of the assumptions adopted for the 2009 review are provided in section A6 of this note.

A3. Demographic assumptions

Fertility and mortality

A3.1 The Guernsey Social Security Department provided Guernsey population data, including details of births and deaths, for each of the years ending 31 March 2010 to 2013 inclusive. Data for earlier years had been provided for the 2009 Review.

A3.2 The relatively small population size and the relatively few years of data mean that it is not appropriate to project population birth and death rates solely from this information. Instead, we adapted the 2012-based principal population projections prepared by the Office for National Statistics (ONS) for England and Wales by applying age and sex-related factors to obtain assumed Guernsey fertility and mortality rates. These age and sex-related factors were derived by comparing actual experience for Guernsey for the calendar years 2008 to 2012 inclusive for mortality (2009 to 2012 for fertility) with England and Wales rates for the same period.

A3.3 The same mortality assumptions are assumed to apply for all beneficiaries and future improvements in mortality in Guernsey are assumed to be consistent with the 2012-based principal projections prepared by ONS for England and Wales.

A3.4 The analysis has indicated lighter mortality in Guernsey relative to England and Wales, with the differential being greater for females, and lower fertility rates in Guernsey at younger ages.

A3.5 The tables below illustrate the assumptions for life expectancy and fertility as at 2012 for Guernsey, together with the corresponding figures based on the assumptions adopted for the 2009 Review and those for England and Wales based on the ONS 2012-based projections. For life expectancy, we have shown figures for 60-year-olds, in 2012, as well as future 60-year-olds, in 2032, to illustrate the effect of assumed future improvements in longevity.

A3.6 The tables show that:

> assumed life expectancies have fallen since the 2009 Review but remain higher in Guernsey than in England and Wales. That is, the projected differential between the Guernsey and England and Wales experience has narrowed since the previous review.

> assumed fertility has increased at older ages but is lower in Guernsey compared to England and Wales at younger ages. Lower fertility in Guernsey was also observed at the time of the 2009 Review.

Table A3: Life expectancy for males and females aged 60 last birthday in mid-2012 and mid-2032

		2009 review	2014 Policy Costings	England & Wales (ONS 2012-based Population Projections)
Males – Age 60 in	2012	27.5	25.8	25.6
	2032	29.4	28.2	28.0
Females – Age 60 in	2012	29.9	29.3	28.5
	2032	31.8	31.5	30.8

Table A4: Age specific fertility rates: number of births per 1,000 women in 2012

Mother's Age	2009 Review	2014 Policy Costings	England & Wales (ONS 2012-based Population Projections)
15	3.0	2.6	2.6
20	43.2	35.9	51.2
25	74.8	69.3	92.3
30	103.7	109.9	115.7
35	76.7	90.1	90.1
40	23.8	27.6	27.6
45	1.6	2.0	2.0

Migration

A3.7 The Guernsey Social Security Department has advised that the migration assumption to be used for this update should be 200 net immigration a year. The Department has also provided details of immigration and emigration by age and sex for each of the years ending 31 March 2010 to 2013 inclusive.

A3.8 The data show variability in the net migration figures for individual years, ranging from net emigration of 460 in 2012-13 to net immigration of 331 in 2010-11, averaging close to a net zero position in recent years. However in the period from 2007 to 2009, net immigration averaged around 450 a year.

A3.9 The migration data provided show that net migration is very variable at all ages. However it indicates that migration is most significant at ages between the early 20s and mid-30s, which is consistent with the experience prior to the 2009 Review.

A3.10 In the absence of robust data to the contrary, we have retained the same distribution of migration by age and sex as adopted for the 2009 Review. This distribution provided for net immigration concentrated around the 20s and 30s age groups, and small amounts of net emigration at child ages and pension ages as shown in Table A5 below.

Table A5: Number of Immigrants assuming 200 Net Immigration

Age	Males	Females	Total
Under 15	-2	10	8
15-24	62	34	96
25-34	46	18	64
35-44	22	4	26
45-54	8	2	10
55-64	0	-4	-4
65-74	-2	2	0
75+	0	0	0

A4. Economic assumptions

A4.1 The 2009 Review assumed:

> a rate of RPIX price inflation of 3% a year
> a real rate of earnings growth of 2% a year net of RPIX price inflation
> a rate of real investment return of 3.5% a year net of RPIX price inflation.

A4.2 The Guernsey Social Security Department has requested that an assumed real rate of earnings growth of 1.5% a year net of RPIX price inflation is used for this assessment, with the other assumptions remaining unchanged. Our understanding is that the request for other rates to be unchanged relates to rates in real terms.

A4.3 This suggests that nominal earnings increases would be expected to be in region of 4.5% a year and that nominal investment returns would be expected to be in the region of 6.5% a year.

A4.4 Earnings growth in recent years has been quite variable, averaging around 5% a year nominal in the period 2006-2008, but with a sharp fall in 2009, followed by modest increases of around 3% a year nominal during 2011 and 2012. Given the recent economic climate, we think that a long-term assumption of nominal earnings growth of 4.5% a year is not unreasonable.

A4.5 We have also considered price inflation in recent years, to check this nominal earnings assumption is consistent with an assumed real rate of earnings growth of 1.5% a year net of price inflation. In the years prior to the 2009 Review, RPIX price inflation was generally in the region of 3% a year. However, it was considerably above this from late 2007 through to early 2009, reaching a peak of 6.4% in September 2008. Since then, price inflation has reverted to around 3%, although rates were closer to 2% during 2013. As such, it does not seem unreasonable to retain a long-term assumption for price inflation of 3% a year.

A4.6 Investment returns have also been quite variable in recent years, with negative returns emerging in 2008 and 2011, and quite high returns earned in 2009 and 2010. Considering average returns over a number of years, an assumption of real investment returns of 3.5% a year net of RPIX price inflation does not seem unreasonable.

A5. Alignment with Accounts

A5.1 We have aligned modelled contribution income and modelled expenditure for each benefit with actual income and expenditure as recorded in the accounts to determine any adjustment required to allow for differences between using a model and assumptions, and actual expenditure. The adjustments made are assumed to apply for all future years.

A6. Assumptions used for the 2009 review

A6.1 The tables below provide an overview of the labour market and benefit-specific assumptions adopted for the 2009 Review of the Long-term Care Fund which we propose are retained for this assessment.

Table A6: Labour market assumptions

	2009 Review
Labour market participation	Constant subject to unemployment assumption
Unemployment	Constant at 250

Table A7: Permanent care / benefits

	2009 Review
Proportions of the population assumed to receive each benefit in future years	Based on the experience of the Fund since its inception in 2003 the age-specific proportions adopted for the 2005 review for permanent and respite care, both nursing and residential, retained for the 2009 review. For permanent care benefits these proportions range from below 1% at age 80 to about 15% at age 100 for male nursing care and from about 1% at age 75 to over 40% at age 100 for male residential care. The proportions for females are slightly higher at all ages, for both benefits.
Proportion of full benefit rate expected to be paid on average	Benefit rates are the maximum amounts provided. In practice it appears that the vast majority of benefits are paid at the maximum level. It is assumed that all benefits are paid at the full benefit rate.
Average expected duration of payment for respite benefits	Respite benefits can normally be provided for four weeks a year. Based on recent experience, the average duration for respite care is assumed to be 2½ weeks, for both nursing and residential care.

Table A8: Administration costs

	2009 Review
Assumed future increases	Administration expenses are assumed to increase in line with earnings.

Appendix B – Population projections

B1. Introduction

B1.1 This appendix sets out details of the projected future population of Guernsey, which underlies the updated projections for the Long-term Care Fund.

B2. Projection methodology & assumptions

B2.1 These projections of the population of Guernsey are based on population data as at 31 March 2013, as provided by the Guernsey Social Security Department, and allow for the interaction of demographic assumptions including mortality, fertility and migration. Demographic assumptions are inevitably subject to a considerable degree of uncertainty, particularly for the more distant future. The projections we have prepared are not predictions, rather they are based on a set of specific assumptions. We have relied on the accuracy of data and information provided by the Guernsey Social Security Department. GAD does not accept responsibility for advice based on wrong or incomplete data or information provided.

B2.2 The mortality and fertility assumptions underlying the population projections provided are based on the ONS 2012-based projections for England and Wales adjusted by constant age-related multipliers to reflect Guernsey's mortality experience from 2008 to 2013 and Guernsey's fertility experience from 2009 to 2013. Details of the assumptions used are provided in Tables A3 and A4 of Appendix A.

B2.3 Migration to and from Guernsey is particularly difficult to project. At the request of the Social Security Department, we have assumed 200 more immigrants than emigrants in each year, that is, constant net immigration of 200 a year.

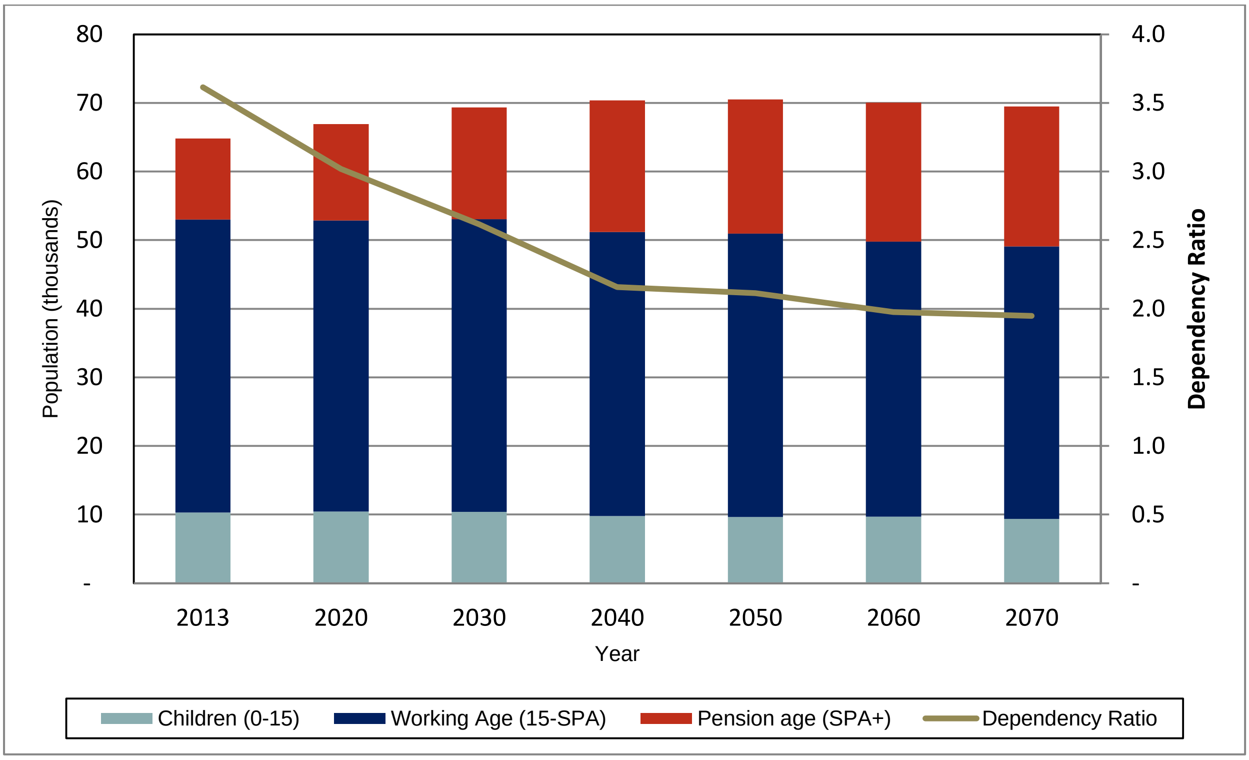
B2.4 The assumed distribution of migrants by age and sex reflects recent Guernsey experience. In particular, net immigration is concentrated around the 20s and 30s age groups, with small amounts of net emigration at some child and pension ages. Details of the assumed distribution is provided in Table A5 of Appendix A.

B3. **Projection results**

B3.1 Figure B1 shows the population of Guernsey in 2013 and the projected future population at 10-year intervals. The projections are based on population data as at 31 March 2013.

B3.2 It sub-divides the population into children (0-15 years), those of working age and pensioners (pension age and above). The projections reflect the planned increase in the pension age from 65 to 67 between 2020 and 2031 but not the proposed increase in pension age from 67 to 70 between 2032 and 2049.

Figure B1: Projection of Guernsey population assuming 200 net immigration



B3.3 The total population is projected to remain reasonably stable over the long-term but once the planned increases in pension age are fully implemented in the early 2030s, the working-age population is projected to decline and the pensioner population is projected to increase.

B3.4 The ratio of the working-age population to the pensioner population as at 31 March 2013, the starting point of the projections is 3.6. It is projected to reduce to around 1.9 in 2070.

B3.5 Table B1 below provides a summary of the projected dependency ratios, together with those projected on the 200 net immigration scenario for the 2009 Review.

Table B1: Projected dependency ratios

Year	2013	2020	2030	2040	2050	2060	2070
Updated projections (200 net immigration)	3.6	3.0	2.6	2.2	2.1	2.0	1.9
2009 Review (200 net immigration)	3.5	2.9	2.6	2.1	2.0	1.8	1.8

B3.6 The slightly higher projected dependency ratios, relative to those projected for the 2009 Review, reflect a more favourable starting position in 2013 from that projected, the small increase in the assumed total fertility rate from 1.6 to 1.65 and the higher assumed mortality rates adopted for the current projections.

Appendix 7a: Options for reducing expenditure from universal benefit: Family Allowance

Family Allowance and means tested benefits

A7a.1 As the system is currently structured, Family Allowance is incorporated within the assessment of Supplementary Benefit. This means that the means tested system would automatically compensate claiming households for a withdrawal or reduction in Family Allowance and the subsequent reduction in their income. There are approximately 650 households who would fall into this category.

A7a.2 The exceptions to this are families who reach the limitation on Supplementary Benefit claims. For these households all or part of their Family Allowance is disregarded from the assessment of their income and therefore a withdrawal or reduction would impact these households. At present this would affect about 20 households, however, if plans to integrate the rent rebate and Supplementary Benefit systems are progressed this number could increase substantially.

A7a.3 How many additional households would be affected would depend on the limit placed on claims and the structure and rates applied to the revised system. Increasing the benefit limitation could significantly reduce the number of affected households

A7a.4 For those who receive financial support solely through the rent rebate system, their Family Allowance is not included in the assessment process and therefore these families would be affected by a withdrawal or reduction of Family Allowance. However, if SWBIC is successful in integrating the two systems most of these households would be transferred onto the Supplementary Benefit system and could be compensated accordingly. If this is not the case alternative mitigation may be necessary.

Restricting the number of Family Allowance claims, which could be made per household

A7a.5 At present, Family Allowance payments are not limited to the number of children in a household and, for a large household, payment of Family Allowance can represent a significant proportion of their income (see Table A7.1).

Table A7.1: Annual value of Family allowance claims by the number of children in a household

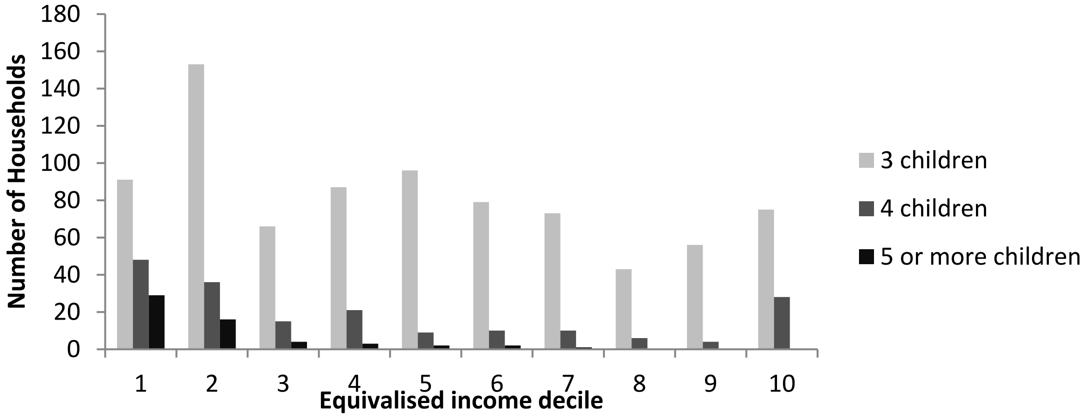
Number of children in household	Annual receipt of Family allowance	Number of Households (Aug 2014)
1	£826.80	3,263
2	£1653.60	2,772
3	£2480.40	697
4	£3307.20	159
5 or more	£4,134.00+	46

A7a.6 A restriction of the availability of this allowance to a maximum number of children (typically two or three) was raised by several respondents in the consultations. Restricting Family Allowance to two children would reduce expenditure by an estimated £1m. This would be off-set by a small increase in administration required to enforce the new criteria.

A7a.6 Of the 7,000 households with children approximately 13% have more than two children and would have their Family Allowance reduced by a limitation of Family Allowance payments to two claims per household.

A7a.7 However, households with a higher income typically have fewer children than those with lower incomes (see **Figure A7.2**). Restricting Family Allowance in this way would, therefore disproportionately affect low income households. It is the view of the Joint Board that this would not be an appropriate way to target the benefit

Figure A7.2: Households with more than two children by equivalised income decile



Means testing Family Allowance

A7a.9 The means-testing of Family Allowance was signalled as a preferred option for many of those responding to the public consultation. However, in order to make significant savings from the means-testing of Family Allowance, the threshold would need to be set at a level which many would consider comparatively low.

A7a.10 A threshold broadly equivalent to median household income (approximately £45,000) would reduce expenditure by approximately £4m. At this level more than 60% of the households currently claiming Family Allowance would no longer qualify. Approximately 40% of households with children would retain this benefit.

A7a.11 While means-testing of Family Allowance would better target the benefit, it would require an assessment of household income and a significant increase in administration. Adding an additional level of means-testing to the current benefit system (in addition to the Supplementary Benefit and rent rebate systems which are currently in place) would add a level of complexity that is undesirable.

A7a.12 However, although it is not the purpose of this report to examine detailed mechanisms for how this might be achieved, one solution could be a sharing of payment information with the Income Tax Office with facility to require households to repay their Family Allowance should their income exceed the threshold (in effect taxing Family Allowance at 100% for households exceeding the threshold). A similar system to this was introduced in the UK in 2013.

A7a.13 It is expected that many households not eligible would “opt out” of receipt in order to avoid having to subsequently repay their allowance. While this would seem to be less burdensome than a separate means-testing system, this could still mean an increase in the number of tax returns requiring manual assessment and an increase in administration for the Income Tax office. The additional cost of this would depend on the details agreed upon but could make a substantial inroad into the financial gain from means-testing this allowance.

A7a.14 If an intention to means test Family Allowance and the administration required were taken into consideration during the procurement of new and potentially more integrated IT systems for the income tax and Social Security Departments, the on-going cost of means-testing could be reduced in the long-term. However, administration would still be more costly than the current system.

Reducing the universal payment

A7a. 15 In 2013 and 2014 the States approved recommendations to freeze Family Allowance for 2014 and 2015 in anticipation of this Review (Billet d’État XX, October 2013). Effectively this reduced the value of Family allowance in real terms. It is estimated that this will have saved the States up to £500,000 by the end of 2015. In this way, the States will have already reduced the real value of Family Allowance by approximately 5% in two years.

A7a.16 Continuing to reduce the universal payment in real or nominal terms could make savings over a period of time without increasing administrative costs. If the value of the weekly payment were reduced by 20% over a period of years this could save in the region of £1.5m.

A7a.17 While relative to a household's income the average impact of this would be small, the distributional impact of this would be such that proportional to household income the greatest impact would fall on low and middle income household and large families, which fall outside the means tested benefit system.

Figure A7.3: Average impact of a 20% reduction in Family allowance payments on all households by income

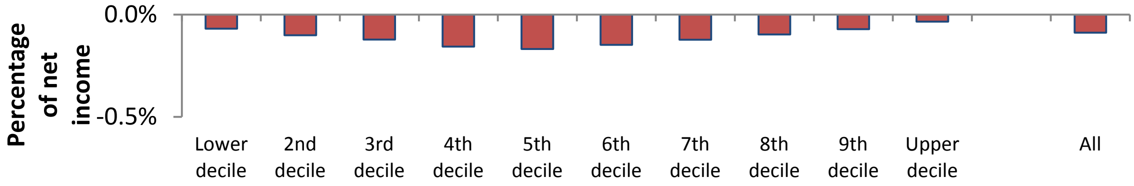
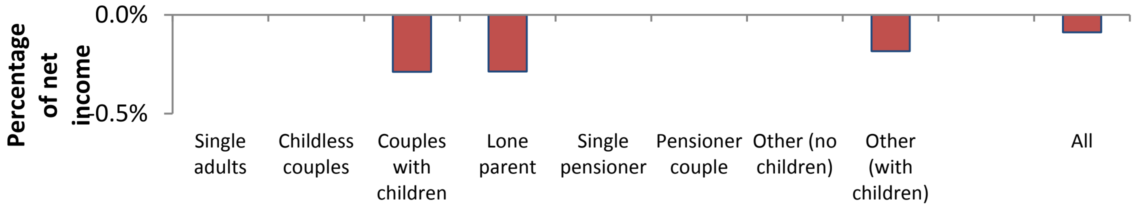


Figure A7.4: Average impact of a 20% reduction in Family allowance payments on all households by household type



Complete withdrawal of Family Allowance

A7a.18 A complete withdrawal of Family allowance would be the most financially beneficial option and could reduce expenditure by approximately £8m per year. This allows for a £2m increase in Supplementary Benefit expenditure to compensate households currently claiming Supplementary Benefit and the possible capture of additional households in the means tested benefit system as a result of the reduction in their household income. In addition, a complete withdrawal of Family Allowance would free approximately £20,000-£30,000 worth of administrative resources at Social Security.

A7a.19 A complete withdrawal of Family Allowance would have the largest impact on household income. It is estimated that, before redirection of these funds, 6,400 households would be negatively impacted by this proposal, with those just above the threshold for Supplementary Benefit likely to be the most heavily impacted relative to their household income.

A7a.20 Figures A7.5 and A7.6 below illustrates the distributional impact a withdrawal would have on households.

Figure A7.5: Average impact of a complete withdrawal of Family Allowance payments on all households by income

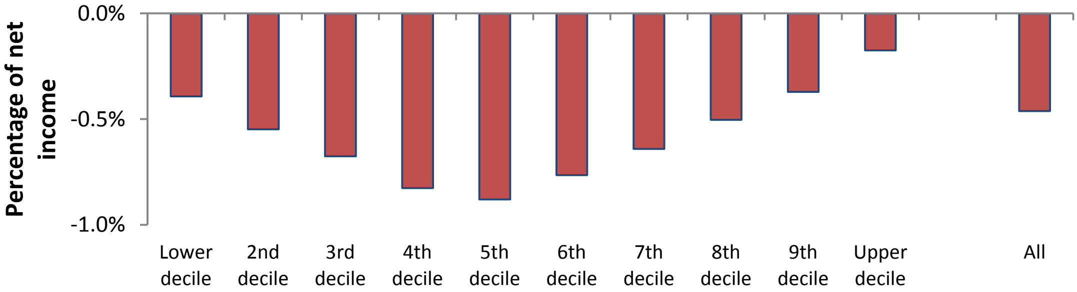


Figure A7.6: Average impact of a complete withdrawal of Family Allowance payments on all households by household type

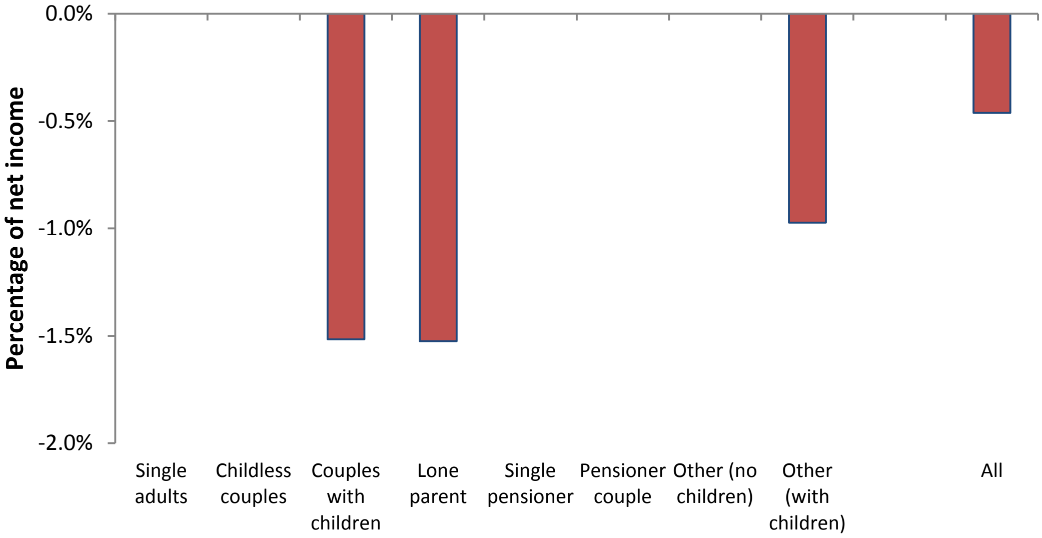


Table A7.7: Summary of impact of various options for reducing expenditure on Family Allowance

Change		Est. saving	Impact analysis
Restriction to number of children	Restricting to two children	<£1m	Limited financial benefit. Number of negatively impacted households: 1,000. Does not address the issue of better targeting benefits. Supplementary Benefit claimants would be compensated by the current mechanisms of the scheme unless subject to the benefit limitation. Those subject to the limitation on Supplementary Benefit could be adversely affected. Most heavily impacted demographic: low-middle income households with multiple children including SPB claimants impacted by the limitation on Supplementary Benefits.
Means testing	Withdrawing Family Allowance for families with a gross income in the greater than £45,000	£4m	Number of negatively impacted households: 4,200. This should target benefits towards low to lower middle income families. Means testing could significantly increase the cost of administering this benefit and erode the financial gain. Introduction of an additional pathway of means-tested benefits adds complexity to the benefit system, which is undesirable. Most heavily impacted demographic: middle income households with multiple children.
Reduction in universal payment	Reduce from £15.90 to £12.72 per week	£1.5m (allowing for increase in Supplementary Benefit required to compensate for reduced income for low income households)	Number of negatively impacted households: 6,400. Does not address the issue of better targeting benefits. Supplementary Benefit claimants would be compensated by the current mechanisms of the scheme unless subject to the benefit limitation. Those subject to the limitation on Supplementary Benefit could be adversely affected. Most heavily impacted demographic: Households with multiple children including those on SPB subject to the limitation on Supplementary Benefits.
Complete withdraw of Family allowance	Phase out the provision of Family allowance benefits completely over ten years.	£8m (allowing for increase in Supplementary Benefit required to compensate for reduced income for low income households)	Has the largest financial benefit. Number of negatively impacted households: 6,400. Supplementary Benefit claimants would be compensated by the current mechanisms of the scheme unless subject to the benefit limitation. Those subject to the limitation on Supplementary Benefits could be adversely affected. Most heavily impacted demographic: Households with multiple children including those on SPB subject to the limitation on Supplementary Benefit. Redirection of some savings to Supplementary Benefit better target benefits expenditure to those in need of support (subject to outcome of SWBIC).

Appendix 7b: Options for reducing expenditure from universal benefits: Prescription charges

Exempt Prescriptions

A7b.1 Exemptions from prescription charges apply to people over 64 years of age, people on Supplementary Benefit, people who claim Severe Disability Benefit; there is also the ability to provide an exemption certificate to anyone who is finding it difficult to pay for financial reasons.

A7b.2 In 2013, the States provided almost one million exempt prescriptions. The percentage of the total prescriptions which are exempt has been increasing steadily over the last 6 years at a rate of about 1 percentage point a year; from 57 % in 2008 to 63% in 2013. As the population ages an increasing proportion of the population will become eligible on the basis of age. This will accelerate the increase in the number of exempt prescriptions issued each year.

A7b.3 In 2013, 18% of the population in Guernsey and Alderney was over 65. By 2020 this is expected to increase to 21% and by 2040 it is expected to reach 30%. As a result progressively more people will become exempt from prescription charges on the basis of age and the cost of providing exempt prescriptions will increase significantly over time.

Table A7.8 Comparison of rates of prescription by age

ASTRO PU 2013		
Age Band	Male	Female
0-4	5.2	4.6
05-14	2.8	2.5
15-24	2.5	4.6
25-34	2.9	6.0
35-44	4.9	8.3
45-54	8.7	12.3
55-64	16.6	19.1
65-74	29.9	30.4
75+	44.9	48.5

A7b.4 This is further multiplied as, typically, people require more prescriptions as they get older. This can be seen in the weightings known as ASTRO-PU, which stands for Age, Sex and Temporary Resident Originated Prescribing Units. This information allows comparison between the average number of prescription items issued by age and sex. For example, this shows that the average woman over 75 would receive 48.5 prescription items; in the same period a 15-24 year old woman would receive 4.6 items.

A7b.5 Being set at the same age at which you can claim the old-age pension, this level has never been increased with changes in life expectancy or improvements in the general level of health among older people. Being above the pension age does not necessarily mean that an individual is on a low income or that they will struggle to pay their prescription charges. There are many pensioners in Guernsey eligible for these benefits that are in receipt of a good income.

A7b.6 **It is the belief of the Joint Board that the universal provision of this benefit to all people over pensionable age is not, therefore, an effective way of targeting this**

benefit. It is recommended that the universal exemption of people of pensionable age from the payment of prescription charges be phased out. For those over 65 with a low income or disabling conditions the other mechanisms for applying for exemption would still be available.

A7b.7 It is estimated that this would save in the region of £1m per annum in expenditure from the Guernsey Health Services Fund.

A7b.8 The Joint Board believes that additional assistance for prescription costs should continue for those entitled via their eligibility to claim Severe Disability Benefit, Supplementary Benefit or qualifying for an exemption certificate for financial reasons.

A7b.9 **However, providing prescriptions free of charge may mean that those receiving exempt prescriptions may not fully appreciate the cost associated with provision of this service. The application of a small nominal charge would help ensure that people valued the drugs, medicines and medical appliances provided. It may also encourage patients to be more discerning in accepting prescriptions where they may already have a supply.**

A7b.10 **Given that many of those exempt from prescription charges are low income households, the charge would need to be set at a level which would not discourage patients in difficult financial circumstances, from accepting prescriptions to the determent of their health.**

A7b.11 The Joint Board recommends that the States direct the Social Security Department to introduce a nominal fee of £1 per prescription for exempt patients.

A7b.12 This would make a nominal reduction in the cost per prescription, but should also reduce the number of prescriptions made unnecessarily, further reducing the expenditure from the fund. Estimates suggest this would reduce net expenditure from the Guernsey Health Service Fund by £1m.

The level of charges

A7b.13 For some years the policy has been to increase the prescription charge by 10p per year (approximately 3% at the current price), which keeps the charge broadly in line with inflation. At the current rate of use, a 10p increase in the prescription charge would reduce net expenditure by the Guernsey Health Service Fund by an estimated £55,000-£60,000. A £1 increase would save an estimated £560,000.

A7b.14 The level of the prescription charge and the level of exemptions are linked. The principle, in the past, has been to keep the prescription charge at a reasonable level so that most people can afford it, thereby enabling the number of exemptions to be kept low.

A7b.15 In England prescriptions are charged at £8.05 per item, more than twice the rate in Guernsey. However, when high prescription charges are levied there is greater pressure for more exemptions to be introduced. To protect those vulnerable to the high charges on health grounds, the England provides a system by which an individual can apply for exemption if they suffer from a condition listed among exempt conditions. 90.6% of all prescriptions in England were dispensed free of charge (2012) compared to 61% locally.

A7b.16 If such a system were to be introduced in Guernsey, a new administrative system would be required to enable people to apply and be assessed for exemptions on medical grounds, which could have significant cost implications. The result may be an increased number of exemptions and additional administration cost, which combined could erode much of the financial benefit of making very significant increases to prescription charges.

A7b.17 It should also be considered that, unlike in the UK where the length of prescription is not specified, a doctor in Guernsey or Alderney can only prescribe up to 28 days' supply. This means that people in Guernsey may receive more prescriptions than they might if they were being prescribed under UK legislation.

A7b.18 **The Joint Board considered the level of the flat fee charge on prescription subsidies and is of the view that there is some limited scope for people to make a larger contribution to the cost of their prescriptions. However, it would be preferable that the flat fee for prescription should be kept to a level which would be sustainable without specified medical exemptions.**

A7b.19 It is estimated that a £1 increase in the prescription charge (to £4.40 in 2016) would reduce net expenditure from the Guernsey Health Service Fund by approximately £500,000 per year.

Figure A7.9: Average impact of recommended changes to prescription subsidies on all households by income

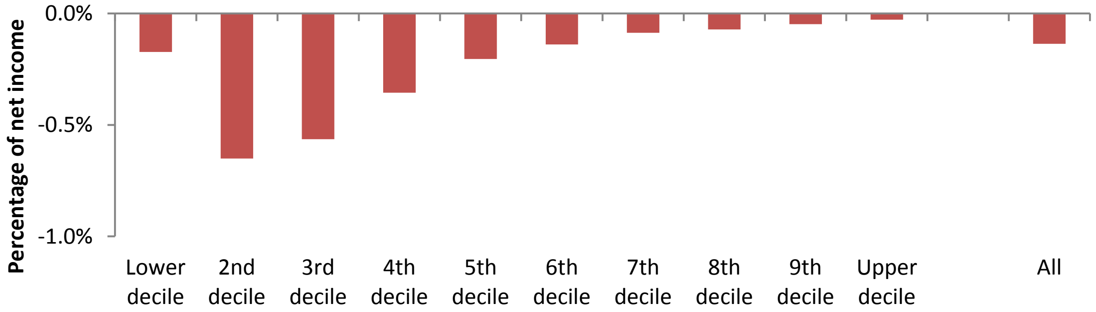
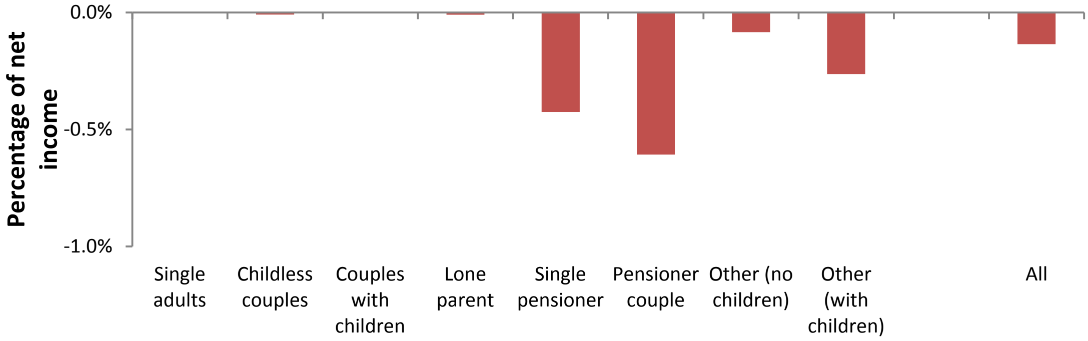


Figure A7.10: Average impact of recommended changes to prescription subsidies on all households by household type



Appendix 7c: Options for reducing expenditure from universal benefit: Primary medical care consultation grants

A7c.1 This grant has a chequered history. The original post war reviews looked at the provisions of the UK health service schemes. This was eventually followed by a review, led by Sir Douglas Black, in 1985 which was followed by the Peat Marwick McLintock report in 1987. Following this the health benefit grants were approved by the States in 1988 as a first phase in reviewing how the States should help people with the cost of health care.

A7c.2 At that time, the medical practices contained both general practitioners and specialists. The Practitioners reserved the right to set their own fees and as a result the States did not (and still do not) have control over the total cost of primary care provision for the majority of patients.

A7c.3 From the outset, the then States Insurance Authority was concerned that the introduction of the grant, which at the time covered more than half of the consultation fee, should not result in private fees being increased more than would otherwise be the case.

A7c.4 Even before the scheme commenced, the States Insurance Authority was compelled to submit a short policy letter following an announcement by the BMA to increase surgical fees by 12% and increase consultation fees by over 30%. This meant that whereas proposals had been anticipated to reduce the amount paid by patients for a consultation from £13.20 by the £8 grant to £5.20, it would reduce instead from £17.19 to £9.19.

A7c.5 Subsequent to the introduction of the benefit in 1991, changes took place with the setting up of the Medical Specialist Group and the splitting of specialists from the general practice groups. The Specialist Health Insurance scheme was introduced which covered specialist treatment from 1 January 1996 at which point claims for health benefits were no longer made for specialist consultations.

A7c.6 There was an attempt to limit the overall costs of all consultations with GPs and nurses in 2003 and an independent review set recommended charges for 2004, 2005 and 2006 to coincide with the raising of the grants to £12 for a consultation with a doctor and £6 for a consultation with a nurse. Agreement to limit the consultation fee was not reached in subsequent years and no further increase in the grant has since been made.

A7c.7 A lot has changed over the years but there is still a concern that not everyone can afford the cost of primary care when required. The Supplementary Benefit medical grants cover the costs of medical consultations for people receiving Supplementary Benefit and for those who may be slightly above that level there is the medical expenses assistance scheme.

Current issues

A7c.8 There are a number of issues with the health benefit grant:

- **It only provides £12 towards the cost of the consultation. This is not sufficient for those who find it difficult to meet the remaining cost of the consultation and it does not provide more if the consultation is undertaken out of hours or other chargeable procedures are undertaken thereby still leaving people with large costs;**

- **It was designed as a first phase in a system that changed and subsequent needs were met in a different way for specialist care which was one of the main drivers for its introduction, due to the large cost;**

- **Over time, without control of the costs charged by surgeries the grant paid has been swallowed by price rises;**

- **Paying grants directly to the surgery is administratively efficient but means that people are not as aware of the total cost of consultations.**

A7c.9 Consistent with the concerns raised at its inception, there is little evidence to suggest that the subsidy has been effective in keeping primary care cost to an affordable level.

A7c.10 As described above, the total cost of primary care appointments in Guernsey is set by the practices and as a result the States have little control over the cost of appointments for most patients. Because of this there has been a tacit acknowledgement that the healthcare grant is not an effective way to reduce the cost to the patient and the grant has not been increased since the last review.

A7c.11 **As the size of the grant has not been increased for more than a decade, the relative value of the grant has been eroded by price rises. While on the surface removing this grant would risk a one-off or phased increase in GP consultation fees of £12, to continue paying the grant when the evidence suggests that it is not achieving its intended purpose would seem illogical.**

A7c.12 **There would be disadvantages in removing the grant, not least that accessing primary medical care in Guernsey is already expensive and a further increase in**

costs may further discourage people from seeking medical attention they may be in need of. However, releasing the £3.5m of expenditure currently tied up in the provision of this benefit could provide an opportunity to find a more effective way of supporting primary healthcare in Guernsey.

A7c.13 It is not within the mandate of this review to redesign the provision of primary health care in Guernsey; however the Joint Board is of the opinion that the provision of this subsidy in this way is inefficient and unsustainable.

A7c.14 To avoid a single large increase in care prices the Joint Board recommends that the subsidy on primary medical care consultations be withdrawn over a ten year period.

A7c.15 The analysis presented below assumes that, as a worst case scenario, the entire cost of the withdrawal of the grant is passed on to patients. Because the medical assistance scheme covers the full cost of primary care appointments for most of those in receipt of Supplementary Benefit, the impact of a withdrawal of this grant is less on the 10% of households with the lowest income than on other households.

A7c.16 Relative to income the impact of this is highest on those households just beyond the threshold for receipt of Supplementary Benefit. Pensioners, who are assumed to visit their doctor more often than other groups, would be more affected by this than those of working age.

A7c.17 **The analysis presented is a worst case scenario, and the impact of this withdrawal could be mitigated by withdrawing the grant in stages. The £3.5m of expenditure released by removing this grant could provide an opportunity to find a more effective way to limit primary care costs to patients.**

Figure A7.11: Average impact of recommended changes to primary medical subsidies on all households by income

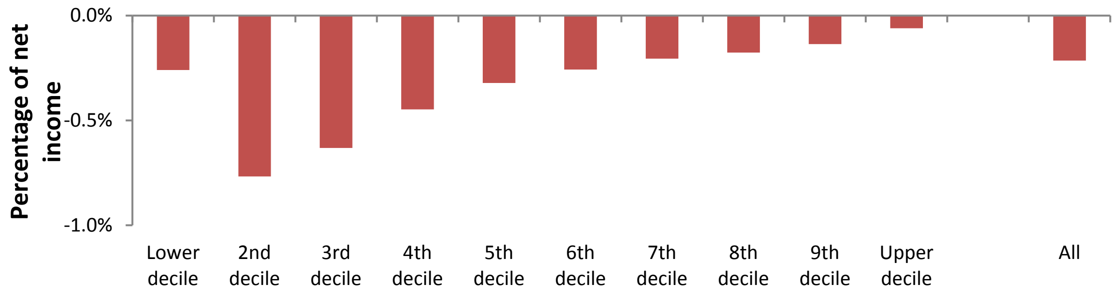
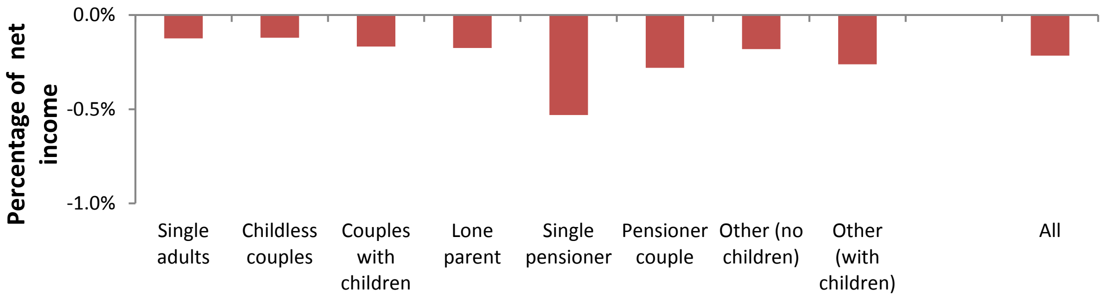


Figure A7.12: Average impact of recommended changes to primary medical subsidies on all households by household type



Appendix 8a: Objectives of changing the tax base

A8a.1 The Joint Board is of the view that the States should diversify the tax base, reducing reliance on direct taxes in favour of indirect taxes. While it is accepted that the States will still gain the majority of its income from direct taxation on personal income, the Joint Board hopes to bring the tax base closer into alignment with practices in other jurisdictions.

A8a.2 As outlined in **Appendix 1 Section 7** the Joint Board believes that Guernsey's over-reliance on direct taxes on income (income taxes and Social Security contributions) poses a significant risk to the future stability of the tax base. In 2014, 74% of the States total revenue was received from the taxes on personal income and contributions to Social Security (including those made by employers). Of this an estimated 90% was charged against the income of the working age population.

A8a.3 This dependence is already very high in relation to other jurisdictions and as the population ages and the workforce becomes smaller relative to the size of the total population, this will place an increasing expenditure burden on a decreasing number of people.

A8a.4 Figures A8.1 to A8.4 overleaf demonstrate how, as more people move into age groups which pay less tax, the average amount of tax paid per adult could decline. For the sake of simplicity, it is assumed that there is no real change in income over the projected period. As demonstrated, the reduction in income could amount to as much as £440 per adult (of working age or older) per year by 2033.

A8a.5 When combined with the known and unknown expenditure pressures over the projected period this represents a significant risk, which will need to be tackled if Guernsey is to place its tax base on a sustainable footing.

A8a.6 Extension of the pension age is also likely to make some improvement in the tax distribution, as it is likely that it will increase the average income, and therefore, the income tax and social security liability of those between the current pension age and that proposed. However, since it is likely that the drop in average tax liability for those approaching retirement (which reflects people taking early retirement or semiretirement before the current pension age) is likely to continue, the advantage of widening the tax base may be less than anticipated.

A8a.7 Proposals to align the tax allowance between those above and below pension age will also alleviate this to some extent as will, in the very long-term, moves to increase private pension provision, but none of the above will eliminate the risk.

Figure A8.1: Est. average annual income tax and Social Security paid per adult by age (2013)

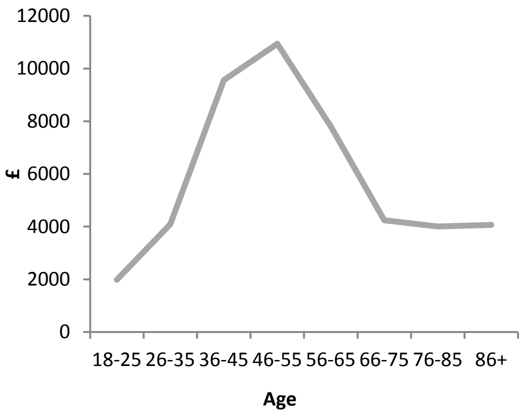


Figure A8.2: Projected age profile of adult population

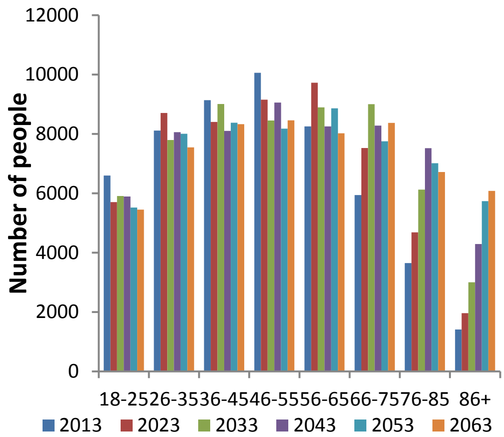


Figure A8:3 Est. total income tax and Social Security paid by age group adj. for projected changes in age profile
(assuming no real increase in earnings per capita)

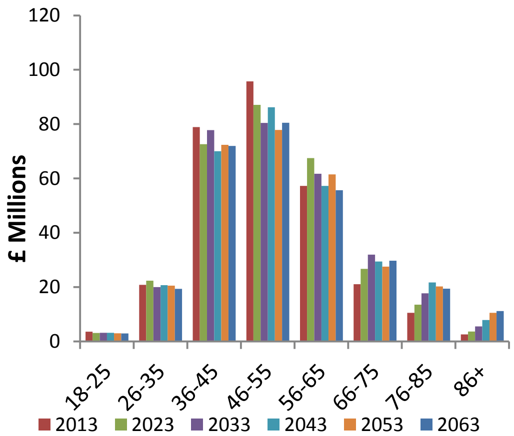
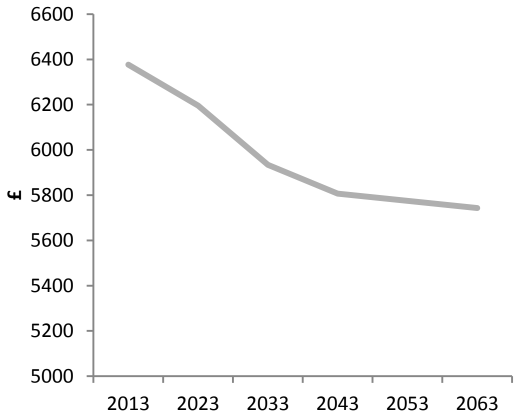


Figure A8.4: Est. average tax paid per adult adjusted for changes in age profile
(assuming no real increase in earnings per capita)

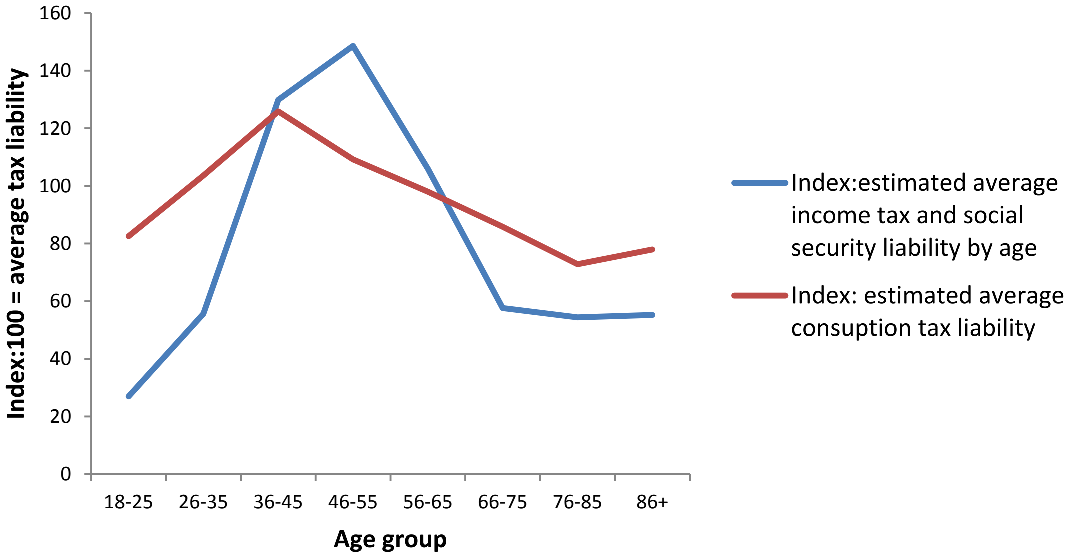


A8a.8 Diversification could reduce the erosion of the tax base demonstrated previously. While Income Tax and Social Security contributions vary with the age distribution of the population, tax on immovable property does not. The total liability for domestic TRP in Guernsey is the same regardless of the ages of those who live in domestic properties.

A8a.9 Consumption, which is primarily driven by income, does vary with age. The total amount of consumption tax an older person would pay would also, on average, be lower than that of the working age person. However, if it is assumed that Guernsey would choose to exempt domestic accommodation costs (as is standard in most consumption tax systems including Jersey's), the distribution of the burden between those of working age and those not of working age is more even. Because the burden of a consumption tax is more evenly distributed across age groups it should be less vulnerable to the erosion of tax revenues demonstrated in figures A8.1 to A8.5.

Figure A8.5: comparison of estimated average liability direct and local consumption taxes by age group

Data sources: Guernsey Households Expenditure Survey 2012/13, income tax, social security, housing department



A8a.10 Population growth (beyond the net immigration of 200 people per year assumed in the modelling) and earnings growth could offset the erosion of income to some degree. The first of these would require a change in the States agreed population policy and both would require economic growth.

A8a.11 **As previously explained, while the Joint Board feels that promoting economic growth needs to be a key objective for the States, it is also of the belief that, to rely on levels of growth which must be, at best, uncertain would be imprudent given the potential scale of this risk. This policy has not proved successful in the wake of Zero-10 and it would be unwise to make the same commitment again.**

Appendix 8b: Analysis of individual tax elements: Income tax rates

Changing the headline rate of income tax

Sustainability	Poor
Economic efficiency	Poor
Fairness	Proportional/progressive
Tax distribution	Narrower

A8b.1 If the sole objective of the Review was to increase revenues, increasing income tax revenues could be a viable option. To do so would be relatively simple. It would require no new administrative systems; and minimal legislative changes and, while an increase in taxation may never be popular, it is an extension of a system most people are comfortable with.

A8b.2 A 2% increase in income tax could raise £25m. An increase in the headline rate of income tax would be mildly progressive (see figure A8.6) as those with higher incomes pay tax on a larger proportion of their income. The impact reduces slightly in the highest decile because a very small number of households (approx. 32) in this decile are subject to the cap on income tax liability.[6]

A8b.3 The impact of an increase in income tax rates is dependent entirely on household taxable income levels and therefore by household type. The average impact is highest in households types most likely to fall in the higher income deciles (couples and couples with children) and lowest in those households types more likely to fall in the lowest income deciles (single parents and lone pensioners).

A8b.4 **However, to increase income tax rates would only increase Guernsey's dependence on direct taxes, placing the majority of the additional burden on an already reducing working age population (see figure A8.7)**. To mitigate the risk of the erosion of the tax base by increases in income tax rates or social security contributions would only be a temporary solution, since the additional income itself could be eroded as the population ages; an argument particularly applicable to social insurance contributions as those over 64 pay a significantly reduced rate of contribution (to reflect the fact that they are no longer required to contribute to their old-age pension).

[6] The income tax cap limits an individual's tax liability (i.e. the maximum amount of tax they pay) to either £110,000 or £220,000 depending on their income sources

Figure A8.6: Average impact of increase in the personal income tax rate to 22% on all households by income

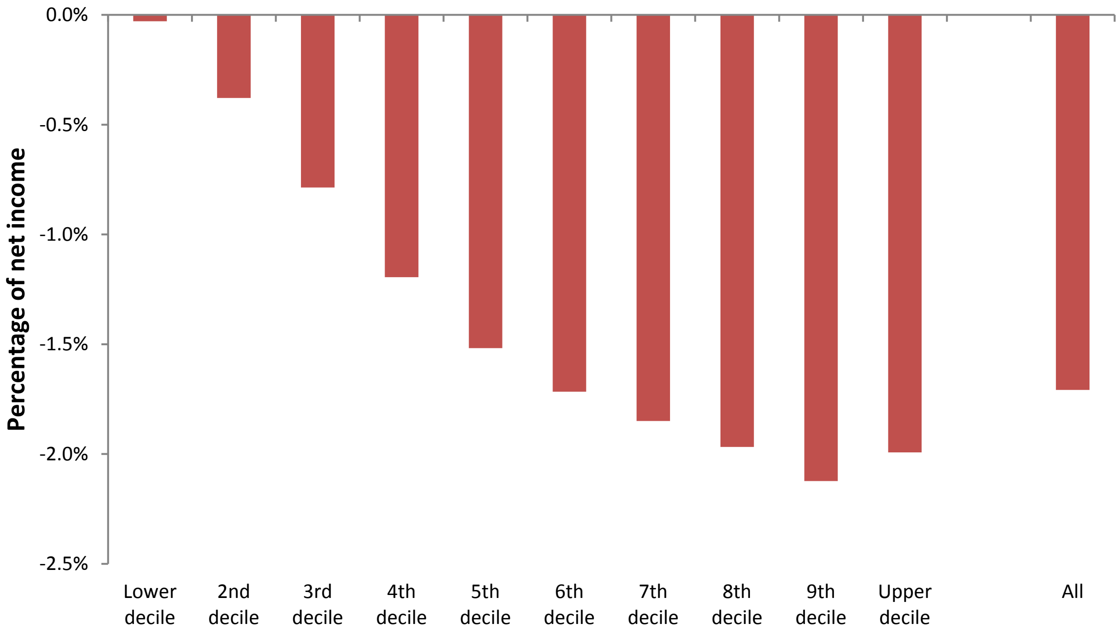
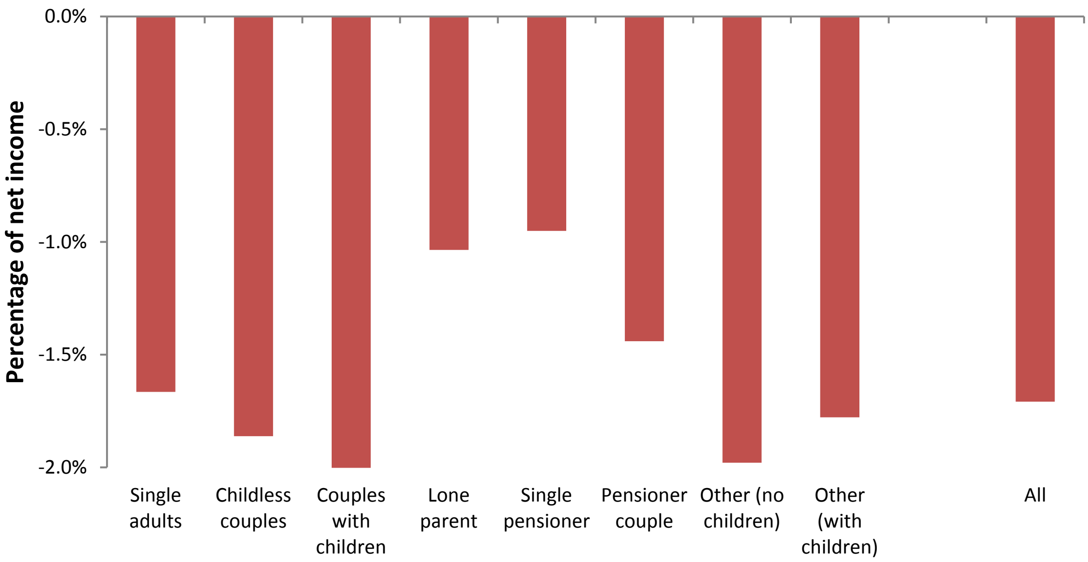


Figure A8.7: Average impact of increase in the personal income tax rate to 22% on all households by household type



A8b.5 Direct taxes against personal income are considered inefficient because they reduce the incentive to work. If an employee earns £10 for an hour's overtime, under the current tax and social insurance regime they would pay £2 in income tax and £0.60 in social security on the money they earn, leaving them with £7.40 to take home. If the tax rate is increased by 2%, they would still pay £0.60 in social insurance but they would pay £2.20 in income tax, leaving them with £7.20 to take home.

A8b.6 The increase in income tax has therefore reduced the incentive for the employee to work by reducing their disposable income received in return for each hour of work.

A8b.7 Increasing Income Tax or Social Security contribution rates also has implications for Guernsey's competitive position. Guernsey must compete in an international labour market both to attract new skills to the island and retain the skilled employees we already have. During the consultation process, business groups have stated that the difficulty in recruiting staff with appropriate skills is a key issue for businesses operating in Guernsey. Increasing rates of income tax could increase this problem.

A8b.8 At present Guernsey's headline rate of tax of 20% is comparatively low, but over recent years the competitive position of Guernsey personal income tax system compared to our closest competitors has been eroded:

- Jersey applies a 20% headline rate but offers significantly bigger tax allowances to those eligible for marginal relief than are offered in Guernsey. While those eligible for marginal relief are taxed at 26%, a single person is eligible for a personal allowance of £14,200 (compared to £9,675 in Guernsey in 2015)

- The Isle of Man applies a "standard" rate of 10% to individuals earning between £9,500 and £20,000 per year[7] . Earnings above £20,000 are subject to the "higher" rate of 20% on earnings above this level.

- The UK also applies a standard rate of 20% on income up to £41,865 (with higher rates chargeable above this). However from April 2014 in the UK a single person is entitled to a tax allowance of £10,000 – higher than that available in Guernsey albeit that Guernsey still offers some reliefs such as that on mortgage interest no longer available in the UK.

A8b.9 This means that, in 2014, a low- to middle- income individual could pay less income tax in any of the three jurisdictions listed above than they currently would in Guernsey.

A8b.10 Guernsey also applies an exceptionally high upper limit on earnings subject to Social Security contributions; £135,252 in 2015 compared with £47,016 in Jersey and £41,865 in the UK and the Isle of Man. This adds a further competitive disadvantage for middle to high income households when considered in comparison to Jersey and the Isle of Man[8], Guernsey's primary competitors in the Sterling area.

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[7] Assuming the individual in question is not eligible for any other allowances

[8] This is less of an issue in comparison to the UK who apply a higher rate of income tax above their national insurance threshold.

A8b.11 This presents issues across the income scale. An uncompetitive direct tax system contributes to the difficulty in persuading local graduates to stay in Guernsey, recruiting necessary skills in the middle-income ranges such as nurses and teachers and to recruit the type of senior executives who often create economic activity and further employment opportunities.

A8b.12 Increasing headline income tax or Social Security rates will only erode the competiveness of Guernsey's personal tax system further and the Joint Board does not advise doing so at this time, although it is acknowledged that, subject to the outcome of projects such as SLAWS, it may be necessary to increase Social Security contributions at some point in the future.

Higher taxes for higher earners

Sustainability	Poor
Economic efficiency	Poor
Fairness	Progressive
Tax distribution	Narrower

A8b.13 The results of the public consultation indicated that a significant proportion of respondents would consider it fair to charge a higher rate of tax to those who have a higher income. Although this would be logistically more difficult than an increase in the general rate, it would not entail the development of any new tax systems. A higher tax rate for higher earners would also make Guernsey's tax system significantly more progressive than it is now.

A8b.14 **By restricting the increase to a smaller percentage of people, the increase in taxation necessary to raise a significant amount of revenue is higher. Either the higher rate threshold would need to be comparatively low or the higher rate would need to be high. For example, to raise £20m (the amount raised by an increase in the headline rate to 21.5%) it is estimated that you would need to charge a rate of 30% on all income above £45,000, capturing about 25% of the employed population.**

A8b.15 However, this must also be considered alongside Social Security contributions. As previously highlighted, the upper limit on contributions in Guernsey is very high - £132,444 compared with £47,016 in Jersey and £41,865 in the UK.

A8b.16 The UK applies a higher rate of income tax (40%) to earnings above £41,865; £5 above the upper limit on National Insurance contributions (£41,860). This means that there is no overlap between the higher rate of tax and national insurance contributions. If the same principle was applied in Guernsey, only those earning over £**135,252** would be subject to the higher rate. At this level, a 30% rate would raise an estimated £6m and would impact approximately 2% of the workforce.

A8b.17 **If set below the upper earnings limit on Social Security, higher rates for higher earners would mean high marginal tax rates (see Appendix 1, Box 1) for upper**

middle earners, who would be liable to pay both the higher rate of tax and Social Security contributions on any additional income they may earn.

A8b.18 **Many of the same arguments can be made against higher rates of taxation for higher earners as were made against a higher general rate. There is a competitive disadvantage in applying higher rates of income tax than our closest competitors. In this case, the most significant issue may be the impact on the ability of local businesses to attract and keep the middle and higher income employees from outside of the Island.**

A8b.19 **The highest earners already contribute a significant proportion of the total amount of tax revenue collected by the States. When ranked by income the top 10% of households contribute an estimated 40% of the total amount of personal income tax and Social Security contributions collected. Adding a higher earners rate would increase this figure.**

A8b.20 **This would make States' revenues more dependent on attracting and keeping higher income households in Guernsey, while making it more difficult to achieve.**

A8b.21 **Highly skilled individuals tend to generate economic growth by developing businesses, and devising new products and services. This innovation creates jobs and wealth for people to spend in the wider economy and is good for the community in general. Taking more money from those who earn more may seem attractive, but charging tax rates which could discourage such people from moving to, or staying in, Guernsey could be detrimental for the Island's economy and its growth potential, which must be the States' first priority.**

Appendix 8c: Analysis of individual tax elements: Personal tax allowances

Reduce personal tax allowances

Sustainability	Poor
Economic efficiency	Poor
Fairness	Regressive
Tax distribution	Broader

A8c.1 The provision of a personal allowance for all tax payers costs the States approximately £80m in lost revenue. The current personal allowance of £9,675 reduces the tax bill of each tax payer by £1,935. Reducing the personal allowance is a mechanism which could be used to generate more revenue.

A8c.2 There are advantages to lowering the personal allowance. The lower it is set, the larger the percentage of people who are eligible to pay income tax. Even paying a small amount of direct taxes provides an individual with a stake in the government and could be seen as a way of interesting a wider cross section of the community in government activities. While in reality most adults pay some form of indirect taxes (for example through fuel and excise duties or Tax on Real Property), the perception of being a "taxpayer" associated with indirect taxes is less apparent than it is in regard to direct taxes.

A8c.3 **The personal tax allowance creates a progressive element within Guernsey's income tax system, with households on lower incomes required to pay tax on a smaller percentage of their total income than wealthier households. To reduce the personal allowance would therefore make Guernsey's tax system less progressive and more proportional. A reduction would have a larger impact on lower income households than wealthier households relative to the size of their income.**

A8c.4 For example if the personal tax allowance were reduced by 20% (from £9,675 in 2015 to £7,740) this would raise approximately £14m and would increase the tax liability for an individual under 65 by £387 per year. For a taxpayer with an income of £20,000 a year this represents 1.9% of their income. For a taxpayer with an income of £100,000 a year this represents 0.4% of their income.

A8c.5 **This means that a proposal to reduce tax personal allowances would be regressive (relative to people's current liability), affecting low income households proportionately more than those with a larger income (see figure A8.8).**

Figure A8.8: Average impact of <u>reducing</u> personal tax allowances by 20% on all households by income

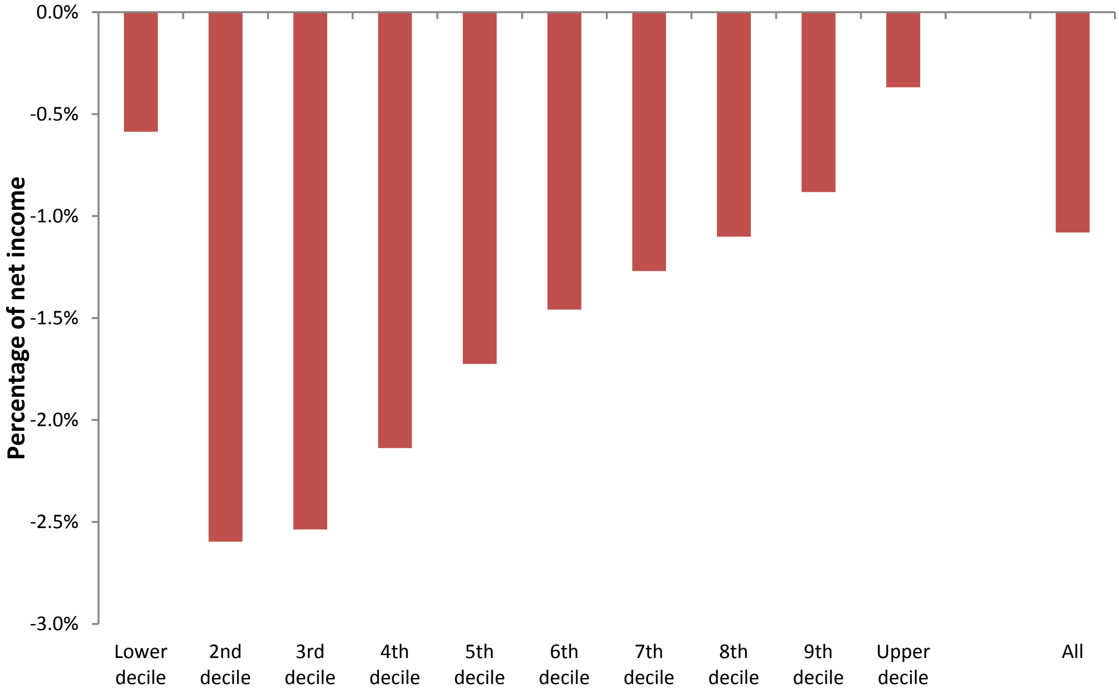
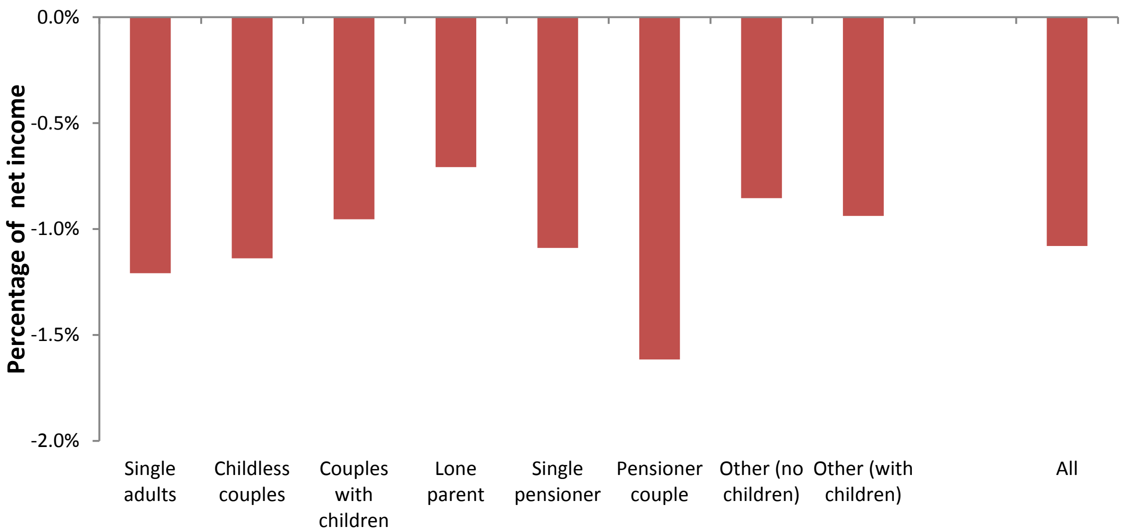


Figure A8.9: Average impact of <u>reducing</u> personal tax allowances by 20% on all households by household type



A8c.6 **Conversely, to increase the personal allowance provides the most benefit (proportional to income) for taxpayers earning just above the income tax threshold and would make the tax system more progressive (see Figures A8.10 and A8.11).**

A8c.7 As highlighted previously, the personal allowances offered in Guernsey are, as of April 2014, less than those offered in the UK, and the Coalition Government has stated its intention to continue to increase personal allowances through the rest of its term in office. The Liberal Democrats are backing an increase in the tax allowance to £12,500 by 2020. To increase personal allowances in Guernsey to this level would cost an estimated £20m in lost revenues.

A8c.8 Personal allowances offered in Guernsey are also significantly less than those offered to taxpayers charged at the marginal rate in Jersey. The personal allowances offered in the Isle of Man are lower than Guernsey's but they offer a standard rate of tax of 10%.

A8c.9 As the system currently stands, many lower middle income households would pay less income tax in any of the three jurisdictions mentioned above, than in Guernsey. This places Guernsey at a competitive disadvantage in the recruitment and retention of staff such as nurses and teachers.

A8c.10 **It is the opinion of the Joint Board the personal tax allowance should not be reduced. Further, the Joint Board feels that it is important that the personal allowances should provide a more competitive footing than those provided in the UK and would therefore recommend that they be increased.**

Figure A8.10: Average impact increasing personal tax allowances to £12,500 (£14,275 for those aged over 64) on all households by income

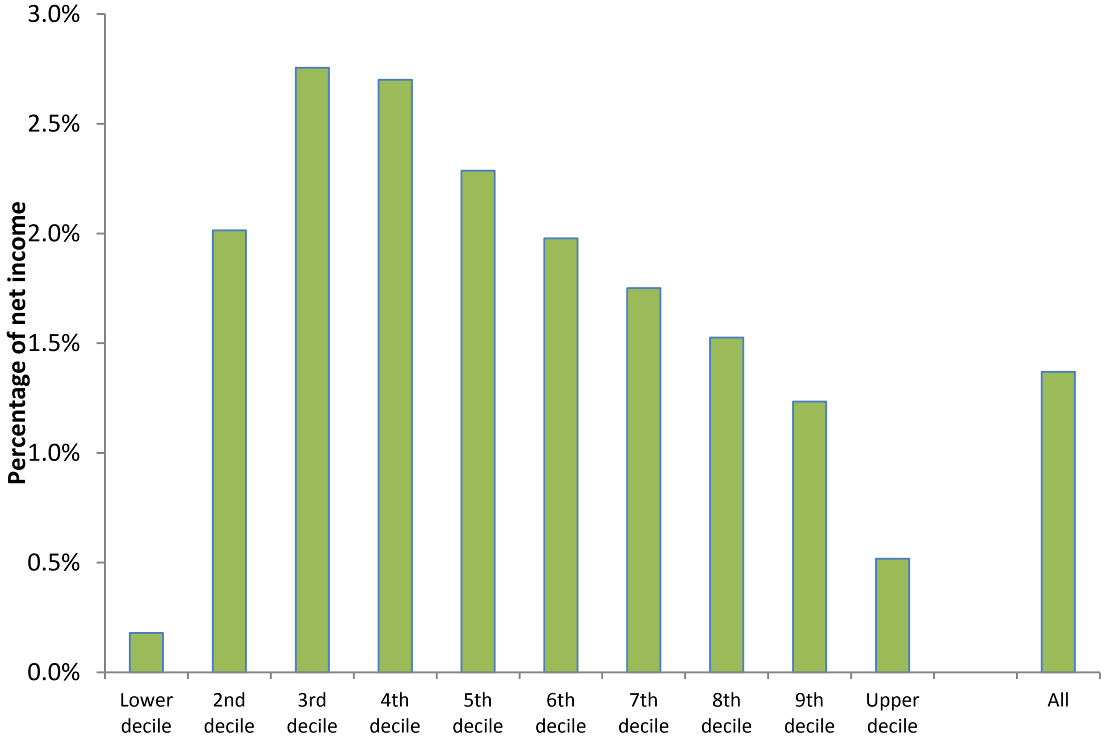
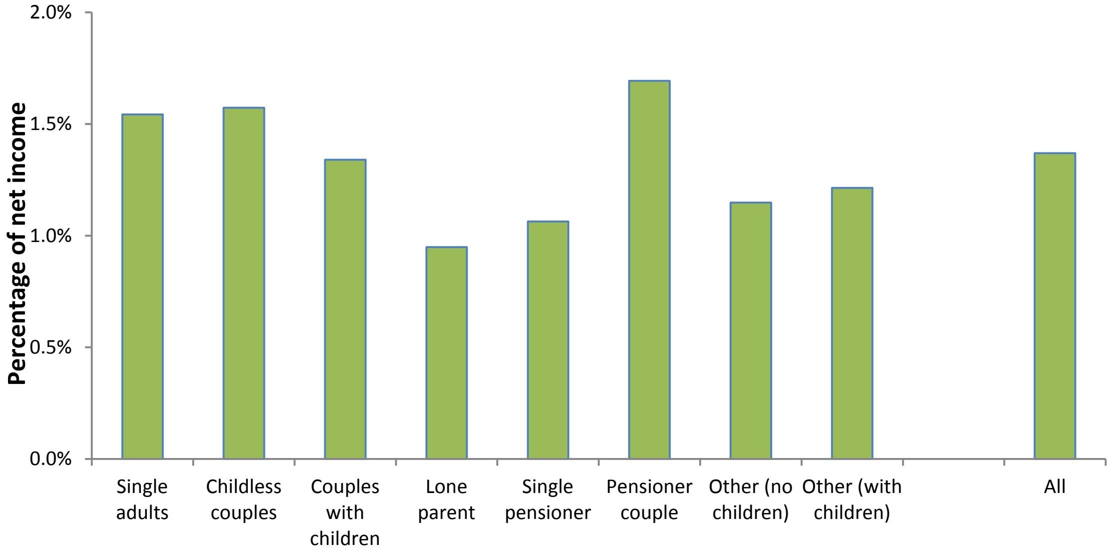


Figure A8.11: Average impact increasing personal tax allowances to £12,500 (£14,275 those aged over 64) on all households by households type



Withdrawing tax allowances for higher earners

Sustainability	Moderate
Economic efficiency	Moderate
Fairness	Progressive
Tax distribution	Narrower

A8c.11 The option of withdrawing allowances for higher earners is similar to introducing a higher tax rate for higher earners. However, the impact on any one individual is limited by the size of the allowance. For example, at the current level of personal allowance - £9,675 - the maximum amount of extra tax any person would have to pay from having this withdrawn is £1,935.

A8c.12 If other allowances, such as the relief given on mortgage interest or the additional allowance given to those over 65, are included in the withdrawal, or if the tax allowance is increased, the revenue generated by the withdrawal of tax allowances for higher earners is higher.

A8c.13 The limited nature of the withdrawal of allowances means that the impact on economic efficiency or sustainability is less, but so are the financial benefits. The issue of high marginal rates when considered alongside Social Security contributions outlined above continues to be a problem if the threshold for withdrawal is set lower than the upper limit for social insurance contributions.

A8c.14 Typically the withdrawal of tax allowances is achieved by reducing the tax allowance received by a set ratio to the amount of income an individual has above the withdrawal threshold (although this is not how Jerseys system works see paragraph A8.50). For example in the UK, tax allowances are withdrawn at a rate of £1 for every £2 above the £100,000 threshold until the allowances are withdrawn completely.

A8c.15 Withdrawing the allowance in this way increases the marginal rate (the percentage of tax paid on each additional £1 earned) for taxpayers between the withdrawal threshold and the point at which their allowance is withdrawn completely. This is because they must pay tax both on the additional money they earn and the allowance they have lost as a result of the increase in their income. Assuming a withdrawal rate of £1 for every £2 of income above the threshold, a taxpayer just above the threshold earning an extra £10 would pay 20% tax on that £10 (£2) and 20% tax on the £5 withdrawn from their personal allowance (£1). In total the taxpayer would pay £3 (or 30%) in tax on their £10 of additional income.

A8c.16 Withdrawing tax allowances at a slower rate would reduce the marginal rate of tax. For example reducing the withdrawal rate to £1 for every £3 above the threshold would reduce the marginal tax rate to those just beyond the withdrawal threshold to 26.7%, a similar rate to the current combined marginal rate experienced by most employed people below the upper earning limit for Social Security contributions. However, it would also reduce the revenue raised from withdrawing allowances.

A8c.17 Withdrawing tax allowances at a rate of £1 for every £3 of income above the threshold, set at the current upper limit on Social Security contributions would raise an estimated £2m-£3m and affect about 2% of the working population. This figure will increase if personal allowances are increased.

A8c.18 The Jersey system (known as “20 means 20”) operates by a different mechanism. Taxpayers are assessed under two different (and essential separate) rate systems: the “marginal” rate and the “standard” rate:

- Marginal rate taxpayers (typically low to middle income households) receive significant allowances but subject to the marginal tax rate of 26% on their income above their allowance;

- Standard rate payers (typically mid to high income households) receive far fewer allowances but are subject to the standard tax rate of 20%.

A8c.19 The system is complex and results in higher marginal rates of tax for lower and middle income households than for higher income households paying the standard rate. The States of Jersey have indicated that they wish to transition away from this system.

A8c.20 Given the difficulties Jersey have identified with their own system of withdrawing allowances, the Joint Board do not feel that this would be an appropriate move for Guernsey. Neither do the Joint Board feel that it would be appropriate to withdraw allowances from a threshold lower than the upper earnings limit imposed on Social Security contributions.

A8c.21 Given how high this current upper earnings limit on contributions is, withdrawing allowances at this level would be inefficient given the limited gain (£3m) and the potential increase in the cost of administering the income tax system, the Joint Board does not recommend withdrawing tax allowances from the current upper earnings limit.

A8c.22 **However, as outlined in Section 5.4, the high upper limit on Social Security contributions does create anomalies in the Social Security system. If, after further review, the States should choose to review and reduce this limit, the withdrawal of tax allowances for those earning above the limit could become a more viable option.**

Figure A8.12: Average impact of withdrawing tax allowances at a rate of £1 for every £3 of income above £135,252 on all households by income

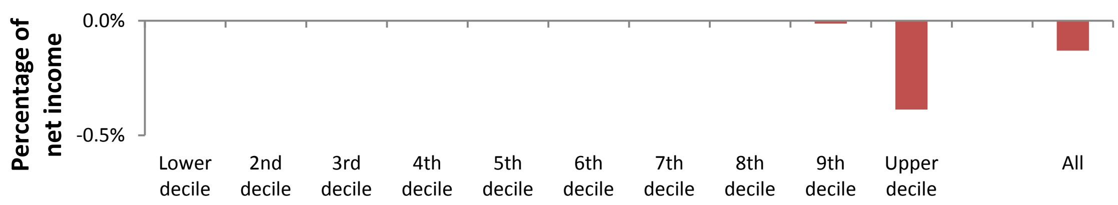
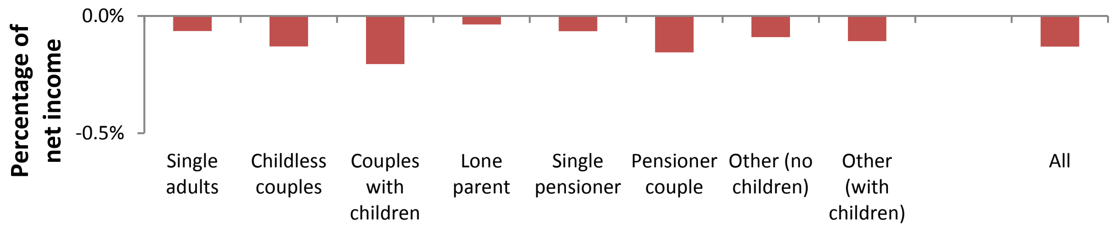


Figure A8.13: Average impact of withdrawing tax allowances at a rate of £1 for every £3 of income above £135,252 on all households by household type



Appendix 8d: Analysis of individual tax elements: Specific tax allowances

A8d.1 The Guernsey tax system offers a small number of specific tax allowances for households in particular circumstances. Each allowance reduces the amount of tax payable by those eligible for it. Unless offset by increases in the personal allowance, withdrawing these would result in a further increase in the percentage of total government income sourced from income taxes.

A8d.2 While this is contrary to the resolution to diversify the tax base, there are advantages to withdrawing these. Giving specific tax allowances to households in defined circumstances is, in many ways, similar to the provision of a universal benefit. Like the provision of universal benefits, these allowances are in many cases not well-targeted and, in some cases, not effective in achieving their original, well-intentioned, purpose.

A8d.3 The effect of these specific allowances is to reduce the average tax rate for households in particular circumstances, in some cases by a considerable amount. The provision of allowances with such narrow criteria inevitably produces inequities between households with similar incomes. For example:

- **A married couple, renting a property, with two incomes earning £50,000 would pay in total approximately 12.3% of their total gross income in income tax (approx. £6,130 per year).**
- **If the same couple had a mortgage on which they paid £5,000 a year in interest, they would pay 10.3% of their gross income in income tax (approx. £5,130 per year).**
- **If the couple were both pensioners but had no mortgage, they would pay 10.8% in income tax (approx. £5,420 per year).**

A8d.4 These allowances do not (and could not) address every circumstance which may affect a household's standard of living. Drawing on the example above, the cost of rent experienced by the first household could be more than the mortgage paid by the second. The pensioners may have paid off their mortgage and have no accommodation costs at all.

A8d.5 In many cases, the provision of these allowances means that the taxpayers need to advise Income Tax of changes in their circumstances and often require manual assessment by Income Tax staff. The removal of these benefits would improve the administrative efficiency of the Guernsey tax system.

A8d.6 **If approved, the additional revenues raised by the measures in this report could be used to increase the personal allowance to a more competitive level, distributing the benefit more evenly across the population. When raised as part of the consultation process, this was received positively with 53% of respondents generally in favour of this and 16% not in favour. Throughout, this appendix is presented both the impact of the withdrawal of these allowances in isolation and the impact of the withdrawal if it is assumed that any revenue gained is redistributed by increasing personal tax allowances on a net neutral basis (i.e. the overall amount of revenue raised will be the same)..**

Withdraw of tax relief on mortgage interest

Sustainability	Good
Economic efficiency	Good
Fairness	Progressive
Tax distribution	Narrower

A8d.7 At the present time homeowners can claim tax relief at 20% on the interest paid on the first £400,000 of a mortgage on their primary residence. As a result of an amendment placed to the 2014 budget and a subsequent resolution approved in the 2015 Budget this relief is now also limited by a £15,000 cap on the amount of interest claimable.

A8d.8 This practice originates from the Income Tax (Guernsey) Law, 1975, which specified that all interest on money borrowed, should be tax deductible irrespective of its purpose. In its original form the relief was therefore accessible, to a greater or lesser degree, to all.

A8d.9 However, through a succession of amendments to the legislation this relief was restricted to apply to mortgages on a principal private residence only. In effect this restricted the availability of this relief to those who had the financial means to become home owners. In its current form, Mortgage Interest Relief has become a subsidy on housing costs available only to those with a mortgage.

A8d.10 Recommendations to remove the relief on mortgage interest were presented in the 2013 budget. Although this was deferred at the time by amendment the Treasury and Resources Department, with the support of the Social Security Department, continue to believe that the issues and financial risks associated with the provision of this relief are still of concern.

A8d.11 There are three issues identified with the provision of this relief:

- The relief transfers a portion of the risk of increasing interest rates from the borrower to States revenues;
- Although viewed as a measure to assist residents to purchase property, the relief has instead exerted an upward pressure on house prices;
- It provides a subsidy on housing costs to those who have a mortgage, regardless of their financial position and not to those who are renting in the private sector.

Risk Transfer

A8d.12 The amount of interest a borrower pays on their mortgage is dependent on two factors: the size of their mortgage and the interest rate. The provision of relief on interest at 20% effectively transfers 20% of the cost of any increase in the interest rate to General Revenue, up to the limits applied.

A8d.13 **At present provision of this relief costs the States approximately £8m a year. This is low in comparison to historic averages, the cost of the relief being higher in times of high interest rates. The current average rates of interest paid on a Guernsey mortgage is just over 3%; the average rates reported by the Bank of England in the five years prior to the financial crisis were almost 6%. If mortgage interest rate return to this level this could cost the States up to £7m - £8m a year in lost revenues.**

A8d.14 To provide some context for this, the current cost of this relief is equivalent to almost 70% of the total value of rent rebates provided through the Housing Department in 2014 (£12m). When interest rates rise, the value of interest relief provided to homeowners with a mortgage may well exceed the cost of rebates offered to social housing tenants.

A8d.15 Although capping the interest claimable at £15,000 limits the risk to the States at its current level, fewer than 200 households (less than 1% of all households) are affected by it. The current median average interest relief provided on mortgages is between £5,000 and £6,000 per annum and interest paid could double before home owners currently paying at this level of interest would be impacted by this limit. As a result there is still a very significant financial risk that the cost of providing this relief will increase when interest rates rise.

Pressure on House Prices

A8d.16 While this relief is now viewed as a way to help people buy their own home, in reality, any benefit it may offer is off-set by the upward pressure this relief places on housing prices. Lenders typically take the relief on mortgage interest into account when determining how much a purchaser can afford to borrow; this typically increases the maximum amount a purchaser can offer for a property, increasing house prices over a period of time.

A8d.17 **Analysis performed by Oxford Economics in 2013 estimates this upward pressure to have added approximately £44,000 to the average house price in Guernsey, almost 9% of the current average residential property value.**

Subsidy on Housing costs

A8d.18 Providing relief on mortgage interest is equivalent to providing a subsidy on housing costs for those purchasing a property (although as stated above this may have proved counterproductive in the longer-term). Outside the welfare benefit system, those without mortgages are not provided with similar subsidies; there is no tax relief offered on private rents for example.

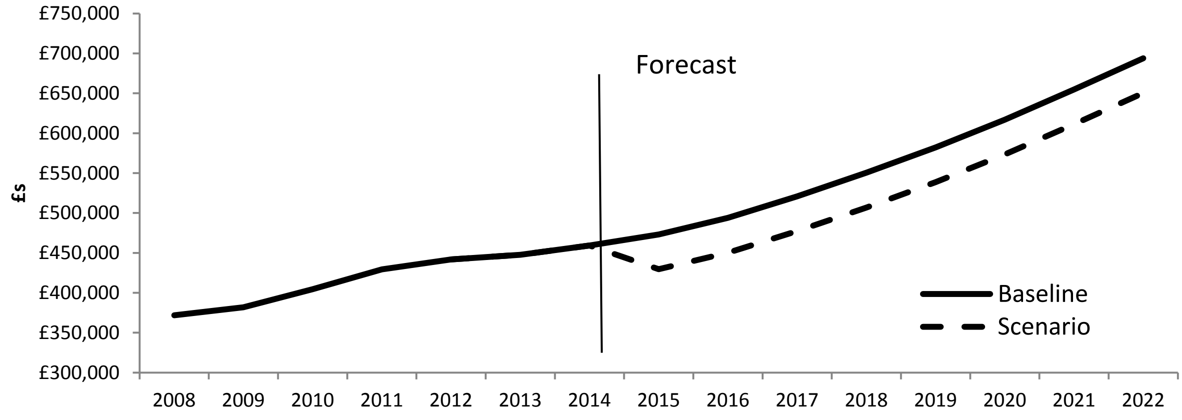
A8d.19 Given the cost of property in Guernsey relative to earnings, many lower- to middle-income households are not able to afford to purchase a property and are therefore not able to access this benefit. Meanwhile households who are able to afford a large mortgage are able to access this subsidy; the larger the mortgage they can afford the larger the subsidy they receive, up to the point they reach the limit on either the capital value or interest paid.

Impact analysis

A8d.20 Figures A8.14 and A8.15 show the projected impacts on both house prices of an *immediate complete withdrawal* of Mortgage Interest Relief. The analysis, provided by Oxford Economics, shows that the removal of Mortgage Interest Relief will reduce the average house price by £44,000 (9%) but that the amount of this reduction relative to house prices will reduce over time.

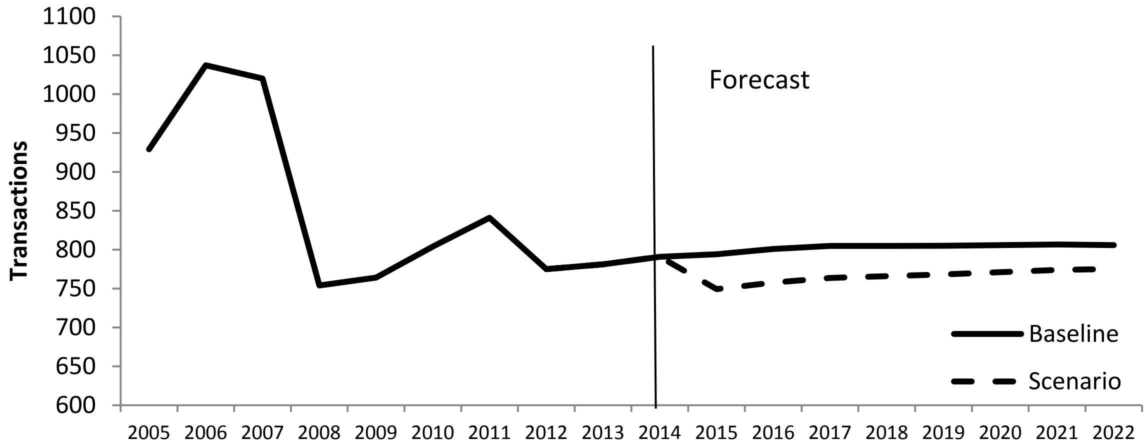
A8d.21 The number of property sales is projected to fall by an estimated 44 sales per year (approximately 5% of annual sales) at the outset; reducing to 31 sales per year (4% of total sales) after eight years. It is estimated that this would negatively impact Document Duty receipts by between £0.5m and £1m per annum.

Figure A8.14: House prices compared to baseline assuming immediate withdrawal of Mortgage Interest Relief, 2008 – 2022



Source: GSY MIRAS model, Oxford Economics

Figure A8.15: Housing transactions, compared to baseline assuming immediate withdrawal of Mortgage Interest Relief, 2008 - 2022



Source: GSY MIRAS model, Oxford Economics

A8d.22 The withdrawal of mortgage interest relief would have a significant impact on the disposable income of households currently paying a large amount of interest, typically those with very large mortgages or higher than average interest rates.

A8d.23 Analysis, presented overleaf in figure A8.16 and A8.17, shows that the withdrawal of relief on mortgage interest would be progressive for households in the first seven deciles, those with higher income being more likely to have a large mortgage. For the top three deciles, the average value of the relief relative to income decreases and therefore the withdrawal of this benefit is mildly regressive at very high incomes. This proposal has little impact on pensioner households as mortgages are typically not extended beyond the pension age.

A8d.24 **When combined with an increase in the personal allowance, this reduces the impact on those with a mortgage and is beneficial for those without a mortgage. By income the benefit is largest among those in lower income households just above the threshold at which they would be eligible to claim means-tested benefit. Pensioner households, few of which have a mortgage, also benefit from redistributing this allowance to all tax payers. Figure A8.18 and A8.19 demonstrate the impact of a withdraw of mortgage interest combined with an increase in the personal allowance in a net neutral basis (i.e. raising approximately the same amount of revenues)**

A8d.25 **The impact of such a measure on house prices, households and on Document Duty receipts could be mitigated by phasing the withdrawal over a ten-year period and the Joint Board would favour this option.**

Figure A8.16: Average impact of withdrawal of Mortgage Interest Relief on all households by income

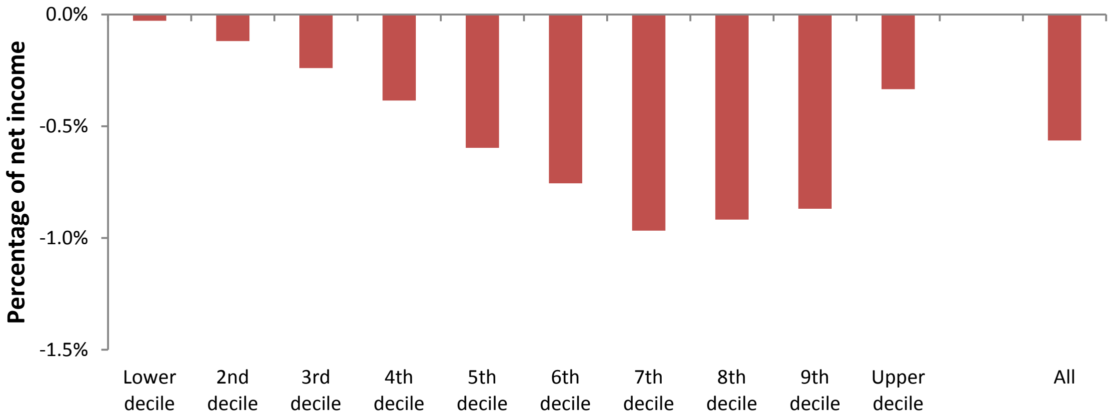


Figure A8.17: Average impact of withdrawal of Mortgage Interest Relief on all households by household type

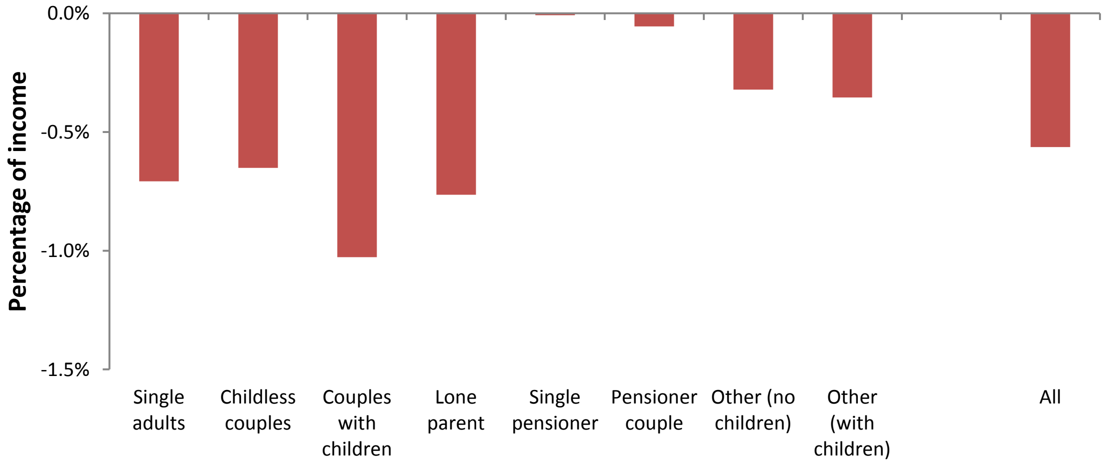


Figure A8.18: Average impact of withdrawal of Mortgage Interest Relief with an increase in personal allowances combined with an increase in personal allowances to £10,950 (£12,725 for over 64s), on all households by income

This represents a broadly net neutral scenario, the additional income tax revenue gained by withdrawing mortgage interest relief being balanced by that lost by the increase in the personal allowance

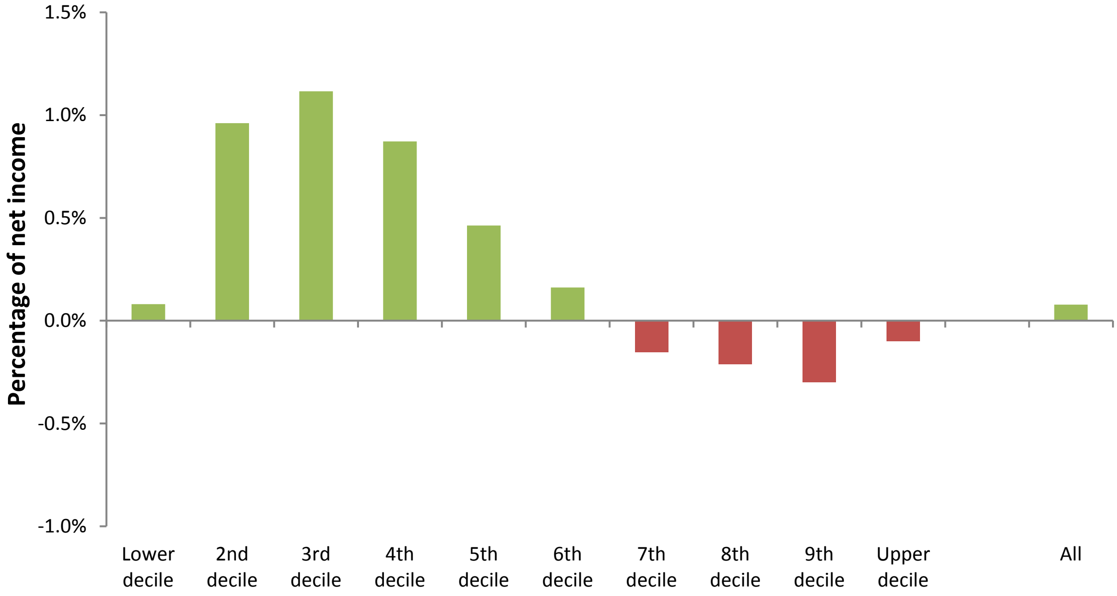


Figure A8.19: Average impact of withdrawal of Mortgage Interest Relief with an increase in personal allowances combined with an increase in personal allowances to £10,950 (£12,725 for over 64s), all households by household type

This represents a broadly net neutral scenario, the additional income tax revenue gained by withdrawing mortgage interest relief being balanced by that lost by the increase in the personal allowance

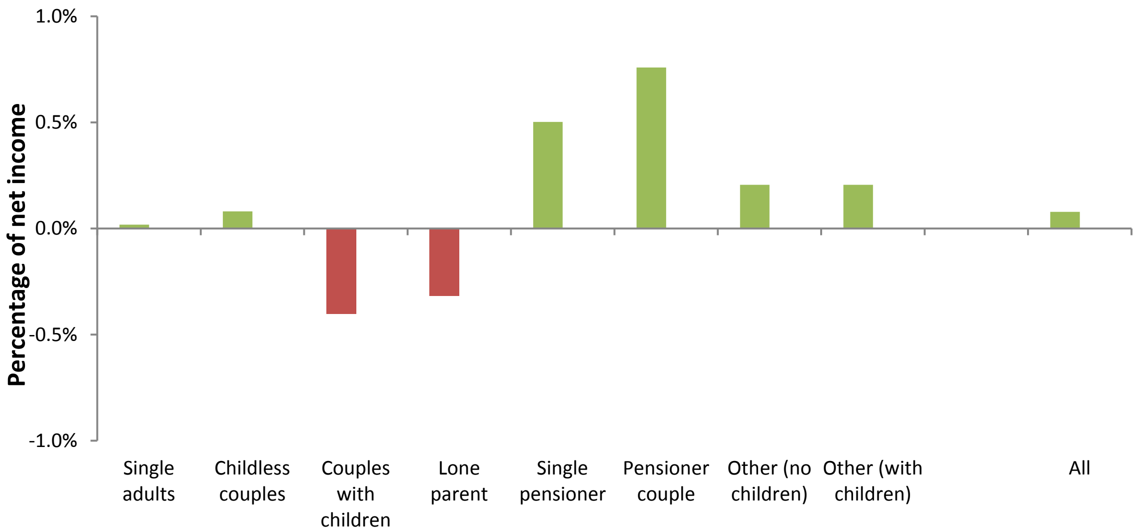


Table A8.20: Proposed schedule for the withdraw of mortgage interest relief

Year	Maximum value of interest deductible	Maximum capital value of mortgage against which relief is claimable	Married couples		Unmarried individuals		Est. revenue impact (year on year assuming no change in interest rates)
			Cumulative est. number of couples affected (assuming each spouse a borrower hence each entitled to relief up to cap)	Estimated maximum impact year on year (based on cap on interest deductible)	Cumulative est. number of individuals affected	Estimated maximum impact year on year (based on cap on interest deductible)	
2015	£15,000	£400,000	3	-	178	-	
2016	£13,000	£400,000	8	£800	222	£400	£0.1m
2017	£11,000	£400,000	22	£800	495	£400	£0.1m
2018	£9,500	£400,000	68	£600	678	£300	£0.2m
2019	£8,000	£400,000	141	£600	914	£300	£0.3m
2020	£6,500	£400,000	275	£600	1,246	£300	£0.4m
2021	£5,000	£400,000	586	£600	1,693	£300	£0.7m
2022	£3,500	£400,000	1,097	£600	2,238	£300	£1.1m
2023	£2,000	£400,000	2,014	£600	2,972	£300	£1.7m
2024	£1,000	£400,000	2,951	£400	3,580	£200	£1.6m
2025	Complete withdrawal		4,266	£400	4,265	£200	£2.2m
Total revenue impact							£8.5m

Additional personal allowances for those over pension age

Background

A8d.26 The provision of an extended allowance for people over the pension age costs the States approximately £3m a year. The ageing population could see this double in real terms by 2050, even without above inflation increases in the allowance. The additional allowance is worth £355 a year (£6.83 per week) for a single pensioner, £710 a year (£13.65 per week) for a married couple.

A8d.27 This provision was introduced in 1989 (Billet d'État XXVI, December 1988), and coincided with the simplification of the Income Tax system to remove the administratively intense system of marginal relief. The increase of the allowance for over 65s beyond that of the rest of the population was given little justification at that time but is believed to have been an additional compensation for those believed to be particularly vulnerable to the changes being made at the time.

A8d.28 **The Joint Board believes that the offer of an extended tax allowance on the basis of age is inequitable, positively discriminating in favour of older people but not targeting those most in need. It also slightly increases the reliance of income tax revenues from the working age population.**

A8d.29 **Being of retirement age does not necessarily mean a household is in need of additional assistance; there are many pensioner households in Guernsey with a very comfortable income or assets. For example, 25% of pensioner households have an equivalised gross income of more than £50,000 a year; 10% have an income greater than £75,000 a year. A large percentage of pensioners (an estimated 60%) are home owners who have paid off their mortgages and have no significant housing costs.**

A8d.30 **The lowest income pensioners, typically those with little or no private pension provision, who are heavily reliant on the States pension, may not have an income high enough to reach the threshold and therefore receive little or no benefit from it. Approximately 9% of pensioner households would fall into this category.**

A8d.31 If the allowance for pensioners were reduced to the level of the allowance available for working age people, analysis suggests that this would be mildly regressive. This additional allowance represents a larger proportion of income for households in lower income decile than those in higher income deciles (see figures A8.21 and A8.22). A8.86 Increasing the allowance available for all taxpayers to the level available to those over 64 would cost an estimated £1.4m but would be mildly progressive (see figure A2.23 and A2.24)

A8d.32 **Given the recommendation to increase the personal allowance the Joint Board is recommending that this allowance be frozen until the proposed, personal allowance available to working age people catches up. As it is recommended that the personal allowance is increased to reflect the withdrawal of specific allowances**

and increases in indirect taxes, this could be achieved relatively quickly (in two to four years).

Figure A8.21: Average impact of reducing the allowance for those aged over 64 to the same level as that for those of working age on all households by income

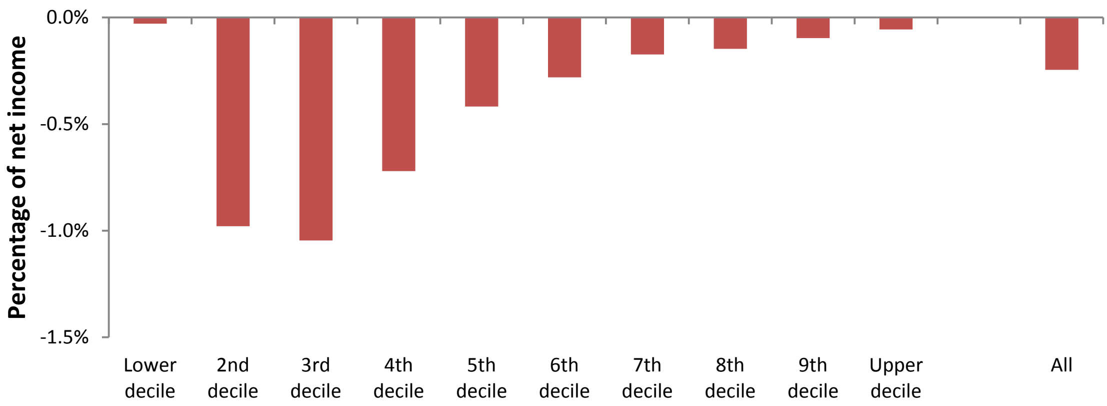


Figure A8.22: Average impact of reducing the allowance for those aged over 64 to the same level as that for those of working age on all households by households type

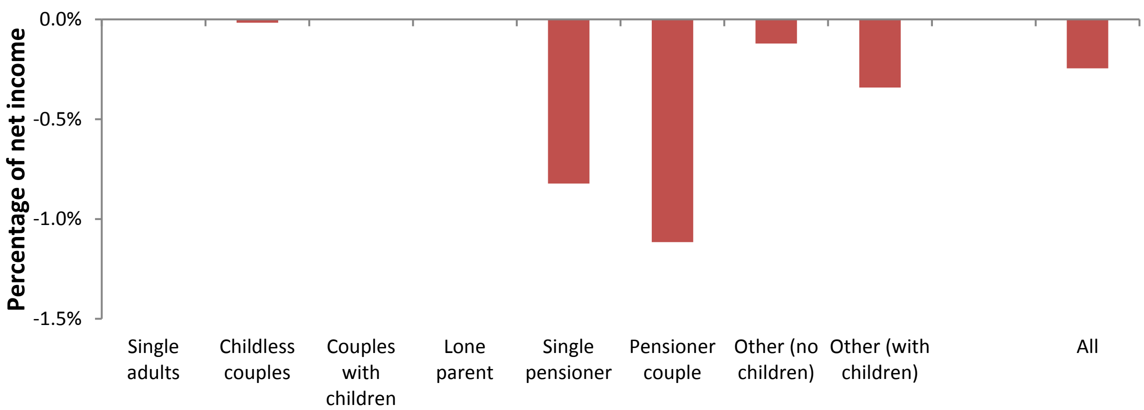


Figure A8.23: Average impact of reducing the allowance for those aged over 64 to the same level as that for those of working age combined with an increase in personal allowances to £11,450, on all households by income

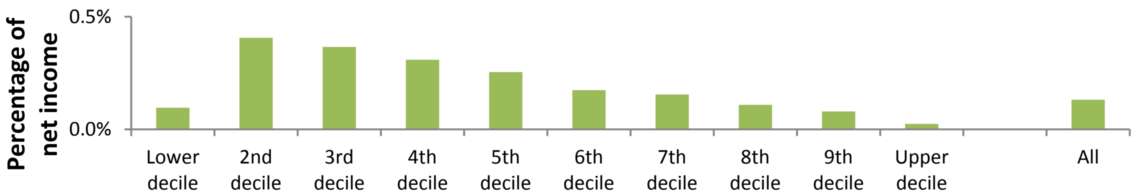
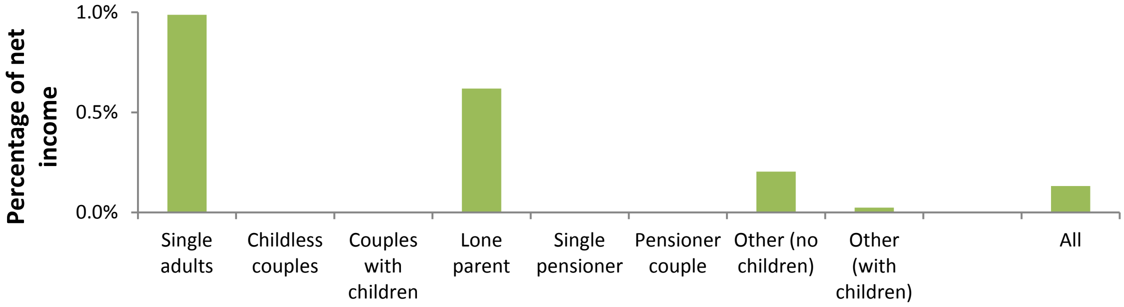


Figure A8.24: Average impact of reducing the allowance for those aged over 64 to the same level as that for those of working age combined with an increase in personal allowances to £11,450, on all households by household type



Appendix 8e: Analysis of individual tax elements: Independent taxation

A8e.1 The income tax system in Guernsey is structured to assess married couples as a unit, requiring only a single form to be submitted declaring the income of both spouses. A married couple can opt for separate assessment, in which case each spouse is responsible for submitting his or her own return and paying the relevant tax due, but the overall tax bill remains the same between them.

A8e.2 A married couple receives a married person's allowance (£19,350 for 2014 - twice the single person's allowance) irrespective of whether one or both spouses receive income. Even if a married couple is separately assessed, they are entitled to the same overall allowances and reliefs. Therefore if one spouse has insufficient income to use their full personal allowance, any excess is transferred to their spouse.

A8e.3 Within the current IT system, their income tax returns, and those income tax returns of people recently married or separated, require manual processing increasing the cost of collecting income tax.

A8e.4 If a couple is not married but co-habit, they are each entitled to the single person's allowance. Any excess allowance may only be transferred between co-habitees if they have children (i.e. they are in receipt of Family Allowance). Again within the current IT system this has to be done manually and increases the cost of collection.

A8e.5 Civil partners are not currently recognized as married couples within the Income Tax law (although the Union Civile project is reviewing this issue) and as a result this allowance is not available to same sex couples.

A8e.6 The legislation and assumptions which underpin this practice are becoming increasingly out-dated and do not reflect modern society. This system discriminates against those unmarried co-habiting or same sex couples who do not have children, as they have no entitlement to transfer any unused allowance. It also makes the collection of income taxes more labour intensive.

A8e.7 It is estimated that the ability to transfer allowances between spouses would reduce income tax revenues by approximately £5-7m[9] per year. The revenue lost by the transfer of allowances between couples will increase if the States choose to adopt the recommendations to increase tax allowances.

A8e.8 To resolve this inequality by allowing every co-habiting couple the ability to transfer allowances would be prohibitively expensive and administratively difficult since it would mean that income tax staff would need to establish a way to identify co-habiting couples and the administration required to alter tax coding notices to reflect changes in circumstances could increase dramatically.

A8e.9 Moving to a system of independent taxation, which would remove the ability to transfer unused allowances and reliefs to another person, would address any perceived discrimination against women and single sex couples as each partner would become responsible for their own tax affairs.

A8e.10 Under current practice, a married couple's total income tax liability is the same regardless of who earns the income. Under independent taxation this would not be the case. For example:

- **Under independent taxation, married couple A, both with income of £30,000 each in 2014, would have a tax liability of :**

    - 2 x (£30,000 - £9,675) = £40,650
    - Taxable at 20%=£8,130.
    - A total of £8,130 between them (the same as their liability under the current system).

- **Married couple B, one spouse with income of £60,000, the other with no income, would have a total tax liability of :**

    - £60,000 - £9,675 = £50,325
    - Taxable at 20%=£10,065
    - The allowances of the other spouse would be "lost".
    - In total they would pay £1,935 a year more than their current liability.

A8e.11 It should be anticipated that faced with the above, some individuals, such as those receiving substantial investment income and those in business, may seek to rearrange their affairs so they would not be adversely affected by the proposal, for example there may be transfers of investments between spouses.

A8e.12 While this would mean an increase in the number of tax forms submitted to the income tax office each year it would also reduce the number of forms which would need to be manually assessed and in the long-term this would reduce the administration cost of the income tax system.

[9] These estimates are particularly challenging because it is unclear to what degree married couples will choose to or be able to rearrange their tax affairs to reduce their liability

A8e.13 A move to independent taxation may also be an incentive to work for spouses/co-habitees with children who do not currently work, and who are not able to utilise the methods outlined above.

A8e.14 The UK already operates a system of independent taxation that treats married women as completely separate and independent taxpayers, for both income tax and capital gains tax, since April 1990. However, recent moves may reintroduce a small additional tax relief for being married.

A8e.15 Jersey has signalled its intention to move towards a system of independent taxation and the States of Jersey published a feasibility report on the subject in October 2013. The issues in Jersey are complicated due to their more complex marginal rate system.

A8e.16 In the Isle of Man, married couples are assessed individually, although there is the option to elect for joint taxation. Joint taxation (optional) means that the husband and wife are jointly and severally liable for all of their joint tax affairs. This system does allow a method by which a couple can transfer unused allowances and reliefs between themselves. Civil partners may elect for joint taxation.

A8e.17 **While the Joint Board feels that a move to independent taxation is the right long-term direction to take, it would need careful management. In isolation, an immediate withdrawal of this could have a considerable impact on some households, in some cases more than £2,000 a year (see figure A8.25 and A8.26). However, the impact on these households could be lessened by increasing the personal tax allowance to offset the increase in revenue (see figure A8.27 and A8.28). If this were to be revenue neutral (i.e. raise the same amount of income tax as the system currently does), an increase in the income tax allowance by £1,050 could offset the impact of this proposal, if the ability to transfer allowances between spouses is withdrawn far all tax payers.**

A8e.18 By income the impact of this would be largest on lower middle-income households (deciles 3 and 4), where there are a larger proportion of couples with a single income

A8e.19 When considered by household structure, those most vulnerable to the change could include:

- Pensioner couples whose income is assigned to one spouse and who are unable to significantly rearrange their financial affairs;
- Couples where one spouse does not work or works limited hours in order to provide childcare;
- Couples where one spouse is prevented from working by illness, disability or incapacity.

A8e.20 **While the analysis presented overleaf assumes that independent taxation is applied to all households, there are intermediate options which could be used in the**

transition that will need to be examined during the next stage. These could include a medium-term aim to apply independent taxation to working age adults without children only, allowing a longer transition period for pensioners and couples with children. Alternatively the transition could enable a partial transfer of allowances, gradually reducing over an extended period of time.

Figure A8.25: Average impact of a *complete* move to independent taxation, at current allowances, on all households by income

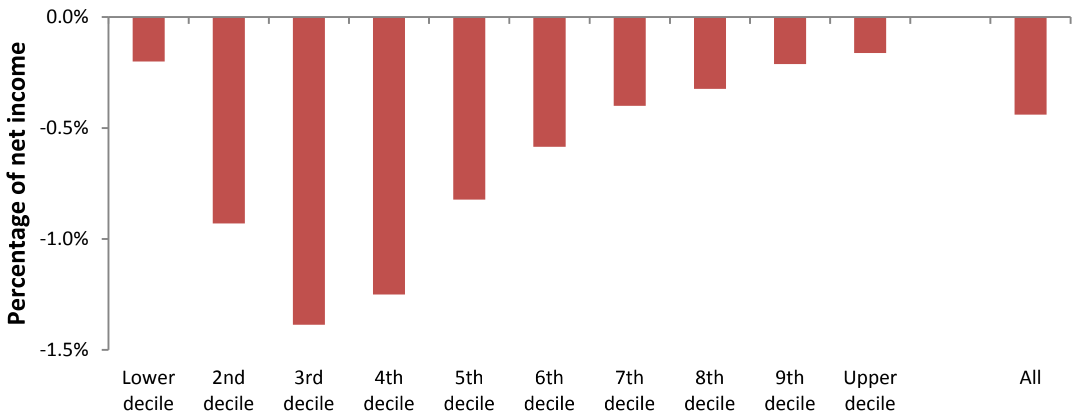


Figure A8.26: Average impact of a *complete* move to independent taxation on all households by households type

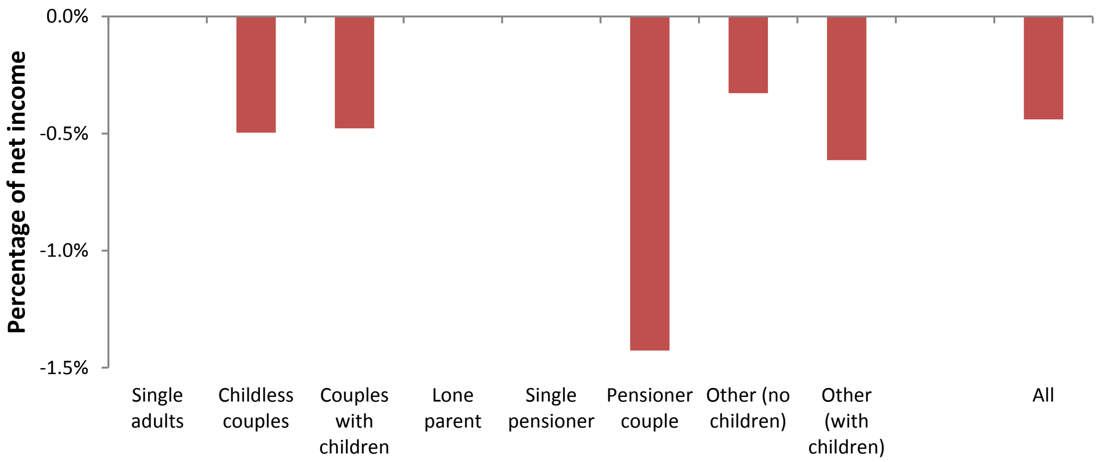


Figure A8.27: Average impact of a *complete move* to independent taxation with an increase in personal allowances combined with an increase in personal allowances to £10,400 (£12,175 for over 64s), on all households by income

This represents a broadly net neutral scenario, the additional income tax revenue gained by moving to independent taxation being balanced by that lost by the increase in the personal allowance

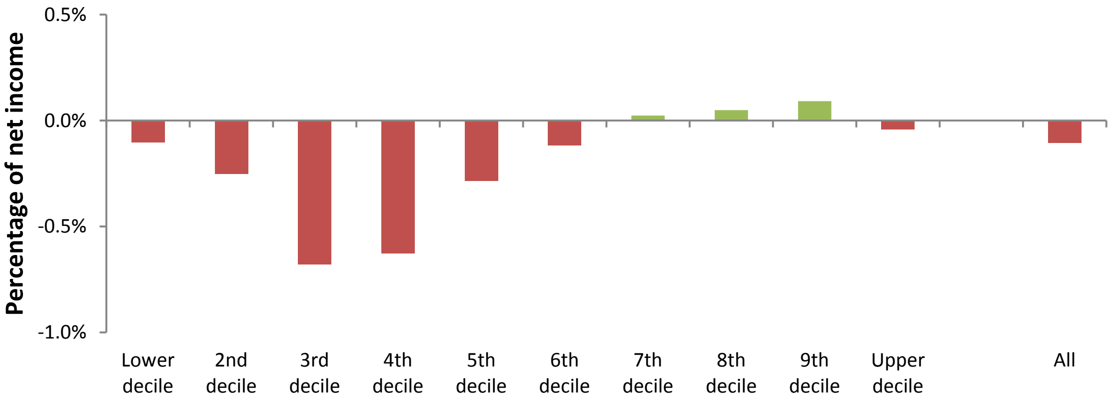
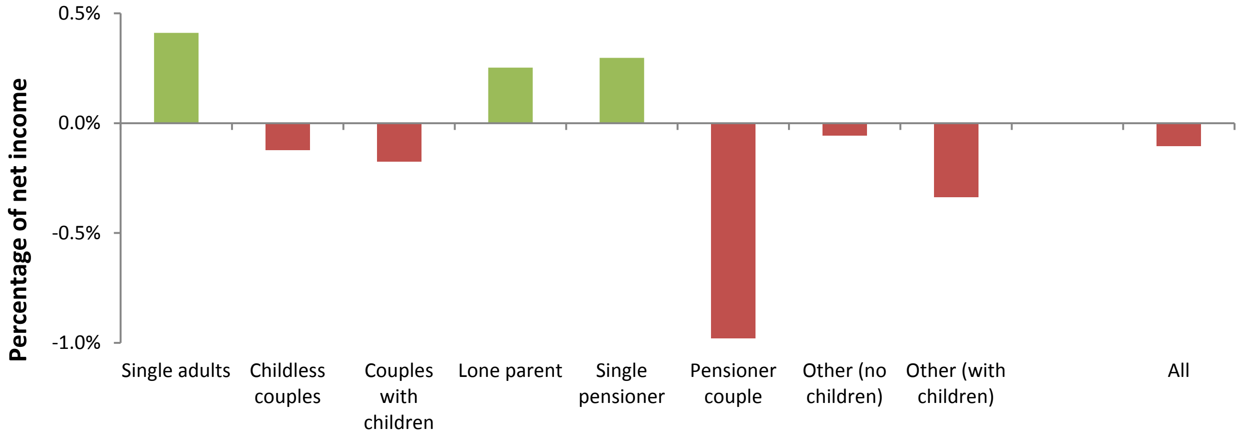


Figure A8.28: Average impact of a *complete* move to independent taxation with an increase in personal allowances combined with an increase in personal allowances to £10,400 (£12,175 for over 64s) on all households, by household type

This represents a broadly net neutral scenario, the additional income tax revenue gained by moving to independent taxation being balanced by that lost by the increase in the personal allowance



Charge of child tax allowance

Background

A8e.21 The Charge of Child allowance ("COC") is offered primarily to single parents. To be entitled to this allowance an individual must be receiving Family Allowance for one or more children and not cohabiting with another person. Couples (married or otherwise) are only entitled to claim this allowance if they are in receipt of Family Allowance and one spouse is totally incapacitated and has to maintain or employ someone to have care of the child(ren).

A8e.22 This allowance is closely linked to issues of independent taxation. In effect the availability of this allowance reflects the fact that a single parent would not have access to a second personal allowance which could be transferred in the event that one spouse did not earn enough to utilise their full allowance.

A8e.23 **If a move to independent taxation is made and the CoC provision is retained, this allowance would discriminate in favour of single parents, who would be able to claim an additional allowance not available to couples. If the CoC allowance is withdrawn but the ability to transfer allowances between married and co-habiting couples with children is retained, the system will discriminate against single parents who will not be able to access the potentially unused allowance of a spouse.**

A8e.24 **The consideration of this allowance must therefore be linked to the consideration of independent taxation.**

A8e.25 In 2015 the allowance is £6,250, claimed by approximately 700 people at a total cost of approximately £1m per annum. Of those claimants, the majority earn income of less than £50,000. If the allowance was closed to new claimants for 2016 et seq then, over time, as the children stopped qualifying for Family Allowances, this cost would be recovered at approximately £50,000 per annum over a period of 20 years.

A8e.26 The impact of this withdrawal would be limited almost exclusively to single parent households. This allowance is claimed by only a very limited number of households and as a result the average impact on all households is very limited.

A8e.27 Again the withdrawal of this could be offset by an increase in the personal tax allowance, but given the size of the allowance and the small number of people it applies to, for most of those claiming it the increase in personal allowance would not be enough to significantly reduce the impact. For the small number of households which do claim this benefit the impact could be significant and if this is to be phased out it needs to be handled carefully.

Figure A8.29: Average impact of a complete move to independent taxation <u>including the withdrawal of the Charge of Child allowance,</u> combined with an increase in personal allowances to £10,525 (£12,300 for over 64s) on all households by income

This represents a broadly net neutral scenario, the additional income tax revenue gained by moving to independent taxation and the withdrawal of the charge of child allowance being balanced by that lost by the increase in the personal allowance

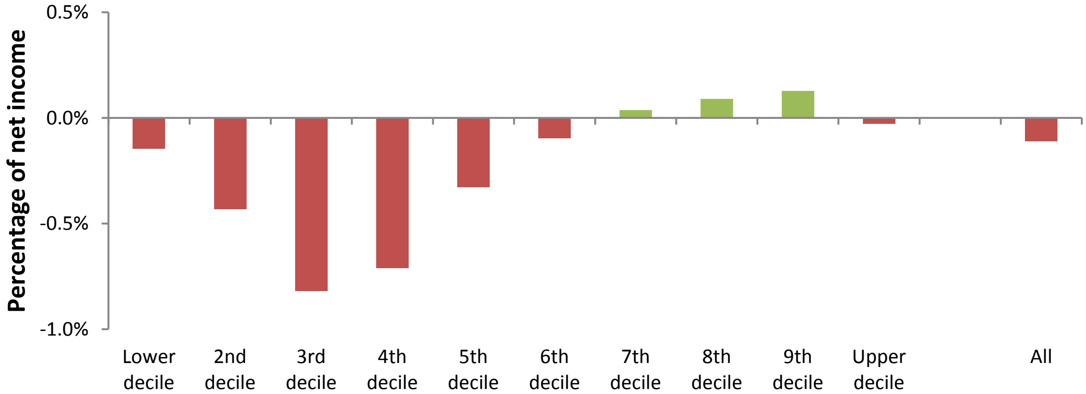
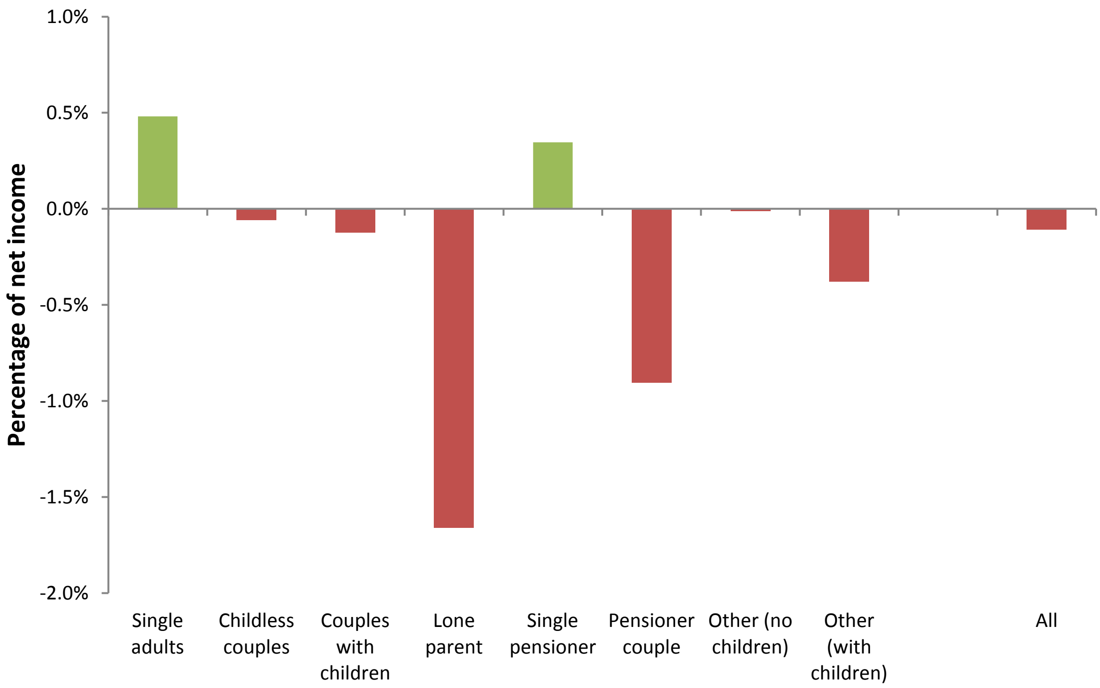


Figure A8.30: Average impact of a complete move to independent taxation <u>including the withdrawal of the Charge of Child allowance,</u> with an increase in personal allowances to £10,525 (£12,300 for over 64s) on all households by household type

This represents a broadly net neutral scenario, the additional income tax revenue gained by moving to independent taxation and the withdrawal of the charge of child allowance being balanced by that lost by the increase in the personal allowance.



Appendix 8f: Analysis of individual tax elements: Social Security contributions

Increasing contribution rates

Sustainability	Poor
Economic efficiency	Poor
Fairness	Proportional/Progressive
Tax distribution	Narrower

A8f.1 The Social Security system was intended to operate on a “pay-as-you go” financing system, which means that today’s contributors pay for today’s pensioners. In reality, in the past there has been an element of overfunding, which has resulted in the accumulation of a substantial reserve in the GIF.

A8f.2 As the population has aged (the first of the baby boom generation having passed in to pension age in 2011/12), the system has become underfunded, relying on the investment return and draw down from reserves to finance an operating deficit.

A8f.3 Given that much of the additional projected expenditure burden is expected to fall on the social security funds, an increase in social insurance contributions would seem a key consideration. Social Security contributions can be divided into five classes: employees, employers, self-employed, non-employed and over 65s.

A8f.4 The different classes are charged at different rates, historically reflecting the different eligibility of those in different contribution classes for various benefits (see figure A8.31).

A8f.5 To increase Social Security contributions would further increase the proportion of revenue received from direct taxes charged against income. While some or all of this could be charged against employers, these contributions are themselves calculated on the earnings of employees and are therefore subject to the same vulnerability to earnings and employment levels as employees’ contributions and income tax. It would also increase the cost of employment in Guernsey and potentially could have a negative impact on employment and unemployment levels in Guernsey.

A8f.6 Further, because those over the age of 64 pay a lower rate of Social Security (reflecting the fact that they no longer need to contribute to their old-age pension, but continue to contribute to the long-term care and health service funds), Social Security contributions are particularly vulnerable to changes in the age profile of the population. However, if, as recommended, the pension age is increased to 70 by 2049 those affected by the increase in pension age would continue to pay a full contribution up to their increased retirement age.

A8f.7 A 2% increase in the rate charged to employees (with a relative increase in rates for other classes) would raise approximately £20m.

A8f.8 Relative to income, such a change would be mildly progressive, due in part to the allowance offered on contributions for those over 64 or non-employed. However, because of the limitations on contributions, in the highest income decile the impact on a household’s disposable income relative to their gross income is lower than those in deciles 4 to 9 (see figure A8.23).

A8f.9 Because those over 64 pay a significantly reduced rate, the impact of this proposal would be lowest on pensioners, placing an increased proportion of the burden on working age households.

Figure A8.31: Comparison of current rates and limits with those in place before the decision to increase the upper limit

		Guernsey 2006 (in brackets at 2015 prices)	Guernsey 2015	Guernsey 2015 eligibility for benefit	Jersey 2014	UK/IoM 2014/2015
Employees	Contribution rate	6.0% on earned income	6.0% on earned income	All employment-related benefits Old-age pension All health-related benefits Long Term Care benefits	6.0%	12% on earnings between £7,956 and £41,865 Plus 2% on earnings above
	Upper limit	£36,036 (£46,773)	£135,252		£47,016	
Employers	Contribution rate	5.5%	6.5%	NA	6.5%	13.8% on earnings between £7,956 and £41,865 Plus 2% on earnings above
	Upper limit	£36,036 (£46,773)	£135,252		£47,016 Plus 2% on earnings up to £155,568	
Self-employed	Contribution rate	10.5% on self-employed income	10.5% on self-employed income	Limited employment-related benefits Old-age pension All health-related benefits Long Term Care benefits	12.5%	9%
	Upper limit	£36,036 (£46,773)	£135,252		£47,016 Plus 2% on earnings up to £155,568	On earnings between £7,956 and £41,865 Plus 2% on earnings above
Non-employed	Contribution rate	9.9% (2.6% for those over 65) on **all** income	9.9% (or 2.9% for those over 65) on **all** income	No employment-related benefits Old-age pension (unless already claiming) All health-related benefits Long Term Care benefits	12.5%	Voluntary contributions
	Upper limit	£36,036 (£45,766)	£135,252 with an allowance of £7,223		£47,016 Plus 2% on earnings up to £155,568	Voluntary contributions

Figure A8.32: Average impact of increase in all Social Security contributions rates by 2 percentage points on all households by income

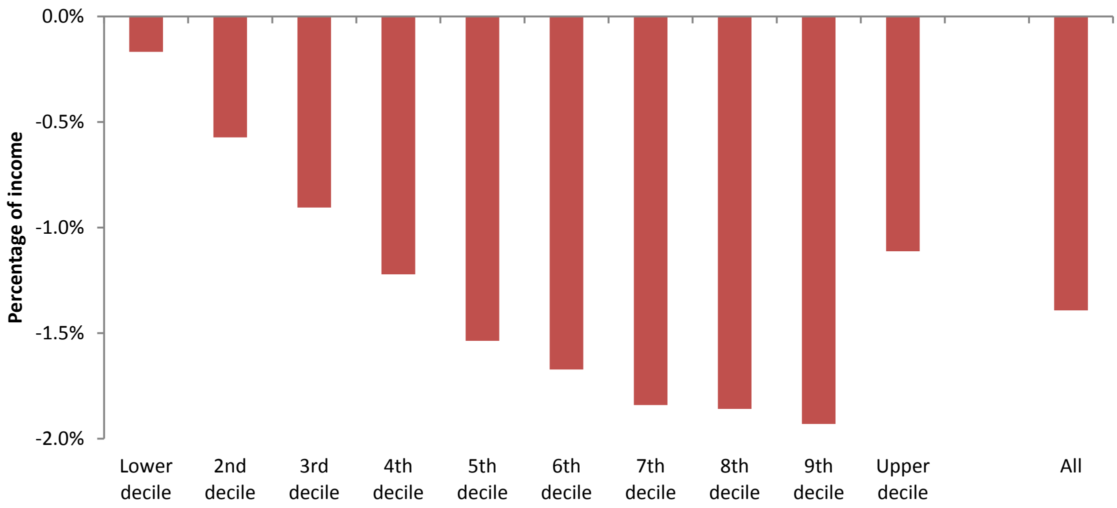
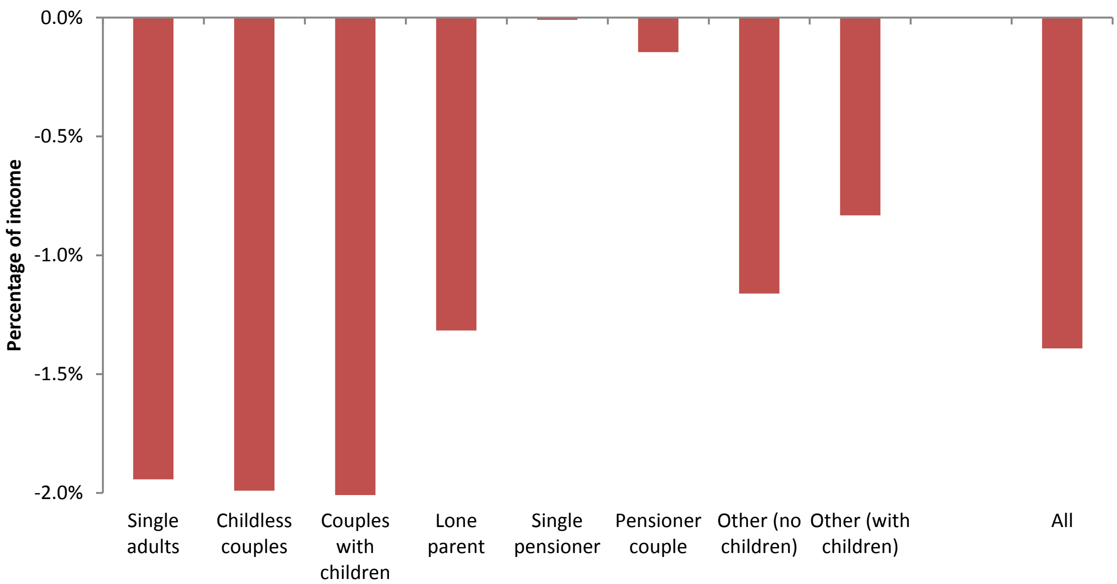


Figure A8.33: Average impact of increase in all Social Security contributions rates by 2 percentage points on all households by household type



A8f.10 Although not demonstrated here, it would be possible to share this burden with employers by dividing the increase between employers' and employees' contributions. However, since the determining factor of an employer's contribution is the employee's wage, such an increase would be subject to many of the same weaknesses as an increase in employee contributions. Any movement in the labour market which would reduce either the number or earnings of the working population, would have a similar impact on both employee and employer contributions.

A8f.11 Further, while sharing this burden with employers would reduce the direct impact of the increase on a household's income, it would increase the amount it could cost a business to employ staff. An increase in costs in direct proportion to their wage bill will reduce the number of staff a firm can afford to employ or the amount they can afford to pay their employees. In this way, an increase in employer's contribution is likely to have a negative impact on the labour market.

A8f.12 **Because of the recommendations outlined in section 5.2 (which should minimise the pressure on the Guernsey Insurance Fund), and the concerns outlined in the section 4.1 regarding the overall level of taxation, the Joint Board feels that it is not appropriate to recommend an increases in Social Security contribution rates at this time.**

A8f.13 **However, given that much of the long-term expenditure pressure will fall on the Social Security Funds, the Joint Board recognises that it may be appropriate to revisit the possibility of increases in Social Security contributions, once the cost implications for the Long-Term Care Fund become clearer as the Policy Council develop the SLAWS further.**

The upper earnings limit and other issues

A8f.14 Prior to 2007, the Social Security system was operated on an 'insurance principle', that is contributors paid now to receive benefit later and the maximum amount of contribution payable was set at a level representative of the average value of benefits being received by current beneficiaries.

A8f.15 At current and historic Social Security contribution rates the point at which an individual's social security contribution is roughly equal to the insurance value of the benefits they might receive is well above median earnings. This means that well over half of contributors do not contribute enough to match the value of the benefits they may receive.

A8f.16 Contributions from those not earning enough to reach this level were historically "topped up" via the grant paid from general revenue into the Social Security Funds. However, when the introduction of Zero-10 (Billet d'État XI, June 2006) was approved the States resolved, by amendment:

"That the General Revenue grant to social security shall be reduced from 1st January, 2008, by increasing the rate of employers contribution by 1% and increasing the Upper Earnings Limit for employers to the equivalent of £100,000, and for self-employed, non-employed and employees to the equivalent of £60,000."

A8f.17 The Upper Earnings Limit (UEL) for employers was increased to £100,000 immediately. The UEL for employees and other contribution classes was increased to £60,000 and then subsequently increased to the same level as employer's contribution (adjusted for inflation) over a number of years. This process was completed in the 2013 uprating report, with contribution limits for employers and employees being applied at £135,252 from January 2015. The limit now caps the contribution of only about 2% of employees.

A8f.18 While the above amendment was successful, the Social Security Department at the time objected to it because it breached the insurance principle upon which the funds were founded. The increase in the cap means that, for higher earners, the amount of money that they contribute to the Social Security Funds is no longer representative of the amount of benefit they may expect to receive or the average amount being received by current contributors. It also means that, rather than the contributions of low earners being subsidised solely from

General Revenue, much of the burden of subsidising contributions of the lower paid has been transferred to contributions paid by higher earners.

A8f.19 The funds have drifted more towards a principal of 'social solidarity' rather than social insurance. In effect, the increase in the upper limit could be viewed as a redistribution of income from higher earners (albeit one limited by the UEL), collected via Social Security contributions rather than income tax, and ring-fenced for the purpose of providing pensions and social benefits. While in principle there may be many who do not object to this, it has had some unintended consequences which are of concern and which undermine the fairness of the current system.

A8f.20 As outlined previously, unlike income tax, both the rate and the income on which a contributor is liable for Social Security contributions are dependent on a contributor's employment classification and age. Up to the point at which the insurance principle still holds, this reflects the varying entitlement of different groups for benefits and the contribution made by employers on behalf of their employees (see table A8.22).

A8f.21 Beyond the level at which contributors could be considered to be paying insurance for their own benefits, those with higher incomes are subsidising the contributions of lower earning individuals. While this in itself may not be of concern, because the rates charged are different for different groups, the degree to which a higher earning individual's income is used to subsidise the contribution of those on lower incomes is dependent on the contributor's employment status.

A8f.22 For example, if it is assumed that the insurance principle would be valid at £50,000[10] for all contribution classes, the amount of money an individual earning £100,000 would pay into the Social Security system beyond this would be:

- **£3,000 if they were an employee (plus a further £3,250 from their employer);**
- **£5,250 if they were self-employed;**
- **£4,950 if they were non-employed;**
- **£1,450 if they were 65 or over.**

A8f.23 Contributions charged for different contribution classes in Guernsey are also based on different income definitions. While employed individuals pay contributions at 6.0% on their earned income only (with a further 6.5% contributed by their employer); a non-employed person under 65 will pay contributions at 9.9% on their total income (see table A8.22).

A8f.24 Combined, the issues described above mean that contributions for non-employed contributors and self–employed contributors can be disproportionately high in comparison to contributions from employees.

A8f.25 Until 2007, limitations on contributions in Guernsey were broadly comparable with those in Jersey. As highlighted previously the UEL on Social Security contributions is now very significantly higher than that of our nearest competitors: with a standard earnings limit of £47,016 applied in Jersey and £41,865 applied in the UK (see table A8.22).

[10] This figure is used for simplicity of reference only.

A8f.26 Both Jersey and the UK apply an element of redistribution within the Social/National insurance systems, by continuing to charge contribution beyond their first "limit". However, importantly, the contribution rate for all classes beyond the primary upper limit is 2% up to a second limit, and there is therefore much less discrimination between contribution classes.

A8f.27 As previously stated the limitations for contributions for employers were also increased in 2007. The justification for this was that the payment of additional Social Security contributions would be the mechanism by which companies would continue to make a contribution to the government in the absence of liability to pay tax on corporate profits.

A8f.28 In reality, a contribution based on an employee's wage has a different impact on business behaviour than a tax on company profits. A business's liability for profits tax is applied after all other costs are taken into account (including the cost of employment). At a basic level, for a business to reduce its tax liability on its profits a business must either increase its expenses or decrease its income, neither of which would be in the best interest of the beneficial owners.

A8f.29 By contrast, an employer's Social Security contributions are directly related to how many staff they employ and how much they are paid. The direct implication of this is that, if employers' contributions are increased, a business may be less able to afford to employ staff. Economically, making employment expensive discourages economic growth.

A8f.30 Restoring the insurance principle by lowering the contribution rate would be expensive. To reduce the cap on employee, self-employed and non-employed contributions to £47,000 (comparable to the current limit applied in Jersey and, adjusted for inflation, broadly equivalent to the UEL applied in Guernsey in 2006) would cost approximately £9m to £10m. To reduce the cap on employer's contributions to the same level would cost a further £10m. This lost revenue would need to be replaced by restoring the grant from General Revenue, necessitating an alternative source of income.

A8f.31 **While a full return to the insurance principle is likely to prove impractical, the Joint Board do believe that further consideration of ways to improve the equity of the Social Security system is needed.**

A8f.32 **There are various options which might be explored including:**

- **Reducing the UEL or restructuring the way it is applied;**
    - **This might include a tiered system similar to that applied in the UK and Jersey, where contributors in different classes pay different rates up to an "insurance" based limit, with a lower, flat rate applied to the income or earnings of contributors above this limit. In Jersey a second limit is applied above which no further contributions are due;**
    - **It might also make it more viable to withdraw tax allowances for higher earners if the UEL were reduced. It is possible to establish a point at which the revenue raised from the withdrawal of tax allowances is broadly equivalent to the money lost by reducing the limit on Social Security contributions (see Table A8.25). The point at which this can be achieved is dependent on how large the personal allowances are.**

- **Reducing the rates paid by self-employed and/or non-employed contributors to reduce the inequity between different contribution classes;**

- **Restructuring the way contributions for non-employed contributors are assessed.**

Table A8.34: Estimated cost of reducing the Upper Earnings Limit on Social Security for employees, self-employed and non-employed contributions and revenue generated by withdrawing tax allowance

Assuming current tax rates and allowances and a withdrawal of all allowances at a rate of £1 for every £3 above upper earnings limit on Social Security contributions

Upper Earnings Limit on Social Security contributions/ threshold for withdrawal of tax allowances	Est. Social Security contributions income lost (£m)	Est. income tax revenue gained (£m)	Net gain/ loss (£m)	Estimated % of tax payers affected
£132,444 (No reduction)	£0.0m	£2.1m	£2.1m	3%
£100,000	-£3.3m	£3.3m	£0.0m	6%
£90,000	-£4.7m	£3.9m	-£0.8m	7%
£80,000	-£6.3m	£4.7m	-£1.6m	9%
£70,000	-£8.3m	£5.9m	-£2.4m	11%
£60,000	-£10.9m	£7.6m	-£3.3m	14%
£50,000	-£14.4m	£10.1 m	-£4.2m	20%
£47,000 (real terms equivalent of 2006 upper earning limit	-£15.5m	£11.2m	-£4.4m	24%

A8f.33 The table above illustrates how a withdrawal of tax allowance could be used to replace a portion of the income lost by reducing the UEL on social security contribution. The overall impact of this would be limited since there would be no impact at all on any individual earning less than the revised UEL. The impact on those above the revised limit is dependent on their current social insurance class:

- Employees with an income above the revised limit could pay slightly more than they do now, particularly if they have non-earned income which would bring them over the withdrawal bracket;

- A self-employed person with an income above the revised limit person would typically pay slightly less;

- A non-employed person under 65 would typically pay slightly less;

- A non-employed person over 65 would pay more.

A8f.34 It is important to note that for the relatively small proportion of people affected by this, such a move would effectively transfer a portion of the total amount paid in the form of Social Security contributions to their income tax bill. While this would improve the equity of the system it could prove complicated to achieve.

The lower earnings limit (LEL)

A8f.35 Within the current Social Security system those with a very low income are not required to make a contribution to Social Security (although they may choose to).

A8f.36 Once a person's employed or self-employed income exceed the LEL they become liable for an employed or self-employed contribution on all their earned income up to the upper limit described above. Once someone becomes liable for an employed or self-employed contribution their non-employed income (such as rental or investment income) is not liable for contributions.

A8f.37 If a person is over 64 or does not have employed or self-employed income exceeding the lower earnings limit they do not become liable for contributions until their total income (including non-employed income) exceeds the lower income limit, which is significantly higher than the LEL. Once this happens a person non-employed or over 64 is liable for contributions, but they receive an allowance on their contributions similar to a tax allowance. This means that those over 64 or non-employed are liable for contributions on all their income between their allowance and the UEL.

A8f.38 This means that for those in retirement, their social security contributions are reduced by the value of their allowance, but for the majority of working age people it is not. Jersey applies their lower earnings limit in much the same way. The UK and Isle of Man apply this as an allowance.

A8f.39 The current application of the LEL for the majority of working age people has implications for the marginal rate paid by contributors just beyond the threshold because once they exceed the threshold by even £1, they become liable to contributions on their entire income, which could cost £7.86 a week making them worse off than before. However, with this they would purchase entitlement to a pension and other contributory benefits.

A8f.40 On investigation this is less of an issue than first thought as it would appear that most of those in the earnings bracket to be most affected by this are either:

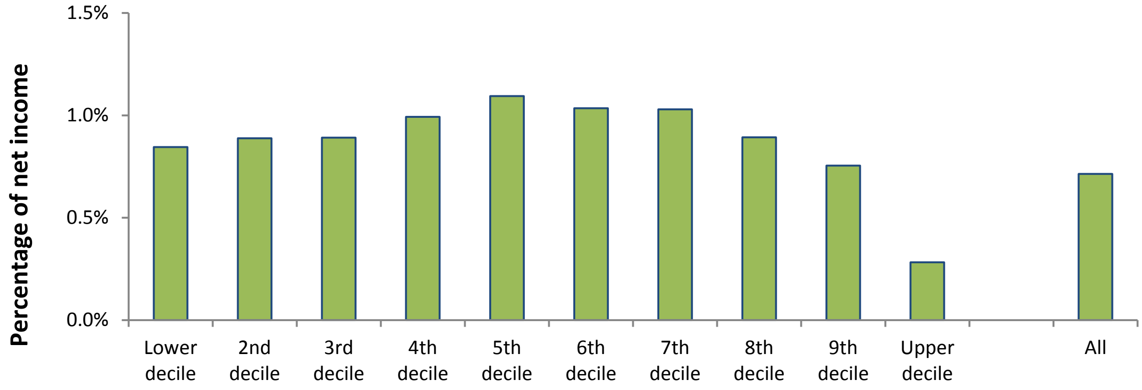
- Supplementary Benefit claimants with casual or part time employment. For these people the assessment process would adjust their benefit receipt to reflect the impact of any changes in their contribution on their disposable income.

- People who have retired or semi-retired before the States pension age and continue to participate in a nominal amount of employment in order to qualify for an employed or self-employed contribution. The intention of this is to maintain their contribution record and preventing liability for non-employed contributions on their non-earned income.

A8f.41 **While the marginal rate issue described above is not a significant problem, the Joint Board does feel that it would be appropriate to consider applying the LEL as an allowance for employed and self-employed people (but not employers). This would bring the assessment of contributions for working age and non-working age people into closer alignment and would be of particular benefit to low- to middle-income working households.**

A8f.42 **When assessed by income this would be most beneficial for middle-income households, particularly those with two working adults. Pensioner households, who already receive an allowance on their contributions, would receive little benefit from this.**

Figure A8.35: Average impact of applying the lower earnings limit as an allowance (at the current level - £6,812) for employed and self-employed people, by household income



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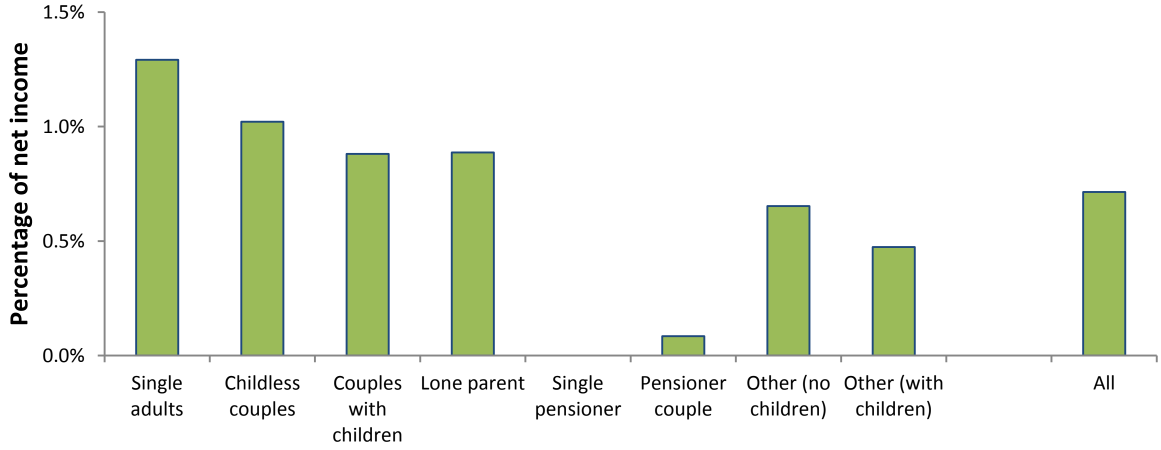


A8f.43 Applying an allowance to Social Security contributions is expensive. Applying the threshold as an allowance would reduce the contribution of each employed person by more than £400 a year and the contribution of each self-employed person by more than £700 a year. In total this would cost up to £12m a year and the income lost to the Social Security funds would need to be replaced, either by increasing contributions by another mechanism or by increasing the subsidy of these funds from General Revenue.

A8f.44 **This cannot be progressed without an alternative source of revenues but the Joint Board does feel that, if the States should accept the recommendation to diversify the tax base by increasing revenues from indirect taxes and decreasing revenues from taxes and contributions charged against income, this would be an appropriate way of achieving the latter.**

A8f.45 There are some difficulties with achieving this. The cost of modifying the current system to allow the application of the threshold in this manner is prohibitive because of the age of the current system and the availability of expertise to modify the software. Progressing this is therefore heavily dependent on the modernisation of systems at Social Security, a goal that should be achieved through the Contributions and Tax Sysyems project.

Appendix 8g: Analysis of individual tax elements: Property taxes

Domestic Tax on Real Property

Sustainability	Good
Economic efficiency	Very good
Fairness	Proportional/mildly regressive
Tax distribution	Broader

A8g.1 The system of taxation on immovable property in Guernsey was modernised in 2007/8. The modernisation converted the old Tax on Rateable Value (TRV), which was based largely on the manual assessment of properties against a set of criteria, to Tax on Real Property (TRP), which is charged at a flat rate per unit (m^2). The modernisation allowed most TRP rates to be automatically assessed from aerial photography, significantly reducing the administration cost.

A8g.2 When the modernisation was implemented, revenues raised from these taxes were increased as part of the package of measures set out to reduce the deficit resulting from the introduction of Zero-10. The majority of this increase was applied to the tax on commercial properties and there is little room for further increase in commercial TRP rates.

A8g.3 However, although the average amount of tax applied to domestic properties was increased in 2008, the tax charged is still relatively low. For example the average domestic TRP bill in Guernsey is about £173 a year in 2015.

A8g.4 **Property taxes are very efficient and very stable. They are easy to collect, they are very difficult to avoid, revenues are easy to predict year on year and they have a limited impact on an individual's behaviour. For example, an increase in TRP would need to be substantial in order to influence people's decisions about which properties they choose to buy. When considered as part of the consultation, 39% of respondents were broadly in favour of increasing TRP as a mechanism to raise revenue compared to 30% who were broadly against it.**

A8g.5 Like all tax increases there would be an economic impact. Increasing TRP would reduce the money households have available to spend elsewhere. The increase could also be reflected (at least in part) in rental prices, although the extent to which this will occur will depend on the other pressures exerted on the rental market.

A8g.6 An increase in domestic TRP is an attractive option. In 2015 domestic TRP is expected to raise approximately £4m. A 100% increase would, therefore, only raise an additional £4m. In order to have a significant impact on the distribution of revenues in Guernsey, the increase in TRP rates would need to be very large.

A8g.7 Figures A8.37 and A8.38 below show the impact by household of an increase in TRP rates by 200% (to three times their current value, which would raise an estimated £8m). Note that this analysis assumes that *all* the increase in TRP would be passed on to the tenants of rented properties via an increase in rents (other than those in social housing), which may or may not occur. For those on Supplementary Benefit it is assumed that any increase in their rent will be absorbed by the benefit system.

Figure A8.37: Average impact of increasing domestic TRP rates by 200%, by income

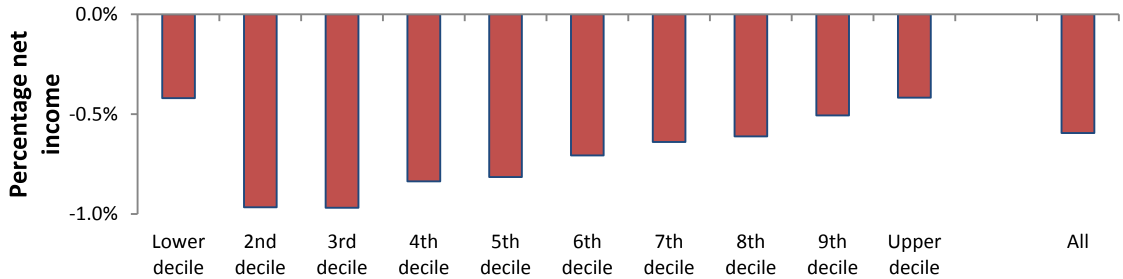
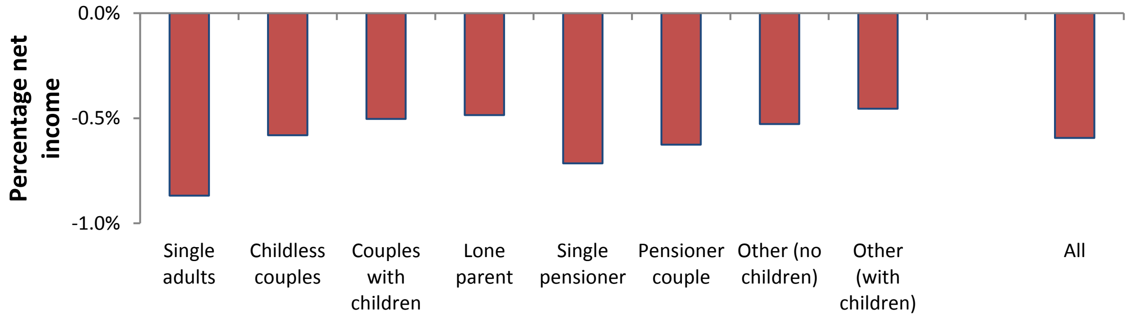


Figure A8.38: Average impact of increasing domestic TRP rates by 200%, by household type



A8g.8 TRP in Guernsey is mildly regressive; lower income households typically spend a larger proportion of their income on TRP than wealthier households. The degree to which this applies is dependent on how much of any increase in TRP is reflected in increased rents.

A8g.9 The very stability of TRP means that it does not adapt with personal circumstances in the way other taxes do. In the event of a reduction in income, the amount of income tax or Social Security paid by a taxpayer will reduce automatically. If the taxpayer's consumption patterns change as a result, their payment of a consumption tax will also reduce. However, they cannot change their liability for TRP without incurring the costs associated with selling property or moving house. Very high rates of TRP could therefore become burdensome in times of financial stress.

A8g.10 Property assets are also not necessarily an indication of high income. There are households, typically of older people, who own substantial properties but have only a limited income. Increases in TRP could be particularly difficult for these individuals, although it could be seen as a mechanism by which to discourage under-occupation of properties.

A8g.11 An increase in domestic TRP has been suggested as an alternative to consumption taxes as a means of diversifying the tax base. To achieve something approaching the same level of diversification as a broad-based consumption tax at 5%, TRP would need to be increased by 1000%, bringing the average bill to a level comparable with the UK. This would raise in the region of £40m (allowing for an increase in benefit costs) which could be redistributed into reductions in direct taxes but, assuming that landlords pass all the additional costs to their tenants, this could result in a considerable impact on lower income households.

A8g.12 This regressive element could be offset by an increase in the tax allowance as demonstrated in Figures A8.39 and A8.40. However, an increase in TRP of this level offset by an increase in tax allowance could prove to be significantly more regressive than the introduction of a consumption tax offset in the same manner (see Appendix 8i). Single adult and single pensioner households could be particularly vulnerable to such a move.

A8g.13 **The Joint Board is of the opinion that there is room for a significant increase in domestic TRP. However, while it would be possible to increase domestic TRP to a level which would make a significant change to the distribution of the tax base, the Joint Board would prefer not to take this approach.**

A8g.14 The Joint Board considered whether it would be appropriate to charge a higher rate for larger properties. This would create a generally more progressive system but, given that the relationship between property size and income is not absolute, the Joint Board favours continuing the current more proportional approach.

A8g.15 In response to requests made during the consultation, the Joint Board also considered whether it might be appropriate for lower rates of TRP to be applied in Alderney than in Guernsey. While the Joint Board acknowledges the economic difficulties faced by Alderney, Members are of the opinion that it would be inappropriate to set a precedent of charging different rates of taxation for residents based on where they live, but this matter should be kept in mind as part of the wider review of the relationship between the Islands.

Figure A8.39: Average impact of increasing domestic TRP rates by 1000% with the additional revenue off-set by an increase in personal tax allowances to £15,625 (£17,400 for over 64s), by household income

This represents a broadly net neutral scenario, the additional tax revenue gained by increasing domestic TRP rates being balanced by that lost by the increase in the personal allowance.

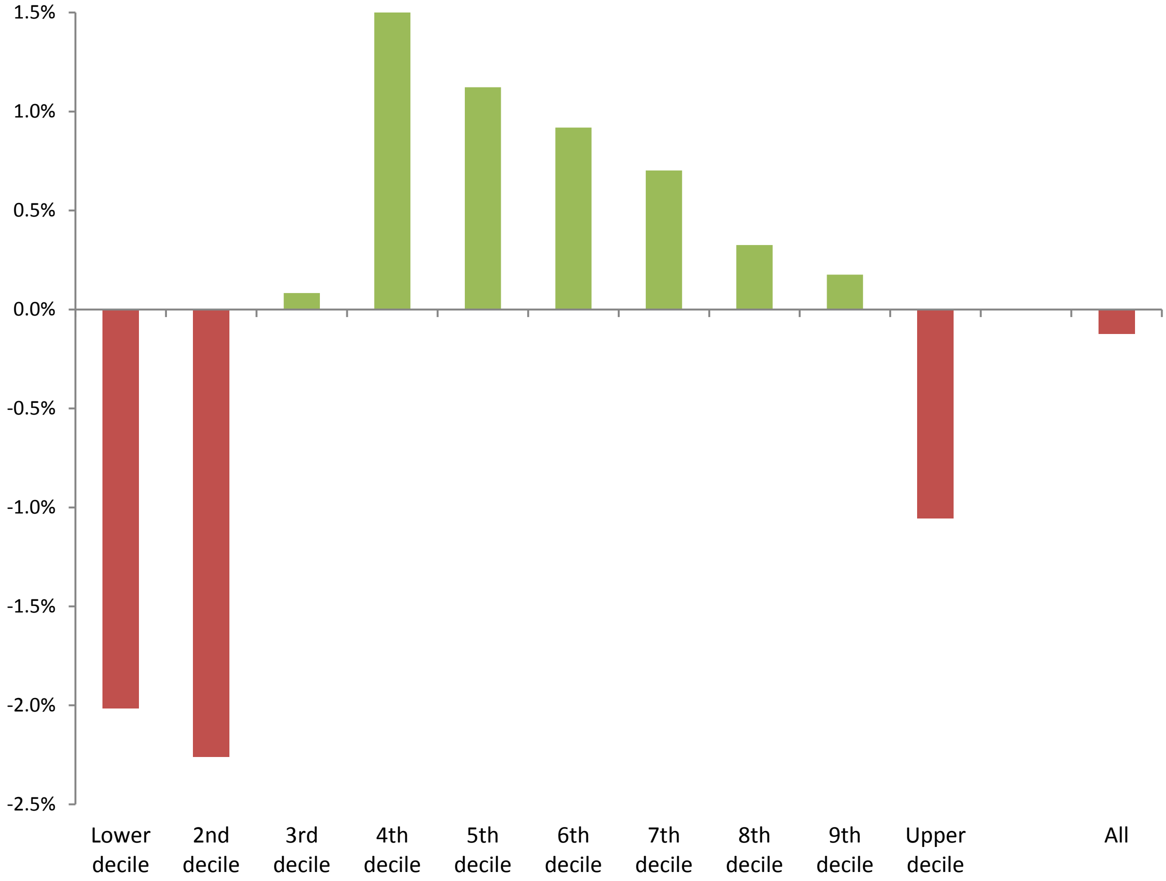
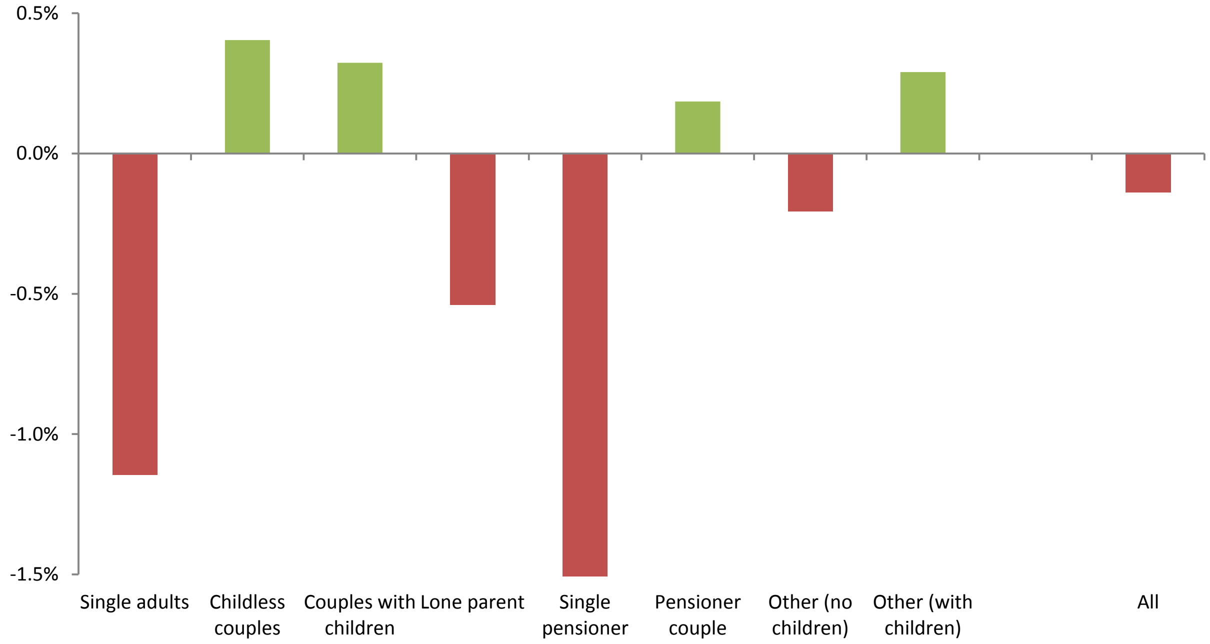


Figure A8.40: Average impact of increasing domestic TRP rates by 1000% with the additional revenue off-set by an increase in personal tax allowances to £15,625 (£17,400 for over 64s), by household type

This represents a broadly net neutral scenario, the additional tax revenue gained by increasing domestic TRP rates being balanced by that lost by the increase in the personal allowance.



Commercial Tax on Real Property

A8g.17 Whilst not strictly within this Review, it is necessary to touch on the TRP charged on commercial properties. As mentioned above, commercial property taxes were increased considerably in 2008, and in 2013 raised £13m in tax revenues.

A8g.18 The rates charged on commercial properties in Guernsey are much higher than on domestic property (see table A8.41). Taxes on regulated industries are particularly high, with utilities and financial industries paying in excess of £30 of tax per square metre per year for office space in Guernsey. For larger utility and finance institutions this can mount to an annual TRP bill in excess of £30,000. Since both regulated utilities and most regulated finance businesses are subject to tax on the profits of some or all of their activities, the total tax take from these sectors is not inconsiderable.

Figure A8.41: Domestic and commercial TRP rates in Guernsey

(Extracted from the 2015 budget)

	Proposed 2015 TRP rate per unit	Proposed increase	2014 TRP rate per unit
Buildings (all zero-rated for Herm)			
Domestic (whole unit) Local Market	£1.14	15.0%	99p
Domestic (flat) Local Market	£1.14	15.0%	99p
Domestic (glasshouse) Local Market	5p	-	5p
Domestic (outbuildings) Local Market	57p	15.0%	49p
Domestic (garaging & parking) (non-owner- occupied) Local Market	£1.14	15.0%	99p
Domestic (whole unit) Open Market	£1.14	15.0%	99p
Domestic (flat) Open Market	£1.14	15.0%	99p
Domestic (glasshouse) Open Market	5p	-	5p
Domestic (outbuildings) Open Market	57p	15.0%	49p
Domestic (garaging & parking) (non-owner- occupied) Open Market	£1.14	15.0%	99p
Domestic (whole unit) Social Housing	Zero	-	Zero
Domestic (flat) Social Housing	Zero	-	Zero
Domestic (glasshouse) Social Housing	Zero	-	Zero
Domestic (outbuildings) Social Housing	Zero	-	Zero
Domestic (garaging & parking) (non-owner-occupied) Social Housing	Zero	-	Zero
Hostelry and food outlets	£5.00	10.0%	£4.55
Self-catering accommodation	£3.15	10.0%	£2.85
Motor and marine trade	£4.25	10.0%	£3.85
Retail	£8.85	5.0%	£8.45
Warehousing	£4.55	10.0%	£4.15
Industrial and workshop	£3.65	10.0%	£3.30
Recreational and sporting premises	£2.15	10.0%	£1.95
Garaging and parking (non-domestic)	£4.55	10.0%	£4.15
Utilities providers	£35.75	10.0%	£32.50
Office and ancillary accommodation (regulated finance industries)	£33.40	10.0%	£30.35
Office and ancillary accommodation (other than regulated finance industries)	£11.15	10.0%	£10.15
Horticulture (building other than a glasshouse)	5p	-	5p
Horticulture (glasshouse)	5p	-	5p
Agriculture	5p	-	5p
Publicly owned non-domestic	Zero	-	Zero
Exempt (Buildings)	Zero	-	Zero
Buildings – Penal Rate	Zero	-	Zero
Development buildings (domestic)	57p	15.0%	49p
Development buildings (non-domestic)	£4.75	10.0%	£4.30

A8g.19 Research conducted by Island Analysis on behalf of the Policy Council in 2011 demonstrated that commercial TRP rates in Guernsey, particularly those on regulated businesses, were uncompetitive relative to Jersey and the Isle of Man, with the tax payable on primary office space for a regulated business costing well over three times as much in Guernsey as in Jersey. Accordingly the Joint Board does not propose any further increases in commercial TRP.

Figure A8.42: comparison of commercial TRP rates in Guernsey Jersey and the Isle of Man (2011)

Source: Island Analysis,

		Property 1 (Prime) 4,000 sq ft office 500 sq ft staff facilities	Property 2 (Secondary) 4,000 sq ft office 500 sq ft staff facilities	Property 3 (Tertiary) 1,000 sq ft office 125 sq ft staff facilities
Guernsey (regulated)	TRP Calculation	=£27.97*(total floor space) *0.09290304		
	Total	£11,681	£11,681	£2,920
Guernsey (unregulated)	TRP Calculation	=£9.094*(total floor area)*0.09290304		
		£3,802	£3,802	£950
Jersey (St Helier)	Rates Calculation	=30(quarters)*(total floor area)*(0.011+0.0114)	=25(quarters)*(total floor area)*(0.011+0.0114)	=19(quarters)*(total floor area)*(0.011+0.0114)
	Total	£3,024	£2,520	£479
Isle of Man (Douglas)	Rates Calculation	=(0.3*(office floor area)*5.25)+(0.125*(facilities floor area)*5.25)		
	Total	£6,628	£6,628	£1,116

Document Duty

Sustainability	Good
Economic efficiency	Very good
Fairness	Proportional/mildly regressive
Tax distribution	Broader

A8g.20 Document Duty, charged on the sale of real property in Guernsey, raised £17m of revenues in 2014. The Duty is charged as a banded percentage charge on the total value of the real property sold in a transaction. The percentage charged on the transaction increases with the value of the property.

A8g.21 Receipts from document duty can be very volatile and are very sensitive to the health of the property market. For example, when the economy as a whole and the property market in particular were very strong in 2007, Document Duty raised £24m, but the following year, with the beginning of the tightening of mortgage lending conditions and the fall in property sales which resulted from it, Document Duty raised only £15m.

A8g.22 Changes were made to the Document Duty structure in the 2014 budget (Billet d'État XXI Oct 2013). These reset the longstanding banding thresholds to be more representative of current property prices. The recommendations also made a temporary reduction in the rates charged, in order to help stimulate the weak property market. This temporary reduction was brought to an end in the 2015 Budget but the property market remains slow.

A8g.23 Document Duty in Guernsey is relatively high compared to Jersey and, at lower property values, the UK (see table A8.43).

Table A8.43: Comparison of document/stamp duty costs in Guernsey, Jersey and UK

Cost of property	Guernsey 2015	Jersey 2015	UK
£250,000	£5,000	£3,250	£2,500
£375,000	£9,375	£5,500	£8,750
£600,000	£18,000	£10,500	£20,000
£900,000	£27,000	£19,000	£35,000
£1,550,000	£46,500	£44,500	£99,750
£3,000,000	£90,000	£127,000	£273,750

A8g.24 Document Duty in Guernsey is also applied on what is termed a slab system (similar to that applied in the UK until December 2014). That is, as the property value increases a larger percentage of duty is charged on its *entire* value. This system was removed in the UK because it heavily penalised anyone purchasing a property just above a threshold value. For example, in Guernsey a house sold with a realty value of £249,999 is liable for Document Duty at 2% in 2015 (£5,000). A house sold at £250,001 is liable for Document Duty at 2.5% (£6,250).

A8g.25 This also creates distortions in house prices in Guernsey since the step change in liability for Document Duty means that there is less incentive to buy properties just above each threshold. Properties which are advertised at a value just above a threshold are therefore less likely to sell or more likely to experience a downward pressure on the price from buyers trying to get the realty value into a lower band in order to reduce their liability for Document Duty.

A8g.26 In the UK and Jersey these rates are now graduated so that they apply only to the proportion of the property value which falls in each band. This eliminates the step change in liability for Document or Stamp Duties and reduces the distorting pressure on the housing market. For example, in March 2015, on a £375,000 property you would pay:

In Guernsey:

The second band rate of document duty of 2.5% on the entire value=£375,000 x 2.5% =		**£9,375**
In the UK:		
0% on the first £125,000	=	£0
2% on the value between £125,001 and £250,000 = 125,000 x 2%	=	£2,500
5% on the value between £250,001 and £925,000 = 125,000 x 5%	=	£6,250
Total	**=**	**£8,750**
In Jersey:		
0.5% on the first £50,000	=	£250
1.5% on the value between £50,001 and £300,000	=	£3,750
2.0% on the value between £300,001 and £500,000	=	£1,500
Total	**=**	**£5,500**

Property speculation

A8g.27 An amendment placed by Deputy Burford (seconded by Deputy Fallaize) to the 2013 Budget (Billet d'État XXVI, December 2012) directed:

"that as part of their comprehensive review of personal taxation referred to in paragraphs 3.1 to 3.4 of that Report the Treasury and Resources Department shall consider the role of taxation in deterring property speculation (having regard inter alia to the suspension in 2009 of the Dwellings Profits Tax (Guernsey) Law, 1975 and the effects thereof), and shall include in their 2014 Budget Report their conclusions together with any recommendations considered necessary."

A8g.28 This 1975 Law levied a tax of 100% on the profits from the sale of a dwelling but with the principal exemptions from the tax being dwellings that had served as the owner's main residence for a year and a day, or dwellings that had been owned for 5 years irrespective of type of occupancy.

A8g.29 According to the 2009 Budget Review, in the fourteen years between 1994 and 2007 (inclusive), the total amount of tax collected from the Dwellings Profits Tax (Guernsey) Law, 1975, was £58,843, with seven of those years generating no tax at all. The Report claimed that the Tax was neither effective in achieving its objective, nor in administrative costs (for both the Income Tax Office and advocates' offices).

A8g.30 Personal or financial circumstances may make it necessary for a property owner to resell a property very quickly. The Law as drafted made no distinction regarding why the property was sold and was more likely to penalise someone selling because their relationship had broken down, than someone deliberately seeking to make a profit on the transaction.

A8g.31 The Law was formally suspended in 2009 (Billet d'État VIII, March 2009).

A8g.32 There is little evidence to suggest that there has been an increase in property speculation and the relatively high cost of selling a property in Guernsey makes it unlikely that this practice is widespread. Statistics show that since the Law was suspended, less than 1% of properties have been sold twice within a year. Of these many were sold at a loss or at a profit not sufficient to cover the cost of sale.

A8g.33 Income Tax staff routinely monitor house sales to identify individuals who appear to be selling multiple properties in a single transaction or have sold several properties over a period of time. Such people may be considered to be in business and become subject to the 20% rate of income tax chargeable on business income arising from the ownership of lands and buildings.

A8g.34 The Joint Board feels that, given the lack of evidence to suggest that there is a significant amount of speculation occurring in the market at this time, the efforts of Income Tax staff to capture those actively seeking to make a profit from the purchase of property are sufficient.

Appendix 8h: Analysis of individual tax elements: Other indirect taxes

Annual vehicle tax

A8h.1 Up until 2007, vehicle owners in Guernsey were required to pay an annual tax on any vehicle to be driven on the road. In 2007, this raised approximately £4m of revenue but was considered to be quite burdensome to administer.

A8h.2 In 2008, the States of Guernsey withdrew the annual tax on vehicles, redirecting this tax to excise duties which were increased to recoup the lost revenues. At the time, this was seen as a way of reducing the administration of vehicle taxes by collecting through a single channel. It also transferred more of the burden of the taxation of vehicles to those who made the most use of their vehicles.

A8h.3 Subsequently, in April 2014 the States approved a resolution to apply first registration tax on motor vehicles, calculated on the width and carbon emissions of the vehicle (Billet d'État IX, April 2014).

A8h.4 At several points during the consultation and engagement process, the re-introduction of an annual vehicle tax was cited as an alternative to a broad-based consumption tax and the Joint Board has considered this option.

A8h.5 Since the abolition of motor tax, reliable estimates of how many cars are in active use in Guernsey have been unavailable (figures of the total number of registered vehicles are available, but there is no indication of how many of these are actually road worthy). It is also possible that a number have been scrapped without de-registration. If it is assumed that the number of cars actually in use is largely unchanged since 2007, an average charge of £100 per vehicle per year would raise an estimated £5m. While it would not be desirable to reinstate the old administration system it might be possible, with the agreement of local insurers to collect this as part of insurance premiums, which would subsequently be remitted to the States by insurers; or it might be possible to adopt a paperless system similar to that now operated in the UK.

A8h.6 An annual tax on vehicles could make a significant contribution to diversifying the tax base. However, like most indirect taxes annual vehicle taxes are likely to be regressive, the cost of the tax likely represents a greater proportion of the income of a low income household than a household with a larger income.

A8h.7 In light of the on-going consideration of vehicle taxes as part of the Environment Department's, Integrated Transport Strategy the Joint Board is not making any recommendations in this area. However, any subsequent States decision on vehicle taxes will need to be considered as part of the transition arrangements so that their introduction can be coordinated effectively with other changes to the overall tax system.

Excise taxes

A8h.8 Excise taxes are a limited form of consumption tax charged only against certain items. These consumption taxes are applied to a very small number of products, often with the intention of discouraging people from buying them. In Guernsey's case they are charged against motor fuels, alcohol and tobacco and are based on the volume or weight of the goods imported.

A8h.9 Guernsey receives approximately 6% of its revenues from excise duties on alcohol, tobacco and motor fuel. In total these raise £35m a year.

A8h.10 In order to raise a significant amount of money in charges on such a narrow range of goods, the increase in the charges made would need to be high and this would have a knock on effect on consumption. For example, all duty charges could be doubled over a period of time, but final excise revenues would be substantially less than twice their current level as people would choose to buy fewer of the goods subject to punitive excise charges and to spend their money elsewhere.

A8h.11 Whilst this may be a desirable outcome if the aim was to discourage these activities, it is not the focus of this Review. In terms of raising revenues for the purpose of diversifying the tax base, increases in excise taxes would show a diminishing return if increased too far.

Appendix 8i: Analysis of individual tax elements: Broad based consumption tax

Sustainability	Good
Economic efficiency	Good
Fairness	Proportional/mildly regressive
Tax distribution	Broader

A8i.1 A return to the issue of a broad-based consumption tax was signalled in the 2006 Future Economic and Taxation Strategy Report which recommended the introduction of Zero-10 (Billet d'État XI, June 2006):

"In stage two, the States, having run a deficit budget for three to five years (i.e. until 2011/2013), *and then after taking into account international events, GST* history in Jersey and economic performance, will evaluate and produce an overall package which sustains the economic position and delivers a balanced States Revenue budget."*

*Goods and Services Tax

A8i.2 While the States did not approve the introduction of a consumption tax at the time Zero-10 was agreed, enabling legislation, which sets the ground work for a GST, was approved by the States in 2009 (Billet d'État XVI, June 2009).

A8i.3 It is clear from the response to this project that consumption tax is not a popular option with more than half of consultation respondents expressing a negative response to the concept. However, given Guernsey's over dependence on direct taxes and the opportunity that a consumption tax could offer to diversify our Guernsey's tax system, the Joint Board do believe it merits serious consideration.

A8i.4 Broad-based consumption taxes are applied almost universally throughout the developed world in various forms. In 2001, 120 countries applied some form of consumption tax and this is now believed to be approaching 160. Guernsey is in a very small minority in not applying one.

A8i.5 If applied on a wide range of goods and services, a consumption tax could raise a significant amount of revenues at a comparatively low rate. At 5% (which would be a low rate compared with most jurisdictions and the same rate as applied in Jersey) a broad-based consumption tax could raise in the region of £45m to £50m per year. Approximately 10% of this tax (about £5m) would be collected from visiting tourists and business travellers. It is estimated that a an additional £4m - £5m could be collected from financial institutions if Guernsey chose to adopt an exemption fee for financial service business similar to that applied in Jersey.

A8i.6 **While not as economically efficient as TRP, consumption taxes are considered to be more efficient than Income Tax or Social Security contributions. This is because Income Tax and Social Security reduce a person's incentive to work, while consumption taxes by increasing prices reduce the amount people can afford to buy. A reduction in the amount people buy is considered less economically harmful than reducing employment.**

A8i.7 Income is the principle driver of consumption. However, revenue from consumption taxes is also considered less volatile than revenues from taxes on income. This is because households can utilise savings or credit to smooth fluctuations in consumption resulting from temporary reductions in income.

A8i.8 The efficiency of a consumption tax is dependent on its design. The more evenly the tax is applied, the less it will influence consumer behaviour. Adding different rates for example by exempting products such as food, reduces efficiency because it makes the consumer more likely to spend their money on exempt products than non-exempt products, distorting the relative economic value of particular goods in relation to others.

The impact on consumer prices

A8i.9 A consumption tax would result in a one-off increase in prices. A 5% tax on consumption could result in a 5% increase in the total cost of taxable goods and services. Table A8.45 below illustrates the impact this might have on the price of a small selection of individual items, assuming the full 5% increase would be added to the retail price of these items. This may not be the case as the experience in Jersey was that some retailers chose to absorb all or part of the tax rather than pass this on to consumers.

Table A8.45: Estimated maximum increase in the price of example goods from a 5% consumption tax

Item	Average price in June 2014	Estimated max price increase due to 5% consumption tax
White sliced bread (800g)	£1.31	£0.06
Tea bags (250g)	£2.44	£0.12
Pork Sausages (1kg)	£6.77	£0.34
Plumber (1 hour)	£36.50	£1.83
Bottled gas	£49.50	£2.48
Wardrobe (2 door)	£658.00	£32.90
Broadband subscription (per month)	£23.99	£1.20
Ladies wash cut and blow-dry	£42.00	£2.10

A8i.10 However, since not all goods and services would be taxable, the impact on inflation rates (RPIX and RPI) would be less than 5%. For example, rents and mortgages, which are among the largest items of expenditure, are typically exempt in most consumption tax systems.

A8i.11 Assuming the full 5% increase were added to all taxable items, and the system developed entailed only a minimal number of exemptions (i.e. financial services and domestic accommodation costs only) it is estimated that the annual increase in RPIX would be increased by approximately 4.0 percentage points and the annual increase in RPI by approximately 3.2 percentage points.

A8i.12 **However, in reality the impact on inflation is likely to be less than this. Retailers set their prices in response to market forces and, as was the experience in Jersey when GST was introduced, some businesses may choose to absorb part of the tax within their profit margin rather than pass the full cost to the customer. It is well known that many national chains apply a larger margin in local stores than in their mainland branches and do not adjust their prices to fully reflect the absence of a 20% VAT in Guernsey.**

The impact on businesses

Administrative burden

A8i.13 In most consumption tax systems, businesses act as the primary collection agents for the tax. It is essential therefore that business groups be involved in the design stages of any consumption tax, to find appropriate ways to limit the administrative burden this may represent.

A8i.14 In a traditional GST or VAT based system, a business collects tax from its customers as part of their total payment for their goods or services. The business then calculates the total amount of tax paid to them by their customers and deducts from this the total amount it has paid in tax on its imports or to its suppliers. The balance is then remitted to the government.

A8i.15 The administrative burden of a consumption tax for an individual business is dependent on the size and administrative sophistication of the business and the type of activity a business is engaged in. Table A8.46 below provides an overview of how these factors might affect the administrative cost for various business groups.

Figure A8.46: Impact on business administration costs of a consumption tax similar to that applied in Jersey

		Business size			
		Small business below the compulsory registration threshold (in JSY turnover of less than £300,000)	**Large businesses with full accounting and administrative support**	**Medium business with moderate accounting and administrative support**	**Small-medium business minimal accounting and administrative services**
Business activity	**All activity exempt**	No admin. requirements. Maximum 5% increase in supply costs	No admin. requirements. Maximum 5% increase in supply costs	No admin. requirements. Maximum 5% increase in supply costs	No admin. requirements. Maximum 5% increase in supply costs
	All activity 0% rated		Small admin burden to reclaim tax on supply costs	Small admin burden to reclaim tax on supply costs	Small – moderate burden to reclaim tax on supply costs
	All activity at standard rate		Small admin burden to remit balance of tax	Small admin burden to remit balance of tax	Small - moderate admin burden to remit balance of tax
	Mixed activities		Small – moderate admin burden to resolve taxable sales and remit balance of tax	Moderate admin burden to resolve taxable sales and remit balance of tax	Moderate admin burden to resolve taxable sales and remit balance of tax

A8i.16 Because the vast majority of developed countries operate some form of consumption tax, modern computerised till systems and accounting packages are almost universally built with the capacity to calculate consumption tax receipts. For businesses which have such systems and who already employ administrative staff, the additional burden of a consumption tax should not be excessive.

A8i.17 For those companies who do not have access to such systems, which tend to be smaller independent businesses and self-employed traders, the task of calculating consumption tax returns can be more onerous. In most countries there is a turnover threshold for compulsory registration. This means that companies below the turnover threshold are not obliged to collect tax from their customers, but neither are they able to reclaim the tax they have paid on their supplies. This has two benefits: it protects small businesses from the administrative cost of a consumption tax and also removes from the government the need to administer the collection of small amounts of revenue at comparatively high cost.

A8i.18 In Jersey the threshold is set at £300,000 turnover per annum. Companies whose turnover is less than this can choose to register for GST (and many do) but are not compelled to. **This is one of the highest compulsory registration thresholds in the world and, at the time of implementation it was estimated that it removed as many as 78% of businesses from compulsory registration while still capturing 90% of turnover.** A consequence of this could add a slight competitive advantage for small businesses relative to the current position. The compulsory registration threshold in the UK is set at £81,000 of turnover per annum.

A8i.19 The type of business a company is engaged in can also have a bearing on the administrative cost:

- **A business which sells only exempt goods or services will have no administrative burden, not being required to either collect tax or eligible to reclaim tax paid on their supplies.**

- **A business which sells only zero rated goods will be able to reclaim tax paid on supplies which will entail some administration, but will not have to collect GST from their customers.**

- **A business selling only taxable goods and services will be required to administer the calculation of the difference between the tax they collect from their customers and the tax they have paid on supplies.**

- **A business which sells a mix of taxable, exempt and zero-rated products will need to differentiate between the sale of goods and services in various categories, and between supplies, which should be assigned to taxable or zero rated sales (which are deductible), or assigned to exempt goods (which are not deductible). These businesses would be subject to the largest amount of administration.**

A8i.20 It is easier for a business to collect 5% on everything than on some products and not others. In this way the application of exceptions can quite considerably increase the complexity of the administration required by businesses and both increases business cost and reduces level of compliance. Increased non-compliance would also require an increase in government administration to oversee the system.

A8i.21 Exceptions also tend to result in legal challenges regarding what should and should not be taxable. The classic example of this is the legal dispute in the UK regarding the classification of McVities Jaffa Cakes as a chocolate covered cake, which would not be liable for VAT, or a chocolate covered biscuit, which would be liable for VAT. Keeping exceptions to a minimum would therefore be of interest to both the States and local businesses.

A8i.22 There are areas where exemptions may be necessary either because the calculation of the "price" of the service is unclear or because there are compelling social or economic reasons for the exemption. Financial services are a good example of this. Banks do not routinely charge a stated fee for their service, but make much of their money by the interest differential between money they lend to and the money deposited with them by their customers. Establishing the taxable value of such services is generally considered too complex and is therefore exempt.

A8i.23 As Guernsey's principle economic sector, the treatment of financial services will need to be carefully considered. If Guernsey is to maintain its tax neutrality for financial vehicles (such as funds or captive insurance cells) supplies made to these vehicles will need to remain outside the scope of any consumption tax.

A8i.24 The treatment of service providers (such as the fund administrators or investment managers) would also need careful review. Because of the nature and mix of the services offered by these companies, administration of a GST type tax is inherently complex and the compliance burden significant. Given the increase in regulatory compliance requirements already placed on these businesses in recent years, to further add to this burden by requiring generic compliance with a consumption tax is undesirable.

A8i.25 Jersey opted to tackle this issue by offering financial institutions the opportunity to pay an exemption waiver which allows institutions to avoid the compliance burden. This system is unique to Jersey and collects approximately £8m in revenues per annum. If a similar system were applied in Guernsey it would raise an estimated £4m-£5m.

A8i.26 **However, if such a system is to be considered in Guernsey it must take into account any other effects which will influence Guernsey's position as a competitive jurisdiction and the desirability of Guernsey as a location for financial services business. This will need to account for the need to limit the aggregate tax burden for each business including considerations such as rates of commercial TRP and the application of the intermediate or higher rate of tax to the profits of regulated finance activities.**

Impact on sales volumes

A8i.27 An increase in the price level alone would mean a reduction in the amount people can afford to buy with their money and this will have an impact on sales volume. However, the same argument is true if Income Tax and Social Security contributions are increased since these would reduce the disposable income a family has available to spend. The impact of both is likely to be higher on the sale of non-essential items and services than the sale of things such as food.

A8i.28 If, as recommended, a consumption tax is wholly or partially offset by a reduction in Income Tax payments, the reduction in consumption resulting from any increases in prices should be at least partially offset by the increase in disposable income.

A8i.29 The potential increase in internet shopping is also an issue, which has been highlighted as a concern to many of those consulted. While no official figures exist, it is widely accepted that internet penetration is particularly high in Guernsey. While this is often attributed to cost factors, both the far wider choice of goods available on-line and the convenience of having goods delivered to your door are key considerations when consumers choose whether or not to buy from a local store or an internet retailer.

A8i.30 The effect of internet shopping on high streets is not an issue unique to Guernsey. Non-perishable consumables can often be browsed more conveniently from a computer screen and high streets are evolving to reflect this, with more emphasis being placed on providing either large high volume, low cost stores such as Primark, which are able to offer a wide variety of low value products, or high end shops focusing on providing a service and shopping experience.

A8i.31 This process is likely to continue, regardless of any decision of the States to introduce a consumption tax, however there are some goods and services which may be more vulnerable than others to a consumption tax.

A8i.32 A consumption tax would be chargeable on the importation of goods, which means for larger value items there would be no added incentive to buy over the internet. However, there is a point at which it becomes more expensive to collect the tax on lower value imported goods than is received in payment. Where the threshold for collection on imports is set is, by necessity, likely to be a balance between the desire to create a level playing field for local and internet retailers and what is cost effective for the States to collect.

A8i.33 In Jersey the threshold is set at an item value of £240, which would generate £12 of tax income at a 5% rate. The UK, which charges VAT at a much higher rate, sets the limit on domestic imports[11] much lower at £36 generating £7.20 in revenue.

Table A8.47: Impact on sale volumes of a consumption tax similar to that applied in Jersey

<table>
<tr><th></th><th></th><th colspan="2">Typical item values</th></tr>
<tr><th></th><th></th><th>Above importation threshold</th><th>Below importation threshold</th></tr>
<tr><th rowspan="6">Business activity</th><th>Essential services requiring physical presence (dentistry, plumbers, opticians)</th><td colspan="2">Service requires physical presence in Guernsey so importation of services from outside of Guernsey is unlikely. Increase in the cost of the service may have a small impact on sales volumes.</td></tr>
<tr><th>Non-essential services requiring physical presence (e.g. beauty therapy, non-essential building work)</th><td colspan="2">Service requires physical presence in Guernsey so importation of services from outside of Guernsey is unlikely. Increase in the cost of the service may have a small to moderate impact on sales volumes but this may be offset by an increase in disposable income resulting from a reduction in income tax liability.</td></tr>
<tr><th>Non-essential services not requiring physical presence (e.g. proof reading, translation)</th><td colspan="2">Without the need for a physical presence in Guernsey, services in this category may already be subject to significant internet sales. The charge of a consumption tax on such product would be difficult to collect and may result in some increase in internet sales. An increase in disposable income to offset the impact of higher prices may be less effective than on other products.</td></tr>
<tr><th>Essential perishable goods (e.g. fresh food)</th><td colspan="2">Perishable goods are difficult to import on an individual basis and the impact of internet sales and personal imports is likely to be small. Increase in prices may have small impact on sales volumes.</td></tr>
<tr><th>Large non-perishable goods (e.g. furniture)</th><td rowspan="2">These items would captured by customs limitation and would therefore be taxable on importation. There would therefore be no additional incentive to import. Increase in price may have moderate impact on sales of non-essential items</td><td>The increase in price may add incentive to import large non-perishable good but shipping costs likely to remain a barrier to importation on an individual basis</td></tr>
<tr><th>Small non-perishable goods (e.g. portable electronics, CD’s DVD)</th><td>Items in this category are already subject to high level of internet sales and personal imports which may increase in response to increase local prices. Local sale of such goods (particularly non-essentials) likely to be most affected by introduction of consumption tax</td></tr>
</table>

A8i.34 Goods which are difficult to transport, either because they are perishable, require a specific importation licence or are expensive to ship are unlikely to experience a significant increase

[11] There is no relief on commercial imports from the Channel Islands

in internet penetration as a result of a consumption tax. The sales most affected are likely to be those which are relatively easy to transport and are likely to be below the collection value.

A8i.35 The types of items most likely to be impacted include:

- **Media, such as CDs, DVDs and video games and books;**
  - **This is an area of retail which is becoming increasingly dependent on electronic formats and downloads. With or without a consumption tax, the sale of physical items in stores is likely to continue to decline.**
- **Low- to medium- value electronics such as low end photographic equipment and computer accessories;**
- **Clothing;**
- **Small to medium sized household items such as linens and kitchenware.**

A8i.36 Keeping the rate of consumption tax low, and establishing the importation threshold at an appropriate level is the most effective way to mitigate this issue.

A8i.37 It has been suggested that the tourist industry could be particularly vulnerable to the introduction of a consumption tax. However, it should be noted that consumption taxes are applied in many small island jurisdictions many of which rely heavily on tourism to support their economy.

A8i.38 It has been many years since the Channel Islands were marketed as a tourist destination on the basis of being "duty free" and while there has been no specific review in Jersey of the economic impact of the introduction of GST in Jersey, it would be difficult to argue that GST has damaged tourism in Jersey. In truth, while output of Jersey's hotel, restaurants and bars sector fell in 2009 (unsurprising given economic conditions at the time), between 2009 and 2012 it has been Jersey's best performing sector, growing in real terms by 8% across this period and outperforming the economy as a whole across this period by some margin[12].

Impact on households

A8i.39 One of the most common criticisms of consumption taxes is that, like most indirect taxes, it is regressive with respect to household income. However, analysis provided by Frontier Economics suggests that this impact has been exaggerated.

A8i.40 Higher income households spend a higher proportion of their money away from the Island or on exempt financial services (which has the effect of delaying consumption and therefore tax until a later date), the impact of which is to lower their local consumption tax burden relative to their income.

A8i.41 However, it is standard in most consumption tax systems to exempt domestic accommodation costs (i.e. rent) from the tax. Because those on low incomes typically spend a much larger proportion of their income on accommodation costs than their wealthier counterparts, this makes the consumption tax less regressive. This is done in both New Zealand and Jersey

12 States of Jersey, Measuring Jersey's Economy: Gross value added (GVA) 2012.

whose consumption taxes are based on a principle of taxing at a low rate on as broad a basis as possible.

A8i.42 The impact analysis provided overleaf is based on the GST charged in Jersey, with only a minimal number of exemptions. Proportions of expenditure on taxable items are based on household expenditure surveys from both Guernsey and Jersey.

A8i.43 The impact analysis includes an assumption that the old-age pension and welfare benefits would be increased to compensate households for the increase in their costs. At a 5% rate it is estimated that this would cost between £3m and £5m depending how far this is extended through the benefit system. This would mitigate the impact of the consumption tax on many low income households. The impact on households with more than median income (i.e. the top 50% of households) would be broadly proportional, the equivalent to approximately 2.5% of a household's net income.

A8i.44 By household type, the average impact of a consumption tax is lowest among household types where the most households are in receipt of pensions and benefits. As a result, as modelled the average impact of consumption tax is lowest on single parents and pensioners. The impact is highest among groups where the fewest households claim benefits or pensions.

A8i.45 At first sight, it might appear desirable to exclude certain essential items such as food to protect those on lower incomes. However in these circumstances a higher rate will be required to offset the reduced tax base and the net benefit to those on lower incomes is minimal. For example, in their initial scoping of GST for Jersey, HMRC calculated that if food is excluded from the tax base the tax rate would need to be raised from 3% to 3.4% to deliver the same tax yield. The net effect of this would be to reduce the annual GST burden of a household in the lowest income quintile by only £12 per year.

A8i.46 The Joint Board is proposing that a consumption tax could be used as a mechanism to diversify the tax base and that the revenue raised could be used to make a very substantial increase in the personal allowance.

A8i.47 **Figures A8.48 to A8.51 overleaf demonstrate the impact of a consumption tax in combination with an increase in personal allowances. This modelling assumes that, overall, the tax system will raise about the same amount of money it does now. However, because a consumption tax would collect an estimated £5 to £6m from the tourist industry and, if Guernsey were to adopt the same model as Jersey, an estimated £4m-£5m from the financial services exemption fee this could mean that, on average, local residents could pay less tax.**

A8i.48 As described previously the increase in pensions and benefits envisaged would effectively compensate most households in the bottom 10%. The extension of the personal tax allowance is of most benefit for those in the lower and middle income deciles (those in deciles 3 to 6) the majority of whom would pay less tax in total in this model.

A8i.49 In monetary terms, the highest income households (those in the top 10%) would pay the most in consumption taxes and for most, the value of the increase in tax allowances would not fully mitigate the increase in their costs. As such, higher income households would pay more tax overall in this scenario.

Figure A8.48: Average impact of introducing a 5% broad based consumption tax by income – after the inclusion of adjustment to pensions and benefits

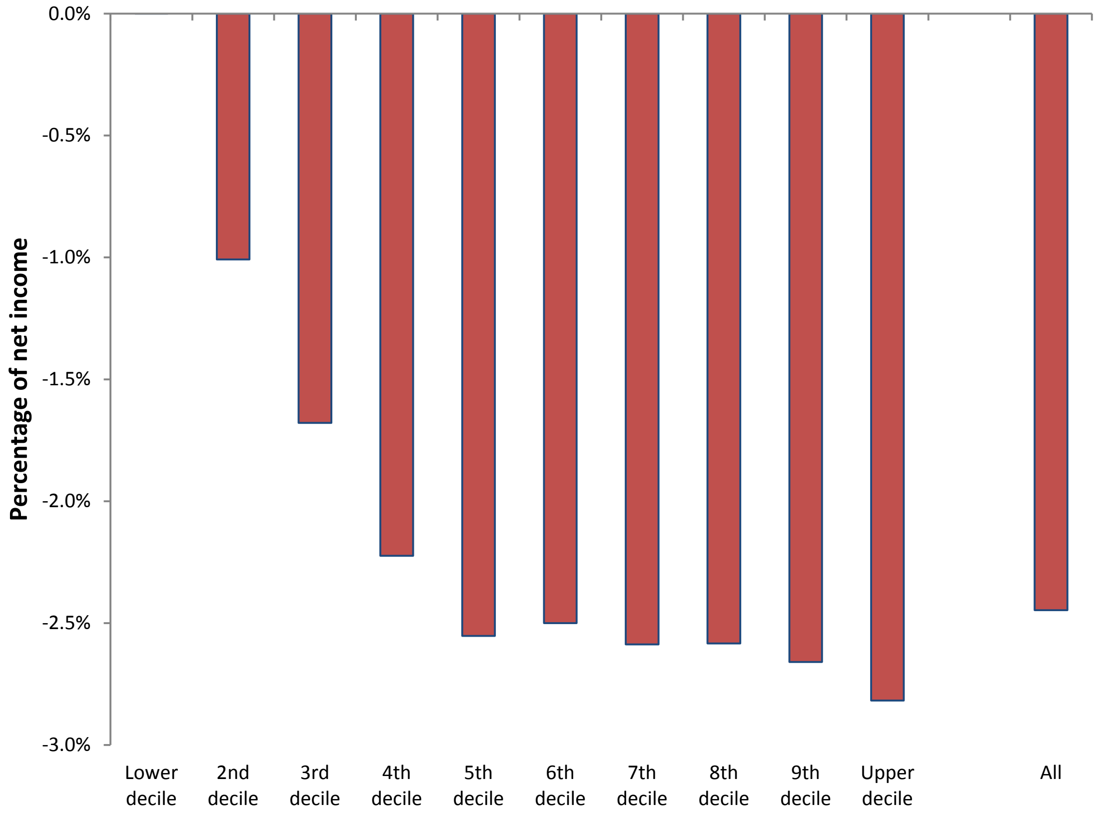


Figure A8.49: Average impact of introducing a 5% broad based consumption tax - <u>after</u> the inclusion of adjustment to pensions and benefits and with an increase in the single personal allowance to £16,375 (£18,150 for over 64s) to offset the increase in tax revenues, by household income

This represents a broadly net neutral scenario, the additional tax revenue gained by introducing a consumption tax being balanced by that lost by the increase in the personal allowance.

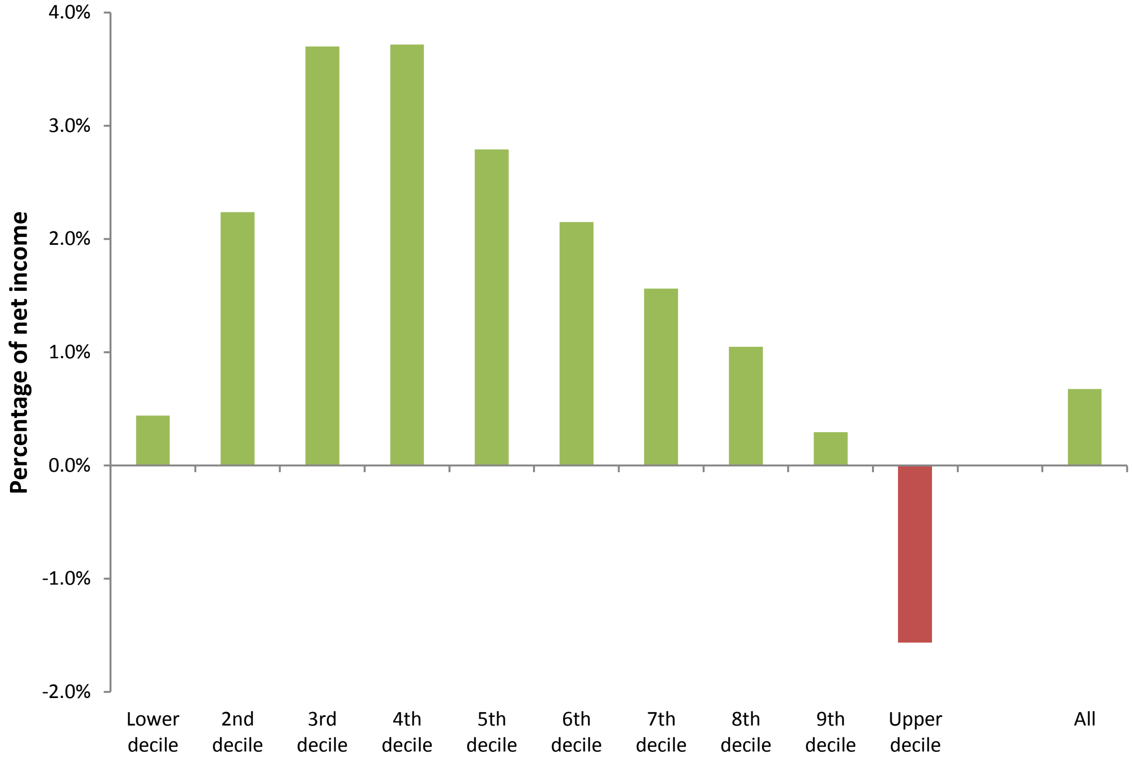


Figure A8.50: Average impact of introducing a 5% broad based consumption tax by household type -– after the inclusion of adjustment to pensions and benefits with no offset through direct taxes

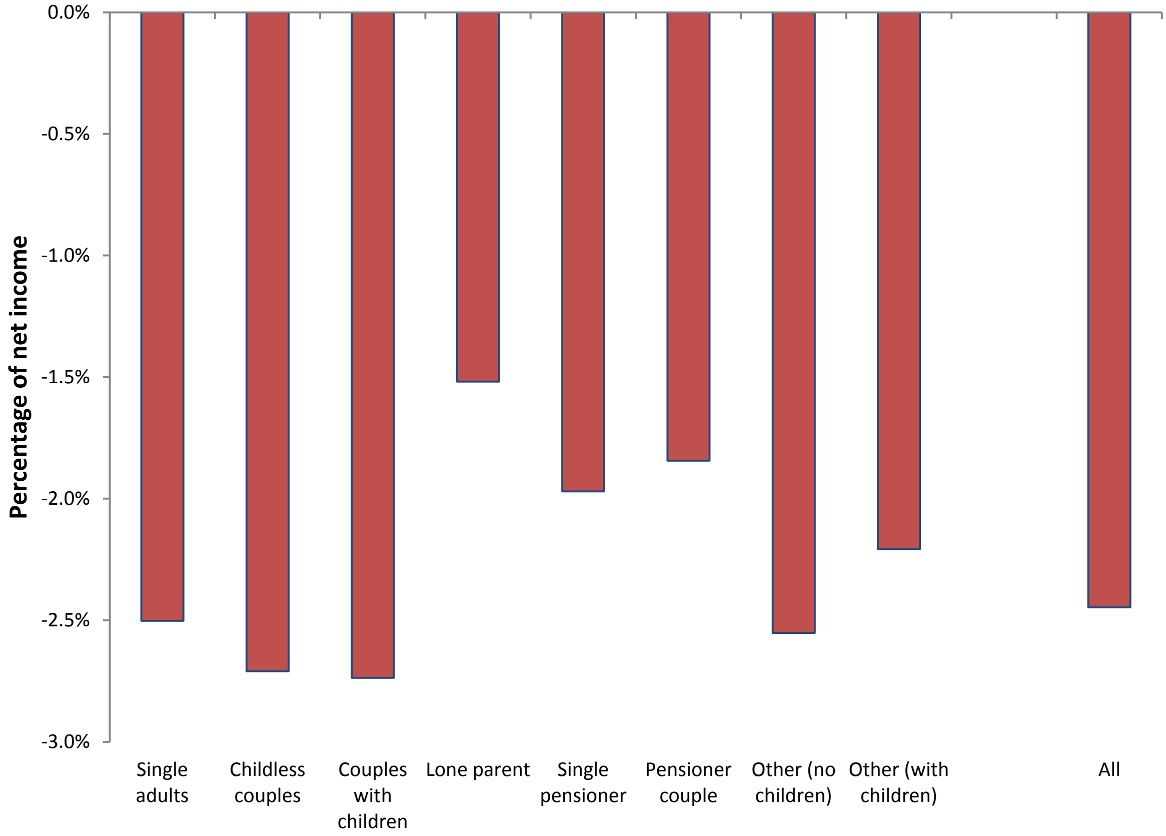
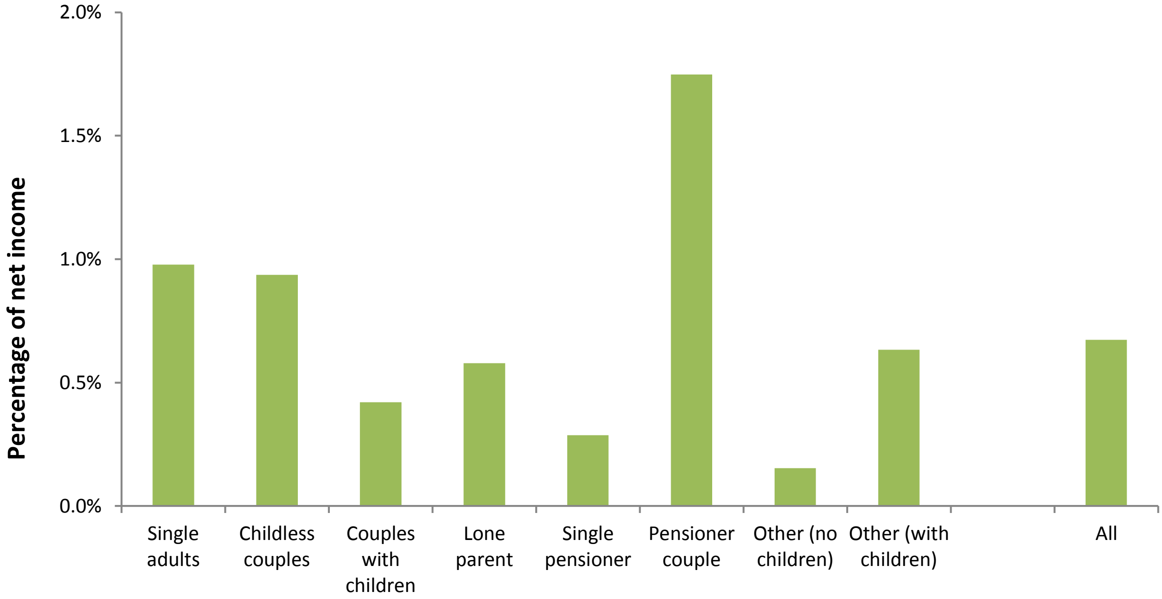


Figure A8.51: Average impact of introducing a 5% broad based consumption tax – after the inclusion of adjustment to pensions and benefits and with an increase in the single personal allowance to £16,375 (£18,150 for over 64s), by household type

This represents a broadly net neutral scenario, the additional tax revenue gained by introducing a consumption tax being balanced by that lost by the increase in the personal allowance.



Administrative options

A8i.50 For the States, the administration of a consumption tax is not as onerous as might be expected. The cost to the government of collection of a consumption tax, relative to the money raised is less than the cost of collecting income tax, even at a substantially lower rate.

A8i.51 If Guernsey was to achieve the same level of efficiency as that achieved in Jersey a consumption tax could be collected for approximately 1p of every £1 collected: an estimated total annual collection cost of £500,000 to collect £50m of income.

A8i.52 GST in Jersey is administered by the equivalent of 8 to 10 members of staff divided between the Treasury Department and Customs. The staff based at the Treasury Department carry out routine inspections to ensure compliance among local businesses; customs staff monitor and charge GST on imported goods.

A8i.53 The Jersey system achieves much higher levels of compliance than is achieved in the UK, because the system in Jersey is much simpler to operate; small businesses are not required to register and the Treasury Department offer training to businesses in how to administer GST.

A8i.54 There are administrative opportunities, which may help keep the ongoing cost of administering a consumption tax down. The first is the possibility of shared administration with Jersey. This would restrict Guernsey to a system at least broadly similar to Jersey but could reduce overheads. It would still be necessary to maintain a boarder presence for the charging of taxes on goods imported and it is unlikely that this would enable Guernsey to reduce the number of additional customs officers which would be required.

A8i.55 The second is the on-going work to modernise the administrative systems at both Income Tax and Social Security. If any software procured for this initiative were to include the capacity to administer a consumption tax as well as Income Tax and Social Security contributions, this could negate the need to purchase a separate systems to administer a consumption tax.

Appendix 8j: Economic overview of consumption tax provided by Frontier Economics

A8j.1 As part of their brief Frontier Economics were asked to examine the economic impact of introducing a consumption tax as part of a package, whereby the majority of the revenue raised were used to reduce the direct tax burden.

A8j.2 **It is the opinion of Frontier Economics that the impact of such a change on the macro-economy are likely to be small, the impact on total consumption caused by the increase in price level resulting from a consumption tax being largely offset by the increase in disposable income resulting from the reduction in the direct tax burden. The most significant impact is a slight negative impact of the net balance between imports and exports.**

A8j.3 The slides presented on the following pages summarise the advice received from Frontier economics on this matter.

The potential impacts of the tax reform on the macro economy are likely to be small

The macroeconomic implications of the reforms can be best understood by examining each of the components in the national income identity which affect economic growth: consumption, investment, government spending, exports and imports.

$$Y = C + I + G + X\text{-}M$$

Consumption	Proposed tax reforms increase disposal income, increasing consumption. A GST increase the price level, reducing consumption. **New tax regime likely to have a small impact on consumption and the economy**
Investment	The proposed tax changes may increase the propensity to save as consumption becomes relatively more expensive **These changes are small and will not impact the economy**
Government spending	Tax reforms intended to be revenue neutral or small gain in revenue, have a minor impact on government expenditure, if at all. **Thus the impact on the economy is likely to be small**
Net exports	The proposed tax reforms will have the effect of increasing disposable income as well as the relative prices of goods and services in Guernsey, therefore increasing demand for imports. **The proposed tax reforms are likely to have a small negative impact on the economy**

Macroeconomic impacts I

The macroeconomic implications of the reforms can be best understood by examining each of the components in the national income identity which affect economic growth: consumption, investment, government spending, exports and imports.

$$Y = C + I + G + X\text{-}M$$

Consumption

- We can think of private consumption as a function of the real interest rate (r-Δp) and of real disposable income (Yd), which is the sum of wage and non-wage income as well as total taxes/net transfers paid/received by households.
- This equates to: $C = \alpha_1 Yd - \alpha_2 (r - \Delta p)$
- Using this equation, we can see that private consumption levels will largely be unchanged by any tax changes
- A reduction in the income tax rate and an increase in the personal allowance will increase the disposal income of the average Guernsey household. While this will lead to an increase in disposable income (Yd above), the increase in price level due to the introduction of the GST will have the opposite effect, reducing consumption.
- **Thus the overall impact of the tax changes is likely to have a relatively small impact on consumption.**

Macroeconomic impacts II

Investment

- Real private investment is assumed to be a function of the real interest rate and real output and can be written as follows:

$$I = \beta_1 y - \beta_2 (r - \Delta p)$$

- The tax reforms effect neither real output or the interest rate directly, but will influence the price level through the introduction of the GST, thus effecting real interest rates (which are a function of prices). The introduction of the GST may increase the propensity to save as consumption becomes relatively more expensive.
- Income levels in Guernsey will be higher under the proposed tax reforms than under the previous system if the personal allowance is increased and the income tax reduced. Whilst this does not remove a disincentive to saving, it does offer a practicable way of eliminating the differential taxation of particular forms of saving, meaning that individual decisions are distorted no more than is necessary.
- However, private savings predominantly takes three forms: investment in domestic capital, purchase of assets from foreigners, and purchase of the domestic government's issued debt. Thus the impacts of any increase in savings only have a slight potential of leading to an increase in domestic investment.
- **The impact on savings from the proposed tax changes are likely to be small and have no impact on the economy**

Macroeconomic impacts III

Government Spending

- The impact of the tax reforms on government receipts will depend on whether the reforms intend to yield a revenue neutral outcome or an increase in revenue of £6million.
- The impact of any potential increase in income will also then depend on whether the government wishes to spend this additional revenue or not, which can stimulate the economy.
- With the Government currently running a deficit, any additional revenue from the tax reforms is likely to be absorbed by reducing this deficit. However, even if revenue gains are invested back into the economy, the impact on the macro economy is likely to be small.
- **These tax reforms are likely to have a small impact on government expenditure and thus on the economy.**

Trade balance

- The proposed tax reforms will reduce the personal tax rate, increase the personal allowance and introduce a tax on goods and services, which will have the effect of increasing disposable income as well as the relative prices of goods and services in Guernsey, therefore increasing demand for imports.
- **The proposed tax reforms are thus likely to lead to a small negative impact on the economy.**

Appendix 8k: Overview of modelling provide by Frontier Economics

A8k.1 Frontier Economics were commissioned to look at the overall financial and economic implications of a broad based consumption tax in Guernsey and how this might be combined with reductions in direct taxes to redistribute the tax burden, including dynamic effects.

A8k.2 This model was subsequently expanded to allow the modelling of additional measures, including TRP increases, changes in the limitations placed on Social Security contributions and the impact of changes to various universal benefits such as Family Allowance and changes to medical benefits. The model was also adapted to generate analysis on the impact of households relative to income on both a non-equivalised[13] and equivalised basis. All the analysis presented in this report is based on equivalised income.

A8k.3 The model is based on detailed, anonymised income data from Income Tax, Social Security and Housing Departments. The income tax and consumption tax burdens both under the current system and revised systems are then calculated on a household by household basis. Where information is not available in sufficient detail for the purpose, Frontier Economics have formulated various assumptions based on a wide range of data including:

- Household expenditure data from both Guernsey and Jersey;
- Local benefit rates;
- Local visitor numbers;
- Expenditure estimate for staying visitor used in the estimation of GST for Jersey;
- UK statistics.

A8k.4 The model is constructed in such a way as to enable the generation of customised scenarios, allowing the variation of the following factors:

- Income tax rates;
- Personal allowances;
- The limitation placed on the maximum value of mortgage interest relief claimable;
- The allowance available for Charge of Child;
- The withdrawal of tax allowances above a defined threshold and the rate at which these allowances are withdrawn;
- The withdrawal of the ability of married couples to transfer tax allowances between spouses;

[13] Equivalisation is a process by which household income data is adjusted for household composition to enable more meaningful comparisons between households of different types. i.e. with one adult, two adults, with children etc.

- The rate charged on the various classes of Social Security contributions;
- The lower limits, allowance and upper earnings limits applied to these contributions;
- The rate of domestic TRP chargeable (with the assumption that increases are passed to any household who are not owner occupiers through an increase in rents);
- The rate of Family Allowance paid to households;
- The subsidy provided on primary care consultations;
- The prescription charge applied per item;
- The automatic exemption of those over 64 from prescription charges;
- The application of a nominal fee for exempt prescriptions.

A8k.5 The model also allows the variation of key assumptions to reflect any new information received including:

- The proportion of expenditure liable for consumption tax by income (which enables modelling of exemptions using expenditure data provided by the Household Expenditure Survey);
- The average rate of saving within the population ;
- Elasticity of consumption by income (the sensitivity of consumption volumes to changes in taxation);
- Elasticity of taxable income by income (the sensitivity of demand to changes in taxation);
- Pass through rate (the percentage of taxation which is passed on to consumers);
- GP consultations per year by age;
- Prescriptions per year by age;
- The uprating of pension and benefit rates due to consumption tax.

A8k.6 The model is also built with the facility to update the raw income and household data which underpins the modelling. This design function was requested with the intention of utilising the data expected to be made available as part of the Rolling Electronic Census Project during 2015, to extend the lifespan of this model and allow it to be used through implementation any transitional stages of the project.

Consumption taxes

A8k.7 In order to generate financial estimates it was necessary to make further assumptions on the structure a consumption tax may take in Guernsey. For the purpose of this modelling, it is assumed that the system will be a broad based, low rate tax very similar to that currently applied in Jersey. The model as presented assumes only a very limited number of exceptions:

- Financial services;
- Accommodation costs;
- Exported goods;
- Expenditure abroad (although this may be subject to the consumption tax of the host nation).

A8k.8 However, the model is built with the capacity to add further exemptions if necessary.

A8k.9 When calculating net financial returns for packages containing a GST a net annual administration cost of £500,000 per annum (broadly equivalent to the cost of collection in Jersey) is incorporated in the calculation. The Modelling also incorporated the cost of increasing Supplementary Benefit and the old-age pension in line with the inflationary increase.

TRP

A8k.10 The impact of TRP is calculated using assumption of the relative expenditure on TRP extracted from the Household Expenditure Survey. It is assumed that *all* the increased costs to a property owner will be passed through to their tenants. This should be considered a worst case scenario. In reality, an increase in TRP could be slightly less regressive than indicated by this analysis.

A8k.11 It is also assumed that all social housing tenants will be unaffected (States-owned properties being exempt from TRP) and that any increase in rents for Supplementary Benefit claimants resulting from an increase in TRP charges will be offset by an increase in benefit claims.