<u>THE STATES OF DELIBERATION</u>
<u>of the</u>
<u>ISLAND OF GUERNSEY</u>

POLICY & RESOURCES COMMITTEE

THE TAX REVIEW

The following Propositions are laid in accordance with Rule 17(9) of the Rules of Procedure of the States of Deliberation and their Committees.

The States are asked to decide:

Whether, after consideration of the policy letter "The Tax Review" dated 20 August 2021, they are of the opinion:-

1. To reaffirm principle 5 of the Fiscal Policy Framework: *"The aggregate amount of States' revenue should not exceed 24% of GDP*".

2. To agree that the Committees of the States are collectively responsible and accountable for ensuring that States expenditure is limited to the amount necessary to fund public services proportionate to the Island's size and population, and to endorse the intention of the Policy & Resources Committee to establish a sub-committee, comprising a Member from each Principal Committee, and charged with the identification and development of options to reduce expenditure or mitigate the anticipated increase in the cost of public services as set out in Paragraph 4.6.

3. To agree that the existing Social Security contributions system should be restructured such that all contributors are assessed on the same definition of income with the same access to allowances and that the Policy & Resources Committee, in close consultation with the Committee *for* Employment & Social Security, should develop detailed proposals for the restructure to establish the rates, allowances and limits which should be applied under such a scheme.

4. To agree that any restructure to meaningfully diversify the tax system requires the introduction of a broad-based Goods and Services Tax and that the Policy & Resources Committee should develop detailed proposals including the measures necessary to mitigate its impact on lower income households in the context of a restructured Social Security contributions system.

5. To agree that, in order to secure Guernsey's long-term financial stability, it will be necessary to raise additional revenues but that no significant changes to the tax system should be implemented until the States Assembly considers, as part of the Government Work Plan debate in June 2022, a framework to co-ordinate the work streams that will achieve and fund an affordable government and public services proportionate to the Island's size and population, including the options for reductions in public expenditure and those that support growth in economic output.

6. To direct the Policy & Resources Committee to report back to the States, following a period of consultation and engagement, with detailed proposals for the restructure of the tax base and its phased implementation in line with Propositions 3 and 4, by no later than July 2022.

THE STATES OF DELIBERATION

of the

ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE

THE TAX REVIEW

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

20 August 2021

Dear Sir

1. Executive summary

1.1 Following consideration of *"The Review of the Fiscal Policy Framework and Fiscal Pressures"* in January 2020 (Billet d'État I, Jan 2020) the States resolved:

"To direct the Policy & Resources Committee, in consultation with all States Members and further to public engagement, to conduct a review to ensure that Guernsey's tax base is capable of raising sufficient revenues to meet long-term government expenditure needs in a sustainable manner within the boundaries of the Fiscal Policy Framework."

1.2 Although much has happened since January 2020, the core issues remain largely unchanged. The costs incurred as a result of the management of COVID-19 are significant, but they are also largely one-off and it is expected that the States' General Revenue position will return to surplus in 2022. However, the significant longer-term fiscal issues remain: the need to support health and care services for an increasing population of older people; the need for ongoing and sustainable investment in infrastructure; and the vulnerability of the income reliant tax base to a potential decline in the workforce as a result of the changing demographics.

1.3 The gap between the revenues received from taxation and the cost of the services and infrastructure they need to pay for is increasing and will continue to widen without action. The most recent financial analysis, as set out in the Funding & Investment Plan (Billet d'État XV, July 2021) suggests General Revenue funding gap of approximately £54m per annum by 2025, after factoring in savings in the cost of delivering public services of a further £10m per annum. In addition, the funding gap on the Guernsey Insurance and Long-Term Care schemes, under current assumptions, totals £33m per annum. The combined total of £87m would require funding of between 24% and 25% of GDP with the likelihood of further pressure on health and care expenditure in future years. There is also the risk of other pressures arising which are currently unknown or unquantified, including those arising from climate change.

1.4 This, without any further reduction in the cost of providing public services or increase in GDP through growth in our economy or population, will place the need for revenues above the 24% of GDP limit in the Fiscal Policy Framework, in other words, require more tax than that considered in this green paper.

1.5 **Meeting the funding requirements of both General Revenue and Social Security within the 24% of GDP limit placed on government revenues may be achievable in the longer term *only if* there is success in measures to enhance economic growth and to alleviate expenditure pressures.**

1.6 **The Policy & Resources Committee considers that the limit on States' revenue agreed by previous the States and set out in the Fiscal Policy Framework remains appropriate. However, keeping the overall cost of the public sector within this limit will only be possible if the States deliver the priorities agreed as part of the Government Work Plan to achieve sustainable economic recovery and accelerate the pace of public service reform. This will require an unprecedented level of fiscal self-discipline and political co-operation.**

1.7 While many people will argue that the States should cut expenditure or grow the economy *before* considering raising taxes to fund our public services, the scale of this issue is such that all three routes to more sustainable finances (increasing revenues, reducing expenditure and facilitating growth) are necessary if we are to meet the needs of our community beyond the end of the current political term. Equally, it is not advisable to wait and see whether growth will manifest before plans are made – economic growth is dependent on many factors, including the conditions in the global economy, most of which are beyond the States' ability to control.

1.8 Significant changes to the revenue structure cannot be made quickly or without a significant amount of planning. Therefore, to ignore the reality of the situation now and fail to plan for the forecast need for more revenues only serves to magnify the problem.

1.9 Although some discussion on reductions in expenditure and economic growth is included for context, this Review addresses the following question:

If it is necessary to increase revenues to the limit of the Fiscal Policy Framework (24% of GDP) to meet the cost of public services, what is the best way to achieve this?

1.10 The Tax Review Steering Group[1] was formed to consider this question and its Report is appended (Appendix 2).

1.11 This Report outlines that there is a primary choice between the taxing of income or the taxing of consumption, with increased taxes on corporate profits also playing a role. While other supporting measures are available (such as taxing property) their revenue raising potential is limited and may be more suited to consideration as part of the annual Budget process than forming part of structural reform of the tax system. The fundamental decision presented to Members is whether to continue our heavy over reliance on income-based taxes or to broaden the tax base by adding a Goods and Services Tax (GST) to Guernsey's financial toolbox.

1.12 The Report presents three potential solutions with accompanying analysis:

- Option 1 focuses on income-based measures only in the form of a 3% Health Tax combined with increased revenues from a restructured social security contributions system;

- Option 2 focuses all revenue raising on a consumption tax applying a GST gradually increasing up to 8% over a period of several years combined with associated measures to mitigate the regressive impact on lower income households, including a reduction in direct taxation via increases in personal allowances and a revenue neutral restructure of the social security contributions system;

- Option 3 offers a hybrid solution combining a GST gradually increasing up to 5% with increased revenues from a restructured social security contributions system.

1.13 The Report also includes discussion around measures which the Steering Group considered but has not recommended for progression at this time including higher earners rates and online taxes. More details are provided in sections 8 to 10 of the Report.

1.14 The Steering Group concludes:

"Having reviewed the analysis undertaken to date, the Steering Group conclude that structural changes to the tax base are necessary. The current social security contributions system has evolved a long way from its origins and in its current

[1] Membership comprises: Deputy Helyar (Policy & Resources Committee lead on Treasury matters), Deputy Mahoney (Member, Policy & Resources Committee), Deputy Roffey (President of the Committee *for* Employment & Social Security) and Mark Thompson (Non-States Member, Committee *for* Employment & Social Security)

form is inequitable. There is an opportunity to reform it which can make it both more equitable and more progressive and this should be pursued further.

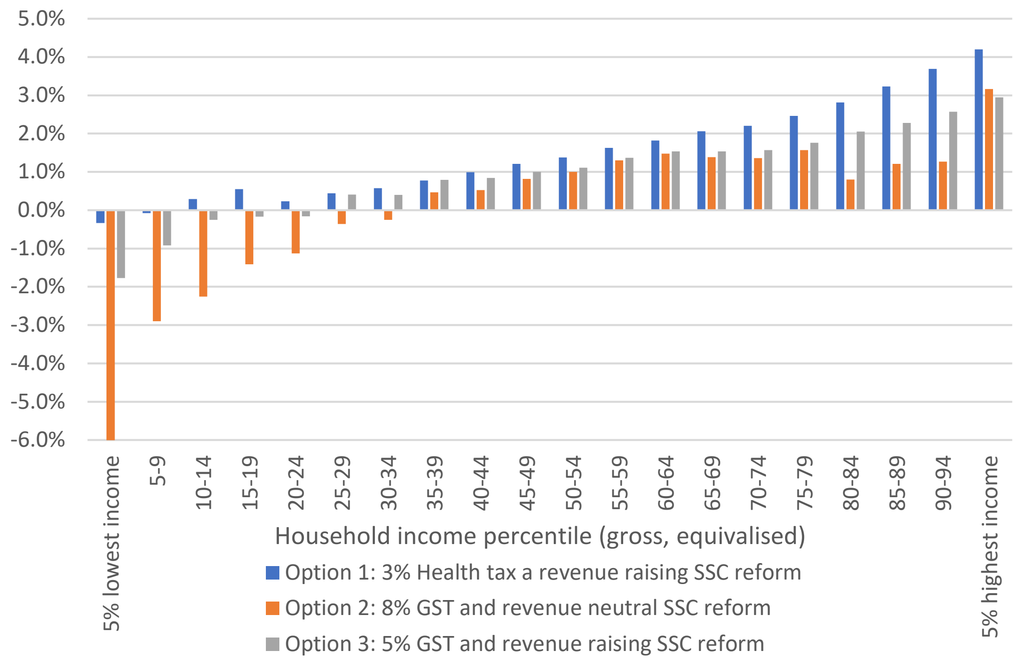
Furthermore, the current heavy reliance on income-based taxes should not be continued. If more revenues are required, it should be from a more diverse tax base and introducing a GST represents the most effective way of achieving this.

The concerns about the regressive impact of a GST on lower income households are valid. However, the analysis suggests that the inclusion of a GST within a package of measures including measures designed to mitigate the impact on lower income households can address these concerns and make the change to the tax base overall progressive. The relatively recent introduction of a GST in Jersey and other jurisdictions also provides examples of how the scheme can be designed so as to reduce the administrative burden on companies.

More engagement with stakeholders is needed before final recommendations can be made. To ensure that engagement is effective in producing a successful outcome for this project the Steering Group recommends that direction be sought from the States on these two key conclusions."

1.15 The options presented by the Steering Group include mitigations designed to address the very valid concerns expressed about the regressive features of a GST. They demonstrate that, with increases in tax allowances, the restructure of the social security contributions system and the redirection of a portion of the revenue generated, these concerns can be well addressed. Mitigation will never be perfect but, as modelled, both options 2 and 3 offer an opportunity to make a net beneficial change for the majority of low-income households in Guernsey – that is, many would actually pay **less** tax overall (see figure 1).

Figure 1: Comparison of average impact of options by household income



1.16 All three options are designed to be generally progressive.

- Those in the first 5 percentiles would be *benefited* by an average of 0.3%, 6.0% or 1.8% of their gross income under options 1, 2 and 3 respectively (or would be £70, £390 or £100 a year better off).

- A middle-income household (in the 50th to 54th percentile) would be negatively impacted by an average of 1.4%, 1.0% and 1.1% of their gross income under options 1, 2 and 3 respectively (or in monetary terms they would pay approximately £850, £550 or £650 more).

- Those in the highest 5 percentiles would pay would be negatively impacted by an average of 4.2%, 3.2% and 2.9% of their gross income under options 1, 2 and 3 respectively (or in monetary terms they would pay an average of £12,900, £10,700 or £9,400 a year more).

1.17 By laying this Policy Letter under rule 17(9)[2] the intention is to present Members with the research undertaken to date and allow debate on the *principles* of taxation before committing further resources to establish the full details of how these principles should be applied. Rule 17(9) allows a Policy Letter covering matters of general policy to be "considered by the States without amendment on the understanding that if the propositions are accepted the Committee will return with detailed proposals which could be accepted or rejected with or without amendments". In this context, the Committee wishes to seek direction from the States on the main policy recommendations reached to date in order to formally establish whether the direction of travel is, or is not, acceptable to the Assembly.

1.18 With this direction, further resources will be invested to develop these proposals to a point where there is sufficient detail to implement them. **The next proposals laid before the States will expand in detail: what changes are proposed; what mitigations need to be put in place and how these will work; and how changes should be phased. As directed by Rule 17(9) Members will then have the opportunity to amend these.**

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[2] *17 (9) Where a Committee originating a matter for debate before the States is of the opinion that the proposals it is submitting to the States are of general policy, and where it is desirable that the principles of that policy should be considered, the Committee may have its propositions considered by the States without amendment on the understanding that if the propositions are accepted the Committee would return with detailed proposals which could be accepted or rejected with or without amendments. Where a Committee invokes the provisions of this paragraph it shall make express reference to it in its propositions.*

1.19 This Policy Letter therefore seeks to test and confirm the States' support in principle for the two primary policy changes recommended at this stage and included in both options 2 and 3, namely:

- The restructure of the social security contributions system to a more equitable basis; and
- The development of a GST along with mitigation measures to support those on lower income.

1.20 The opportunity to formally capture the Assembly's views and establish the key elements needing to be addressed as this work is progressed further are as important as the Propositions. The debate on this Policy Letter will inform how the next phase of work progresses.

1.21 If the Propositions are accepted, the Policy & Resources Committee would ask the Steering Group to conduct more detailed engagement with businesses and the public and develop more detailed proposals before bringing back formal recommendations.

1.22 In recommending further development of a restructure of the tax system, it is recognised that various factors will influence its progression. The success of government policy to stimulate and enable economic growth and accelerate public service reform could mean the extent of revenues required may be less or that the timing of their introduction can be delayed. Conversely, if Government spending continues to rise, further increases will become necessary.

1.23 In committing to report back with formal proposals in mid-2022, the Policy & Resources Committee undertakes to co-ordinate this work with the progress on other workstreams which will contribute to the States' long-term financial stability. This includes Public Service Reform and any other initiative intended to manage expenditure; population policy; and other policies intending to promote economic growth. The intention is to bring forward a more holistic framework of the financial landscape as part of the Government Work Plan debate in June 2022.

1.24 The Committee *for* Employment & Social Security has relayed its intention to take steps to address the known funding shortfall on the States Pension and Long-Term Care scheme, quantified through the recent valuations by the Government Actuary, without further delay. That Committee intends to include within its annual contributory uprating report proposals for a phased increase in the social security contribution rates under the existing structure which would increase contribution revenues by an estimated £34m a year by 2031. It would be that Committee's intention that such increases are halted as and when the decisions arising from the Tax Review are implemented, assuming that those decisions deliver a sustainable solution.

1.25 The increases proposed by the Committee *for* Employment & Social Security represent almost half of the total amount which could be raised within the Fiscal Policy Framework and would ensure that those schemes are fully funded. However, it is clear from the analysis undertaken that the overall cost pressures are significantly greater than the 'headroom' available within the Fiscal Policy Framework and this would therefore significantly reduce the amount available for funding General Revenue pressures and make staying within the 24% of GDP limit on revenues more difficult. This highlights the need for such matters to be considered holistically and not by Committee mandate. It is for this reason that the Policy & Resources Committee, while working closely with the Committee *for* Employment & Social Security, has taken the lead in co-ordinating this work and presenting this Policy Letter. Further co-operation across other areas, such as population policy will also be necessary.

1.26 It should further be recognised that corporate income tax rates are under global consideration. The OECD[3] is working to establish a global solution to reform the international corporate tax framework, impacting how large multi-national enterprises are taxed around the world. As technical discussions on these proposals are ongoing, how these will impact Guernsey is still far from clear. The Steering Group has included the best available estimates of additional revenue that will be raised through changes to the corporate tax system (£10m). The eventual outcome may be more or less than the estimates included and taxes in other areas will need to be adapted to this as the situation evolves.

2. Current Economic Context

2.1 The current economic conditions, and those that may prevail at the point any changes are implemented need to be considered. COVID-19 caused a significant amount of economic disruption in 2020 but, as a whole, the economy has recovered far better than expected. This has been reflected in tax receipts during 2021 which are currently ahead of that budgeted.

2.2 The level of unemployment, having reached a peak of more than 5% during May 2020, has returned to 1.4% in June 2021, compared to 1.1% immediately prior to the first lockdown. The current key issue within the workforce has shifted away from unemployment towards challenges with labour supply. While employment numbers remain lower than during 2019, this is in part because of the combined disruption COVID-19 and the changes in visa requirements for EU nationals working within the UK Common Travel Area following Brexit has caused to recruitment of staff from outside of the island. Sectors reliant on travel, primarily the Hostelry Sector are still impacted, but Construction, Information and communication, Real estate, and Professional services sectors have all expanded since 2019. The shift in the workforce distribution away from lower paid hostelry

[3] The Organisation for Economic Co-operation and Development

jobs is at least partly responsible for the real growth in median earnings reported for Q1 2021 and it is not yet clear how much of this is genuine wage growth.

2.3 COVID-19 has also created disruption in the housing market, and Guernsey, like many other jurisdictions is experiencing significant upward pressures on both purchase and rental prices. This pressure on the housing market is likely to complicate any policy development around population since the cost and availability of housing may become a barrier to attracting people to Guernsey. A Housing Action Group has been established to address the current housing supply issues, with a particular focus on the provision of affordable housing.

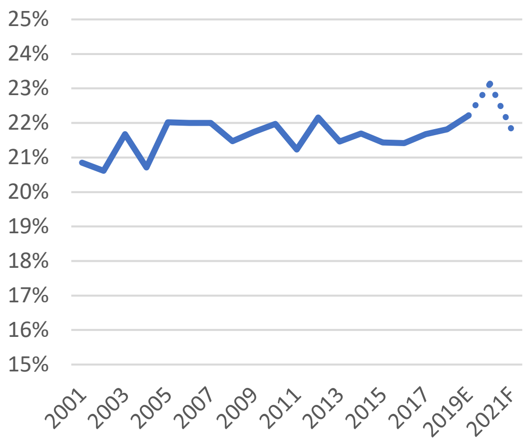
2.4 Inflation pressure is not restricted to housing. Both the UK and Guernsey inflation figures have shown an upward pressure on prices during the second quarter with RPIX rising to 2.3% in June 2021. This is likely due to a combination of the effects of Brexit on imported goods and global supply chain disruption caused by widespread lockdowns in key producing nations. The UK (who report inflation data monthly) reported a fall in CPI between June and July but the Bank of England is expecting it to rise again before the end of the year. Inflation measures in Guernsey are expected to follow a similar trend.

2.5 In the broader policy context, the planned introduction of Secondary Pensions is also expected within two years and its phasing may coincide with implementation of tax measures. This may result in some households saving for retirement for the first time which will have an impact on their disposable income. Any further progression of the Tax Review workstream will need to consider the combined impact on household income of both changes in taxation and an increase in pension saving.

3. Expenditure: Is 24% of GDP the right size of government?

3.1 The limit placed on government revenues by the Fiscal Policy Framework is set at 24% of GDP (Billet d'État I, Jan 2020). This limit is just over 2% of GDP higher than the average level of revenues generated over the three years between 2017 and 2019 (see figure 2)[4].

Figure 2: Aggregate revenue as % GDP



3.2 This limit was set reflecting what was considered to be the **minimum** amount required to meet the States' known and quantified long-term expenditure pressure. These are detailed in the January 2020 policy letter and included:

- **the demand on health services as the population ages (£5-10m over 5 years);**
- **the demand on the States Pension system as the number of pensioners increases (£8-18m per annum);**
- **The demand on the Long-Term Care Fund as the population ages (£7-23m per annum);**
- **The extension to cover NICE approved medical treatments (£5-12m per annum);**
- **A reform of primary care services to make these more accessible (£9m-20m per annum);**
- **The costs to achieve greater parity in terms and conditions across different public sector staff groups (£35-40m per annum); and**
- **The loss of revenues and administrative cost from the introduction of Secondary Pensions legislation (rising to £9m per annum in the medium term).**

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[4] Note that the estimated increase in revenues in 2020 as a % of GDP is due to the forecast negative impact of COVID-19 on GDP being larger than the % impact on revenues

3.3 The anticipated long-term cost of these totalled between £80m and £130m a year.

3.4 A significant proportion of this pressure is on the cost of delivering **existing** services to an increasing number of people as a result of the ageing of the population. These pressures are not new or unique to Guernsey and most developed jurisdictions are or will face similar pressures as their populations age.

3.5 For many of these cost pressures there is little discretion available in the rising cost unless there is an appetite to make significant policy changes determining what services and benefits people are entitled to. For example, the States Pension (the States' largest single expense) costs more than £130m a year but the pensions system and eight other benefits are administered by just six members of staff. Costs have increased year on year since 2011 and will continue increasing well beyond the middle of this century as a result of the increasing numbers of people of pensionable age entitled to the benefit and the uprating policy applied by the States. With administrative costs representing less than 1% of expenditure, administrative efficiency can make little impact. To make a material change in the expenditure profile of the States' Pension would require either significantly reducing the value of the pension over the long-term or reducing the number of people entitled to claim it.

3.6 Although the States' priorities and policies are constantly evolving, the core challenges remain the same. In addition, while many of these pressures are described as long-term since their impact will grow over many years, they are now apparent in the States' financial baseline. While it is impossible to set out precise numbers, broadly the current status can be summarised as follows:

- the Fiscal Framework was amended to increase the assumed capital spend requirement from 1.5% of GDP per annum to an average of 2%, implying an additional cost of £16m a year and this assumption of a higher level of capital spending has been built into the Funding & Investment Plan;

- the demand on health services as the population ages is already manifesting and an annual upward pressure has been factored into the Funding & Investment Plan of approximately £3m each year;

- The latest actuarial review suggested that to fund the States Pension and other benefits paid from the Guernsey Insurance Fund requires additional revenue of approximately £28m per year under the current assumptions (previously estimated at £8m - £18m);

- The Government Work Plan was successfully amended to retain the extension of services to cover NICE approved medical treatments with an ICER up to £40,000. The financial information presented in figure 5 has been amended to reflect this. This is to be funded from reserves until 2025 but there is no long-term funding source identified to date (the estimated cost remains £5-12m per annum);

- The work to develop primary care services is ongoing, and it is noted that this workstream may result in costs which may place additional pressure on tax revenues or result in charges to islanders outside the tax system;

- After the debate on Supported Living and Ageing Well Strategy: Extending the Life of the Long-Term Care Insurance Scheme (Billet d'État XVI, September 2020,) and a subsequent actuarial review, the current estimate of additional funding requirement for the scheme is £6m a year (previously estimated at £7-23m). Work to extend the coverage of the scheme to include care in a person's home may increase this;

- The loss of revenues forecast from the early stages of the implementation of Secondary Pensions and the costs associated with it are also factored into the Funding & Investment Plan from 2023 (still expected to rise to approximately £9m per annum although in the very long-term tax will be collected as pensions are in payment);

- The plans laid out in the Funding & Investment Plan, which include use of £160m of the Bond proceeds and £200m of additional borrowing to cover the States medium-term recovery and capital investment plans, with an estimated cost of £10m a year to service this debt; and

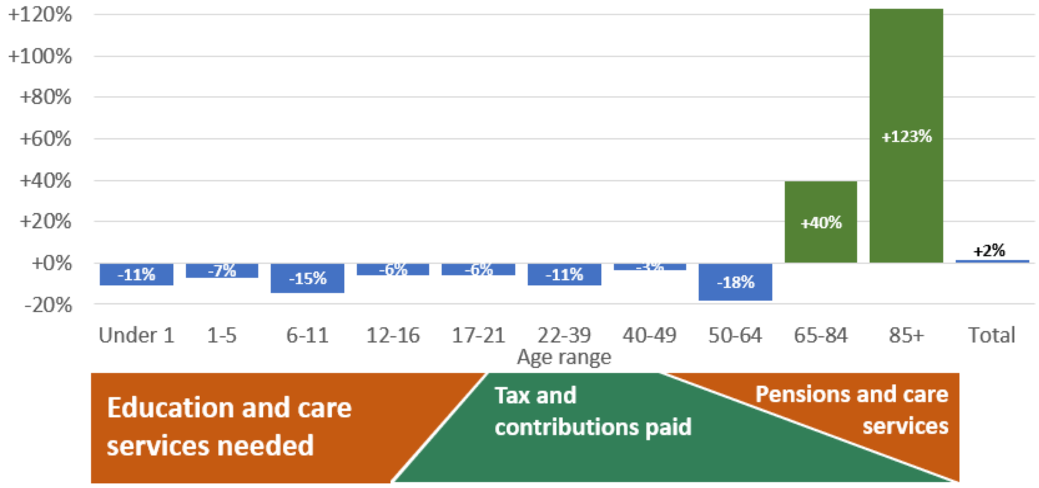
- The COVID-19 pandemic significantly reduced GDP in 2020 and any lasting impact on the economy is likely to reduce the available headroom going forward. Current estimates are that the available headroom, post recovery, has reduced slightly from £80m to between £70m-£75m (including replacing revenue lost through tax relief on secondary pensions).

3.7 It should be acknowledged that this kind of long-term forecasting is inherently difficult. Every decision the States take that has a significant financial implication or any shift in the island's economic wellbeing has the potential to change the outcome. There is also the risk of other pressures arising which are currently unknown or unquantified, including those arising from climate change. However, some of these costs are inescapable, already manifesting themselves and captured within the baseline presented in the Funding & Investment Plan. This is resulting in lower surpluses leading to pressure on the amounts available to invest in infrastructure.

3.8 These pressures will continue to grow beyond the five-year projections included in the Funding & Investment Plan. This is evidenced by the upward pressure on the baseline cost of the Committee *for* Health & Social Care and the known funding requirements to support the States Pension and the Long-Term Care

Scheme. **It will be necessary to increase the capacity of these services over time just to provide people with the same level of care they are entitled to today.**

Figure 3: Demographic change 2019-2040

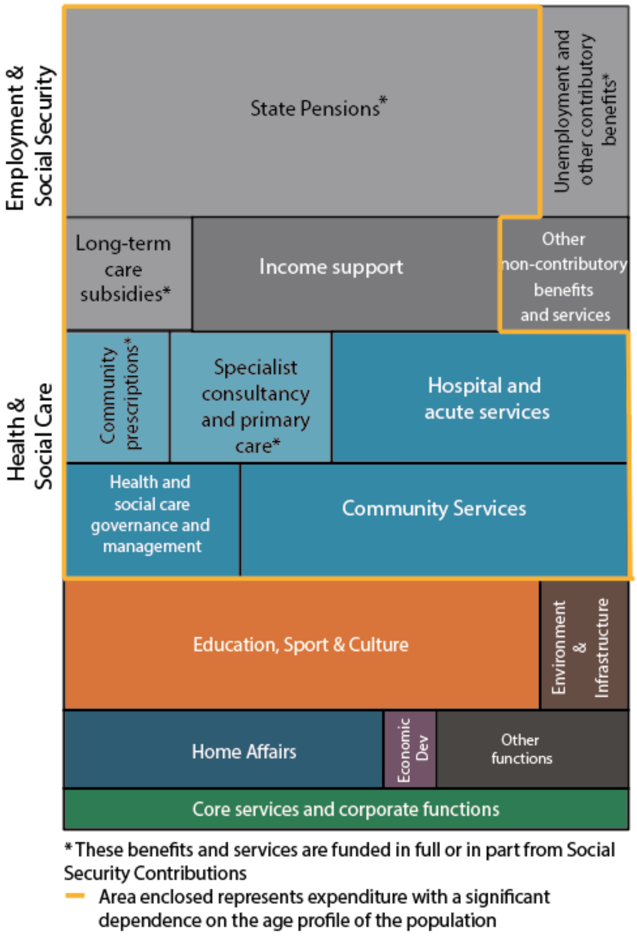


3.9 A significant proportion of States spending is in some way linked to the demographic profile. As well as more obvious elements such as the States Pension and Long-Term Care, it is estimated that about 30% of income support claims relate to pensioner households including about a third of those people in nursing or residential placements.

3.10 Within health and social care, the per capita cost of providing services for older age groups, who typically have more complex care needs, is significantly higher than for younger people. As the distribution of the population shifts towards older age groups who need this higher level of care, the cost of providing services will increase.

3.11 Overall, as much as 60% of the States' expenditure is dependent to some extent on the number of older people in the population (see Figure 4) and the extent of the pressure this is already exerting on States' spending is considerable. The number of people claiming a States Pension has increased from 15,047 in 2010 to 18,692 in 2020 (and could increase to more than 24,000 by 2040). As a result, the annual cost of providing these pensions has increased from £82m to £134m – a 63% increase in the total cost relative to a 27% increase in the rate at which the pension is paid.

Figure 4: Distribution of States Expenditure



3.12 Analysis presented in 2017 as part of the Partnership of Purpose Policy Letter suggested "health and care costs will outstrip the available funding within ten years" (Billet d'État XXIV, December 2017). The same report suggested that, without change, between 2017 and 2027 real terms spending on public health and care services could increase by more than £20m. This is now expected to be an underestimate as the cost of health and care services has already increased in real terms by £15m between 2017 and 2020 and the Funding & Investment Plan includes an estimate of an average of £3m a year further upward pressure as a result of demographic and other cost pressures on existing service levels.

3.13 The Policy Letter recommending the 24% of GDP limit on revenues described it as *"challenging but achievable"*. It is certainly no less challenging now. It can only be achieved by a significant improvement in fiscal discipline.

3.14 The States agreed proposals within the Funding & Investment Plan to invest up to £568m to support the capital requirements over the current term funded through borrowing up to £200m, using £160m of the proceeds of the Bond and depleting reserves. This is intended to enable the immediate progression of the States' priorities. However, it is a temporary solution only and a way of managing but not removing the underlying structural deficit. Without further action, beyond 2025 the States will again have to consider how best to support their spending requirements in the face of the same pressure to provide for the increased demand for existing services and maintain an appropriate level of capital investment. A longer-term solution is required.

Figure 5: Estimated structural deficit beyond 2025

5 YEAR PLAN - Middle Case £m	Est structural deficit by 2025
Adjusted Baseline Position	**11.2**
GWP Revenue Impact	
Brexit (on-going)	(1.1)
Recovery (on-going)	(3.5)
NICE TA's	0[5]
Transformation Savings	5.8
RICE	(1.7)
Budget measures	4.0
Baseline incl. GWP	**14.8**
Net Financing income/(charge)	(2.0)
Overall Surplus	**12.8**
Capital @ 2% GDP	(66.5)
Result after Capital Provision	**(53.7)**
Revenue requirement of Guernsey Insurance and Long-Term Care Funds	**(33.7)**
Total Forecast Funding Gap Beyond 2025	**(87.4)**

3.15 Figure 5, adapted from the Funding & Investment Plan, illustrates the forecast structural deficit (after provision in full for capital spending) beyond 2025 including the ongoing cost of the priorities of the GWP and the forecast savings of Public Service Reform.

3.16 At the level of capital expenditure set out in the Fiscal Policy Framework (2% of GDP), the estimated structural deficit on General Revenue beyond the 2025 horizon is estimated at £54m per annum[6]. Based on the most recent actuarial review, the social security contributions system has a further requirement for £34m of funding under the current policy. This would bring Guernsey's funding gap to £87m with increases in health and care costs likely to continue rising beyond this. This would put the funding requirement beyond the 24% of GDP limit if met entirely from additional revenues.

3.17 While the calculation is different, the message is the same as that conveyed in January 2020**. A revenue limit set at 24% of GDP is not enough to cover everything the States may want without compromise.** Raising revenues is not the only answer and if this limit is to be retained in any meaningful way, measures to grow the economy and limit expenditure growth have a vital role to play. Expenditure restraint and economic growth will need to carry a significant part of the burden.

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[6] This table has been updated to reflect the States decision to approve the amendment laid to progress the implementation of NICE drugs in line with the original timetable

4. The Role of Expenditure Reduction

4.1 Expenditure restraint delivered through operational efficiency alone cannot meet the scale of this challenge and is likely to only limit the overall growth in financial pressures. The current Funding & Investment Plan includes expenditure savings rising to £10m per annum, but the overall cost of public services is still set to increase.

4.2 Should there be a desire to reduce expenditure significantly more, it will be necessary to make changes to the scope of public services and benefits provided and who is entitled to access these.

4.3 To illustrate the scale of cuts that would be required to meet the funding gap by reduced expenditure alone, £75m is the equivalent of:

- 60% of the money spent annually on the States Pension; or
- the entire combined budget of the Committees *for* Economic Development, Environment & Infrastructure, Home Affairs, the Policy & Resources Committee core services, The Scrutiny Management Committee, The Development & Planning Authority, the States' Trading Supervisory Board, the Royal Court and the Law Officers.

4.4 However, expenditure restraint does have a role to play in keeping within agreed limits. Priority 4 of the Government Work Plan includes an acceleration of the pace of public service reform and transformation and an element of the annual cost savings of this programme (£10m) are already incorporated in the baseline above. If these are not achieved the financial situation may be worse.

4.5 To achieve additional reductions in spending beyond this will require a more fundamental consideration of what level of services are provided and who is entitled to access them. This may include considerations such as the minimum contribution requirements attached to the long-term care scheme or means testing currently universal benefits. In combination, such measures have the potential to make further contributions to improving the States' long-term financial position and reduce the need to raise additional revenues, but they are unlikely to remove it entirely.

4.6 **The Policy & Resources Committee considers that it is now vital that such options are properly explored and therefore wishes to co-ordinate an exercise to identify and scope opportunities which might materially reduce expenditure or mitigate expected cost increases. It is proposed that a sub-committee, comprising a Member from each Principal Committee is formed, and charged with the identification and development of options to reduce expenditure or mitigate the anticipated increase in the cost of public services.** This should include consideration of potential opportunities for further means testing, outsourcing or restricting the entitlement to some services on the basis of residency period or contribution record.

5. The Role of Economic Growth and the Population

5.1 The economic consequences of COVID-19 have worsened the financial position, both in respect of the largely temporary cost implications and by the potential long-term impact on the level of GDP. The assumption made in forecasting for the Funding & Investment Plan was an effective loss of up to two years of growth opportunity. This has reduced revenue forecasts and reduced the monetary value of the available headroom within the fiscal rules.

5.2 The reverse effect is also possible. It is highly unlikely that Guernsey would be able to sustain the level of economic growth required to meet the entirety of the fiscal challenge. To do so would require a full recovery of the economic activity lost in 2020 and an estimated 3% real growth (above inflation) each year for at least five years beyond that, compared to a recent average of 0.7%.

5.3 However, a more realistic increase in average economic growth levels could make a meaningful contribution to resolving the issue. Were the economic growth rate to exceed the forecast by 0.5% a year over a five-year period, this could add a total of £10m a year to States' revenues by the end of the period. Investment in economic growth, captured under GWP priority 3: Sustainable economic recovery, therefore has an important role to play.

5.4 The States have prioritised a review of the population and immigration approach, which will be co-ordinated by the Committee *for* Home Affairs with the Policy & Resources Committee and the Committee *for* Economic Development. The purpose of the work is to gain a greater understanding of the Island's population requirements for sustainable economic growth, and to inform decision-making in relation to the Island's population, housing stock, infrastructure, skills base and future trade policy. The scoping of that review has already acknowledged the interconnections between that piece of work and the Tax Review.

5.5 Across the medium-term, limiting the requirement for government revenues to 24% of GDP may be achievable *if* it is supported with investment in policies to enhance economic growth and measures to mitigate expenditure pressures. If those measures are unsuccessful it may not be sufficient longer-term.

5.6 **The Policy & Resources Committee considers that the limit on States' revenue agreed by previous States and set out in the Fiscal Policy Framework remains ambitious but appropriate. However, keeping the overall cost of the public sector within this limit will only be possible if the States deliver the priorities agreed as part of the Government Work Plan to achieve sustainable economic recovery and accelerate the pace of public service reform.**

6. Raising revenue

6.1 The decision to raise revenue is a difficult one, but one that is best taken before the financial situation reaches a critical position. The intention of this review is to ensure that discussions on how to raise revenue are done in a way that considers both the social and economic impact of such changes. The analysis presented by the Steering Group suggests that revenues could be raised up to 24% of GDP without significant long-term impacts on economic growth, albeit that within this there may be some redistribution away from sectors such as retail, wholesale and repairs toward those responsible for the provision of both public and private sector care services.

6.2 Revenue raising has the potential to create some economic impacts in the short-term[7] dependent on how revenues are raised. Taxes based on income may result in lower consumption, suppressed GDP growth and reduction in employment. A GST would generate an increase in inflation of about 60% of the headline rate.

6.3 The Steering Group concluded that of the levers available, taxes on income and taxes on consumption (e.g. a GST) offer the greatest potential for raising additional revenues. Other measures such as TRP, environmental and customs duties may contribute but are not practical options for meeting the scale of the challenge presented. The primary focus therefore should be the choice between taxing income and taxing consumption and the Steering Group concluded that a tax on consumption should be at least part of the solution.

6.4 While they are not discussed in detail in the Report this does not mean other taxes have no role to play. The Government Work Plan included a Resolution "*To direct the Policy & Resources Committee to include proposals in the annual Budget Report for each of the years 2022, 2023, 2024 and 2025 to generate an additional real-terms increase in revenues for each of these years of £1million per annum*" (Billet d'État XV, July 2021). Measures such as changes to TRP, document duty, excise duty, motor taxes or environmental taxes could be considered in the context of the annual Budget setting process.

6.5 The Steering Group presents three options for raising additional revenue up to the limits of the Fiscal Policy Framework which it considers could be workable in practice. These ultimately present a choice between continuing Guernsey's reliance on income-based taxes or diversifying the tax base with a GST, accepting that other measures will be needed to mitigate the regressive impact on low-income households.

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[7] defined in this case as up to 3 years

6.6 There are some common elements to these options covered briefly in Sections 4 and 5. The options themselves are covered in Section 6. More detailed discussion of these are included in the Steering Group's Report which is appended.

7. Corporate Income Tax

7.1 Guernsey's current corporate tax system, zero-10, was introduced in 2008 following clear indication from the EU Code of Conduct Group (Business Taxation) (the 'Code Group') that the previous regime was considered harmful. It is therefore not possible to revert to the corporate regime that was in place before zero-10, as this would not meet international tax standards, a key principle of the review. Much of the revenue lost in the restructure of the corporate tax system was replaced by increases in commercial TRP rates and increases in social security contributions from employers.

7.2 Zero-10 was deemed compliant with the Code of Conduct in 2012, with the exclusion of the deemed distribution element of the system. It was reviewed again in 2017, when the EU compiled its list of non-cooperative jurisdictions at which point Guernsey committed to the introduction of legislation on economic substance to meet the required standards to be deemed a co-operative jurisdiction.

7.3 In accordance with the States Resolution from 2015[8], the Policy & Resources Committee continue to monitor the appropriateness of the corporate tax regime, having due regard for the need to retain an internationally acceptable and competitive tax environment for the islands' businesses. Officers therefore monitor developments at the OECD and also developments with regard to the EU list of non-cooperative jurisdictions for tax purposes.

7.4 Most recently the EU Economic and Financial Affairs Council (ECOFIN) has approved guidance on foreign source income exemption (FSIE) regimes, also known as territorial regimes, which acknowledge that they are a legitimate approach to prevent double taxation but identify potentially harmful elements that could be present in such regimes. It is understood that the Code Group has screened jurisdictions with FSIE regimes, and in May 2021 wrote to those jurisdictions from which it would seek commitments to repeal or amend their harmful FSIE regimes. This indicates that territorial regimes are not a paradigm

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[8] Billet d'État IV, of 2015 the Personal Tax, Pensions & Benefits Review – "To direct the Treasury and Resources Department, having due regard for the need to provide a stable platform, maintain business confidence, support and encourage financial services and to retain an internationally acceptable and competitive tax environment for the islands' businesses, to continue to closely monitor the appropriateness of the corporate tax regime, and to report back to the States should it consider any changes are necessary."

or magic bullet, but remain subject to the same type of international pressure as the Zero-10 regimes employed by the Crown Dependencies.

7.5 The OECD has been working to establish a global solution to reform the international corporate tax framework, impacting how large multi-national enterprises are taxed around the world. That framework is based on two broad work streams, Pillar 1 relating to the proposal for partial re-allocation of taxing rights and Pillar 2 which proposes to introduce an agreement that large multinational enterprises (MNEs, those with group revenues of at least Euro 750m) pay a minimum effective rate of tax on their profits. These proposals seek to address issues that are linked to the increasing globalisation and digitalisation of the economy.

7.6 At the recent Inclusive Framework meeting in July, an overwhelming majority of jurisdictions (which included Guernsey) reached agreement on the proposals. Technical discussions will now continue, developing a detailed implementation plan by October.

7.7 The number of companies headquartered in Guernsey who would meet the criteria for an MNE under international rules is very limited. As technical discussions continue, it is not yet clear how these rules will be applied and therefore whether Guernsey would implement aspects of Pillar 2 that were not a minimum standard. Nor is it clear what the behavioural effects of the changes might be. As a result, the estimated revenues which might be generated from the implementation of the OECD proposals are limited and uncertain at this time.

7.8 The working assumption the Steering Group has used is that changes to the corporate income tax system may generate £10m a year of additional revenues.

7.9 In the longer term it may prove to be more or less than this figure if, for example, the rules are applied in such a way that some portion of the expected tax is paid elsewhere or if later discussions include the extension of the rules to include a wider range of companies. Any implementation plans for other tax measures will need to be flexible enough to allow for changes in the corporate landscape.

8. Reform of Social Security Contributions

8.1 As identified in the Policy Letter laid on Reform of Health Care Funding (Billet d'État X, June 2019) if the social security contributions system were to be designed today, it would not look as it currently does. The existing system, which has evolved organically through numerous changes, has some evident inequities.

8.2 The amount people are asked to contribute to social security benefits to which they have a largely uniform access is currently influenced by how an individual gains their income, their age, or their employment status.

8.3 The proposed reform of the social security contributions system (set out in the Steering Group's report, section 8), which will see it more closely aligned with income tax into a generally fairer and more progressive structure, would be difficult to achieve as a standalone change. However, as part of the wider reform of the tax structure, there is an opportunity to implement this, and a more progressive social security structure could partially offset the regressive elements of other changes such as a GST.

8.4 The restructure also addresses two extant Resolutions in relation to the social security contributions system and the inequities inherent in the current structure:

To direct the Social Security Department to review the assessment of Social Security contributions to ensure that the treatment of contributors in different contribution classes is equitable; such review to have particular regard to the upper earnings limit on contributions, the rates charged for self-employed and non-employed contributors and the definition of income used in the assessment of contributions for non-employed contributors.

(Billet d'État VI, April 2015)

To direct the Policy & Resources Committee in consultation with the Committee for Employment & Social Security to progress the second stage of the workstream, as described in section 10 of this Policy Letter, and review the structure of Social Security contributions collected for the support of health and social care services and ensure that these are appropriate, fair and sustainable, and to consider the prioritisation of this work stream for the new Assembly in the 2021-25 Policy & Resource Plan.

(Billet d'État X, June 2019).

8.5 The proposal made is that the contributions system be simplified so that all contributors are treated in the same way. The restructure would:

- Give all contributors (not employers) an allowance aligned with income tax;
- Charge all individuals below pension age the same "personal" rate on both earned and unearned income, with a reduced personal rate for those over pension age (reflecting that they no longer need to contribute to a pension but are typically the largest users of health and care services);
- Apply a reduced "employer" contribution to self-employed income; and
- Remove the upper earning limit on contributions for employers (but not for individuals).

8.6 The application of the allowance would make the system much more progressive, but costs £19m in isolation. Therefore, there needs to be an increase in the rate charged in order to bring the system to a net neutral position. At the current value of the tax allowance and with an increase in employer contributions to 7.5% (a proposal which enables the packages presented to achieve a more even balance between the contribution of households and corporate entities to raising revenues) the personal rate needed to make this net neutral rate (that is, not to raise any additional revenues) is about 8% (compared to the current 6.6% for employees). Once restructured it is possible to raise revenues in a more progressive manner than from the existing system. However, because the current system favours some groups there are cohorts who will benefit (generally those of lower income) while others will be disadvantaged by the proposed changes.

8.7 In the absence of raising more revenues, the resulting system may change the liability of an individual with an income of £50,000 as follows:

Figure 6: Comparison of liability before and after restructure

Personal rate 8% (4% if over pension age), employer rate 7.5% (5% for self-employed), allowance aligned with personal income tax allowance

Income composition	Current liability (figures in brackets represent employer contribution)	Liability after restructure (figures in brackets represent employer contribution)
£50,000 employed income:	£3,300 (+£3,300)	£3,050 (+£3,750)
£10,000 employed, £40,000 unearned:	£660 (+£660)	£3,050 (+£750)
£50,000 unearned income:	£4,300	£3,050
£50,000 self-employed income:	£5,500	£3,050 (+£1,906)
£50,000 income over State Pension Age	£1,400	£1,525

8.8 The £50,000 example used approximates the earned income value at which a net neutral restructure is close to balance for an employed individual. The impact on a contributor will depend on their specific circumstances, but generally employed individuals with an income below £50,000 would pay less in contributions, those with a higher income would pay more.

8.9 This is not a simple change, albeit the outcome will be far simpler and more transparent than what currently exists. In unravelling such a complex scheme to replace it with something simpler those people who are most favourably treated under the current scheme may be worse off when conditions for all contributors are equalised. This is impossible to avoid whilst retaining the total revenue generated by the scheme. Nevertheless, **the restructure represents a significant improvement in terms of both the equity and progressiveness of the social**

security contributions structure and would make any further revenue raising from this source fairer. As such, it is recommended for inclusion in any final package of measures.

8.10 The Committee *for* Employment & Social Security has indicated its support for a restructure of contributions (Appendix 1). However, notwithstanding this, it has relayed its intention that the steps to address the known funding shortfall on the States Pension and Long-Term Care scheme, quantified through the recent valuations by the Government Actuary, should be taken without further delay. That Committee intends to include within its annual contributory uprating report proposals for a phased increase in the social security contribution rates under the existing structure which would increase contribution revenues by an estimated £34m a year by 2031. It would be that Committee's intention that such increases are halted as and when the decisions arising from the Tax Review are implemented, assuming that those decisions deliver a sustainable solution.

8.11 The proposals under development by the Committee *for* Employment & Social Security represent almost half of the total amount which could be raised within the Fiscal Policy Framework limit and would ensure that those schemes are fully funded. However, it is clear from the analysis undertaken that the overall cost pressures are significantly greater than the 'headroom' available within the Fiscal Policy Framework and this would therefore significantly reduce the amount available for funding General Revenue pressures and make staying within the 24% of GDP limit more difficult. This highlights the need for such matters to be considered holistically and not by Committee mandate. It is for this reason that the Policy & Resources Committee, while working closely with the Committee *for* Employment & Social Security, has taken the lead in co-ordinating this work and presenting this Policy Letter.

9. Goods and Services Tax

9.1 The addition of a GST to the tax base presents an opportunity to make a substantial move to diversify the tax base away from taxes on income. Economically, the analysis provided also shows it would be the less damaging, particularly if it can be combined with a reduction in direct taxes (See Appendix 2).

9.2 There are a range of concerns which have been raised regarding the application of a GST. The first of these relates to the potential for the tax to be regressive at low incomes. The analysis conducted suggests that, in isolation, this is true. The Steering Group particularly wished to establish that it would be possible to mitigate this impact effectively and therefore examined how this might be addressed in some detail. The suite of mitigation measures included in the options presented includes:

- reductions in tax and contributions for lower income households by way of the restructure of the social security contributions system and/or an increase in the income tax personal allowance which are most beneficial for lower and middle-income households;

- Pre-emptive adjustments to the States Pension which will bring forward the normal inflation linked increase in the pension by up to 12 months;

- Pre-emptive adjustments to Income Support at a level above the estimated impact on inflation reflecting the greater impact on lower income households; and

- Cost support schemes specifically targeted at reaching low-income households who are not eligible for Income Support.

9.3 The analysis presented shows that, if carefully designed, the overall impact of a change in the tax system to include a GST could be progressive and that lower income households might be benefited by the changes resulting in them paying **less** tax overall.

9.4 There will clearly be an additional administrative burden for businesses with the introduction of a GST. This is estimated at less than 1% of turnover on an ongoing basis although it is expected to be higher in the first year when the process is new (Deloitte LLP, July 2021), but this will depend on the type of business activity undertaken and the level of sophistication of each company's accounting processes. Measures such as a broad application with only limited exemptions, a high compulsory registration threshold (which has been modelled at £300,000) and the application of an International Services Entity scheme similar to that applied in Jersey could help limit this impact.

9.5 The potential for an increase in internet sales has also been raised as a concern. A GST would be applicable to imported goods but most jurisdictions apply a de minimis value below which the tax is not collected. This is intended to balance the revenue raised with the administrative cost of collecting the tax on personal imports. In Jersey this de minimis is set at £135 – the same level as the UK VAT de minimis. Further consideration to what level would be appropriate to apply in Guernsey, and more detail on the other features described will form part of any more detailed work.

9.6 The introduction of a new tax will also result in an additional administrative burden for the States. It is estimated that a GST would cost in the region of £800,000 a year to administer which is based on the experience of administering the scheme in Jersey. The administration of the scheme is expected to be split between the Revenue Service for the primary administration and the Border Agency in relation to the application of the tax to imports.

9.7 Further concerns raised include the possibility that, once introduced the rate of a GST could be raised beyond that initially agreed. The next phase of this workstream will include consideration of whether it might be appropriate or possible to apply mechanisms by which future increases in the rate could be restricted, if the limit placed on government revenues is not considered a strong enough measure.

10. The Options

10.1 The Steering Group presents three pragmatic solutions to the question posed. All are intended to have a net progressive structure (albeit after mitigation in the case of Options 2 and 3) and all divide revenue raising between households and corporates, with Options 2 and 3 also including revenue raised from visitors and other non-residents.

10.2 **Option 1** retains Guernsey's existing structure focussing on taxes raised against income in the form of an income-based health tax and an increase in the revenues raised through social security contributions. This meets the progressive objective and, for some, may be considered fairer, but it further exacerbates some of the existing issues with the tax base.

10.3 In 2015 the States resolved:

"To acknowledge that there are risks and challenges associated with the States' considerable reliance – by international standards – on direct personal taxes and social insurance contributions; and to agree in principle that it would be advantageous to diversify sources of States' income in ways which take account of the principle of 'ability to pay'."

Billet d'État IV, 2015, Planning a Sustainable Future: The Personal Tax, Pension and Benefits Review

10.4 And again in 2017

"To direct the Policy & Resources Committee, in developing its proposals for income measures from 2018 onwards, to consider the merits and disadvantages of any new forms of taxation, with the exception of taxes on capital; this recognises that there will be a clear presumption that over this period (in light of the island's changing demographics) the tax base will broaden and diversify consistent with the principles of seeking a greater contribution from those individuals and entities most able to bear the burden."

10.5 With two successive Assemblies recognising that the lack of diversity in the tax base is an issue, exacerbating this issue further by focussing entirely on revenue raising measures charged on income cannot be recommended.

10.6 **Option 2** places most of the revenue raising burden on a GST which would increase gradually to an 8% rate over a number of years and presents a net reduction in taxes on income due to the effect of the associated mitigation measures. As discussed in the accompanying economic analysis (Deloitte LLP, July 2021), this reduction in direct taxation could have short term economic benefits and economically this option would be the most efficient[9].

10.7 There would be a potential for significant short-term pressure on price inflation (expected to be approximately 60% of the rate implemented) leading to regressive impacts which could be costly to mitigate. Any proposal which includes a GST would need some of the revenue raised to be diverted towards the compensation of those on lower incomes and the higher the rate applied the larger the redistribution will need to be. As demonstrated in the Steering Group's report, it is possible to achieve a system in which the majority of lower income households could be benefited by the changes (that is, paying less tax overall), even at a relatively high rate of GST.

10.8 The cost of administering a GST is the same regardless of the rate and it is therefore administratively, as well as economically, more efficient to target a higher rate. It has the highest potential to diversify the tax base and the lowest potential to create short term pressure on employment and GDP.

10.9 **Option 3** presents a mix of elements from Options 1 and 2, combining a lower rate of GST (5%) with an increase in revenue from the restructured social security contributions. The lower rate of GST reduces the impact on inflation and the extent of mitigation required for lower income households, but the inclusion of increased revenues from the contributions system creates a limited degree of pressure on employment and GDP growth.

10.10 This creates a more moderate approach. It would align the Guernsey GST rate with Jersey's and may be publicly more palatable and less costly to mitigate albeit would lose some of the economic and administrative efficiency associated with focussing entirely on a GST.

10.11 The Steering Group has concluded that the tax system should include a GST. This would be consistent with the extant Resolutions listed above and offers the best

[9] Economic efficiency refers to the extent to which a tax distorts people's behaviour and impacts the economy. An efficient tax creates the least distortion.

opportunity to meaningfully diversify the tax base. **On that basis, the Policy & Resources Committee is asking the States to confirm that any restructure to diversify the tax system requires the introduction of a GST.**

10.12 The Steering Group also recognises that the details of this scheme are important and need further public consultation. The modelling has been conducted in broad alignment with the schemes applied in Jersey and New Zealand which have some attractive features:

- Jersey applies a high compulsory registration threshold to protect small businesses from administration costs. At the £300,000 turnover threshold applied in Jersey (compared to £85,000 in the UK) it is estimated that this could keep between 30% and 50%[10] of businesses from being required to register. Those businesses not required to register would be subject to GST on any taxable supplies, but they would not be obliged to charge GST on their sales, complete quarterly returns or make any remittance to the States. This removes the need for smaller businesses to conduct any administration in relation to a GST although the increased cost of supplies will still likely be passed on to customers.

- Jersey offers an optional International Services Entity Scheme designed to reduce administration for much of the finance sector. This scheme removes the need for financial services providers, whose services are largely exported and therefore zero-rated, to register and complete quarterly returns in order to reclaim any GST incurred on supplies. A fee is applied to access the scheme and based on the revenues raised in Jersey this is expected to raise £6m.

- Both Jersey and New Zealand also apply the tax to the vast majority of goods and services, with very limited exemptions. This creates a scheme significantly more efficient, economically and administratively, than a scheme like the UK's VAT which applies a complex regime of exemptions, zero-rating and reduced rates.

10.13 The further development and consultation will aim to refine this position and confirm which of these elements should form part of any final proposal, including detail on what goods and services should be subject to exemptions and zero rating.

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[10] These estimates are based on the submission of claims to the Covid Business support scheme which may over represent small businesses and are therefore presented with a wide range

11. Consultation and Engagement

11.1 The Steering Group has undertaken initial engagement on the proposals presented to date, both with States Members and with industry and community representatives. This has been undertaken through a number of presentations and workshops encouraging participation and comment. However, further engagement is needed on the details of a scheme before final proposals are presented to the States for consideration. Further formal consultation, including public meetings, will be undertaken following the direction provided by the debate of this Policy Letter and further detailed modelling.

11.2 The President of the Committee *for* Employment & Social Security and a non-voting Member from that Committee are Members of the Steering Group. Communication and engagement was undertaken with the Committee *for* Employment & Social Security as this work progressed. The Committee *for* Employment & Social Security has indicated its support for the proposals to restructure social security contributions in order to address the identified issues and to make the scheme more progressive. A letter of comment from the Committee *for* Employment & Social Security on the proposals is attached at Appendix 1.

11.3 Engagement was also undertaken with Alderney States Members to ascertain any concerns raised in relation to the specific circumstances in Alderney. The primary issues raised related to the differences in the costs of goods between the two islands and the consequential potential for GST to impact Alderney residents more as a result. Work is planned for the next stage to establish the price gap between the two islands so this concern can be examined in more detail.

11.4 Another concern raised was the potential for the restructure of the social security contributions to discourage people owning property in Alderney from making these available to rent. Again, this will need to be investigated further.

12. Progression of the Workstreams

12.1 Subject to the approval of the Propositions in this Policy Letter, a substantial and detailed exercise is required to develop formal proposals to make significant structural changes to the tax base. **The next proposals laid before the States will expand in detail what changes are proposed, what mitigations need to be put in place and how these will work, how changes should be phased and how and when the operational implementation of these changes should be applied.**

12.2 It is the intention of the Committee that the next update of the Government Work Plan will also set out how the implementation of changes to the tax base can be co-ordinated with other measures needed to support the States' financial position. This will include the progression of priorities in relation to the population, economic recovery, Public Service Reform and changes to service levels. These priorities could have a significant influence on how far and how fast changes to the tax base will need to be progressed.

12.3 A significant investment of staff time and resources will be required to bring these proposals to the point at which a final decision can be made by the States on implementing changes. It is estimated that up to £250k will be needed, including scoping the necessary IT, consultancy support on detailed development, and public engagement and communication. If necessary, the Policy & Resources Committee will use its delegated authority to make funding available from the Budget Reserve.

13. Conclusions

13.1 It is evident from the information available that the scale of the States' long-term fiscal pressures is such that it will be necessary to raise additional revenues at some point in the near future. If we are to stay within the rules that the States have set through the Fiscal Policy Framework, then this must be accompanied by a measurable and significant commitment to reduce expenditure and promote economic growth. Accepting that revenue raising may be necessary in no way reduces the importance of financial discipline, public service reform or economic investment. All will be required if we are to live within the limits set.

13.2 The Steering Group has presented pragmatic solutions to the question set. While an option that does not include a consumption tax is included, to progress in this direction would only exacerbate the risk and vulnerability created by an already heavy reliance on taxes charged against income. The Policy & Resources Committee therefore supports the conclusion that, if significant additional revenues are required and the need to diversify the tax base is accepted, then the optimal solution includes a consumption tax. However, the Committee believes that this must be accompanied with measures taken to address its regressive effects on lower income households and that further work will be required to refine such measures. Two successive Assemblies have laid resolutions to address the issue of the narrowness of the tax base and implementing a tax in place in almost every other jurisdiction in the world is the most practical way to address this.

13.3 The Steering Group has also recommended that the inequities in the social security contributions system be addressed. Again, these are issues formally recognised by two successive Assemblies (Billet d'État VI, April 2015) (Billet d'État X, June 2019). A system which presents a similar eligibility for benefits but applies liabilities that can vary enormously depending on how you gain your income cannot be equitable and should be addressed if there is a reasonable opportunity to do so.

13.4 The detail of how these options are structured is important. The Steering Group has demonstrated that there are ways to mitigate concerns about the regressive impact of a GST, and examples of good practice on its application which could maximise the efficiency of the Guernsey system while minimising the administrative burden. However, it is recognised that the details are important and that more engagement and development is required before the States can be expected to support firm proposals.

13.5 The Steering Group has committed to a six-month period of development and more detailed engagement and consultation but formal in principle endorsement from the States is sought on the key elements before this is undertaken.

14. Compliance with Rule 4

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

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

14.3 In accordance with Rule 4(1)(b), the Propositions have been developed with consultation and engagement as explained in section 8 of this Policy Letter.

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

14.5 Rule 4(1)(d) concerns the financial implications to the States of carrying into effect the proposals. As set out in paragraph 12.3 of this Policy Letter, it is estimated that £250,000 will be needed to bring these proposals to the point where the States can make a final decision on the proposals. The more fundamental implications of these proposals for government revenue and expenditure are dealt with throughout this Policy Letter and therefore not repeated in this section.

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

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

PTR Ferbrache
President

HJR Soulsby MBE
Vice-President

J P Le Tocq
MAJ Helyar
DJ Mahoney

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

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

Our Ref:
Your Ref:
Date: 20 August 2021

By email

Dear Deputy Ferbrache

Tax Review

The Committee *for* Employment & Social Security ('the Committee') considered a draft of the Tax Review Policy Letter at its meeting on 18 August 2021.

The Committee very much supports the holistic approach taken by the Policy & Resources Committee in conducting the Tax Review. The Committee recognises the pressing need to raise more revenue to support the provision of essential public services, pensions and benefits for our population in the future.

The Committee supports the restructure of the existing social security contributions system to make it more equitable, noting that more detailed work is necessary to establish the appropriate rates, allowances and limits to be applied.

The Committee welcomes the introduction of an allowance on social security contributions for all contributors (not just non-employed persons) as part of the restructure. However, the Committee notes that the consequential substantial loss in revenue will need to be replaced through other measures in order not to worsen the already unsustainable position of the Guernsey Insurance Fund and the Long-term Care Fund. Therefore, this must not be implemented in isolation.

For some time, the States has shied away from agreeing measures to secure the long-term financial sustainability of the Guernsey Insurance Fund. The Fund has been in deficit, before investment returns are taken into account, since 2009. It is estimated that the operating deficit of the Guernsey Insurance Fund will increase to £38.3m in 2022. This is ameliorated to some extent by investment returns, resulting a forecast net deficit of £19.2m in 2021, but it should be noted that as the fund declines so will the extent to which operating losses can be mitigated by investment returns.

Although we have a large buffer Fund (valued at £702.4m as at 31 December 2020), the Government Actuary's Department has calculated that the Guernsey Insurance Fund will be exhausted by 2039 unless something is done to address this matter. It is a matter of deep concern that the pension fund could be exhausted in just 18 years if no measures are taken to prevent this. The equivalent of approximately £28m per annum of additional revenue is needed to make the Fund sustainable under current assumptions.

The Government Actuary projected that the balance in the Long-term Care Fund will fall to zero in 2053. This does not take into account the decision in principle, taken by the States of Deliberation in August 2020, to extend the coverage of the Long-term Care Scheme to cover care delivered in peoples' homes. The current estimate of additional revenue required to make the Long-term Care Fund sustainable, not taking into account the cost of this significant policy change, is £6m per annum.

The operating deficit of the Guernsey Insurance Fund is increasing and every further year of inaction only makes the situation worse and the potential solution more painful for contributors. The Policy & Resources Committee is already aware that the Committee intends to propose in its forthcoming annual Policy Letter on contributory benefits and contribution rates, a gradualist approach to increasing social security contributions. I would like to reiterate that this proposition is certainly not intended to undermine the Policy & Resources Committee's aim to address the island's fiscal issues in a holistic manner. The Committee very much supports this approach.

Instead, it seeks to provide a 'Plan B' in the event that the States does not support Proposition 2 of your Committee's Policy Letter on the Tax Review. Or if they do but then don't see through on that decision in principle.

This Plan B, under which contribution rates would gradually be increased over a ten-year period, aims to secure the long-term future of the Guernsey Insurance Fund which funds the States Pension (and other social insurance benefits), and Long-term Care Insurance Fund which funds long-term care benefit that addresses the significant financial risk to individuals of requiring long-term care.

The Committee is proposing this gradualist approach for two reasons. Firstly, to avoid becoming anti-competitive through a large increase now when we know that other jurisdictions are facing similar challenges and will be forced to address them sooner rather than later. Secondly to allow the situation to be regularly revisited in the light of changing circumstances and the required total increase in contributions to be reduced or increased as required.

Returning to the Policy & Resources Committee's Policy Letter; of the two options presented by the Policy & Resources Committee which include the introduction of a broad-based Goods and Services Tax (GST) (i.e. options 2 and 3), the Committee's preference is option 2 (8% GST). This option raises more tax from GST and provides more opportunity to implement mitigating provisions which make the overall package the most redistributive and the best for lower and lower-middle income households of the three proposed. It also leaves the island less reliant on the taxation of income than either of the other two options.

The Committee is aware that this outcome will be counter-intuitive to many as a GST in itself is widely recognised as being regressive in nature. This is why the Committee stresses the need to view the competing possible packages in the round, including the impact of all of the measures included, rather than just homing in on the GST element. We very much hope that the Policy & Resources Committee will stress this requirement in order to judge the pros and cons of all of the possible packages.

The Committee suggests that the public messaging in respect of this Policy Letter should draw attention to the results of the analysis set out in figures 15, 19 and 23, showing the average impact by household income and household composition of the three options, and figure 24, which provides a high level comparative assessment of the options.

The Committee looks forward to continuing to work closely with the Policy & Resources Committee to address the future financial challenges faced by the island.

Yours sincerely

Deputy Peter Roffey
President

Appendix 2: Tax Review Steering Group: Technical Report and Recomendations

TAX REVIEW STEERING GROUP

Technical Report and Recommendations

Table of Contents

1. Executive Summary

1.1. In January 2020, the States of Guernsey resolved to undertake a review of the tax system (the 'Tax Review') in light of prospective long-term pressures on government finances (Billet d'État I, Jan 2020). This preceded the COVID-19 pandemic, which has made the need to address the issue more immediate, although it is not the root cause. The purpose of the Tax Review is to ensure that the tax system has the capacity to raise revenues up to the limits on revenues set in the Fiscal Policy Framework should this be necessary.

1.2. The fiscal pressures are significant. The population is ageing, and pressure is already manifesting in the cost of health care and pension provision. This pressure will continue to grow as an increasing number of people will need to depend on these services. A sustainable solution to supporting an ongoing capital programme is also needed. The borrowing recommended in the Funding & Investment Plan can support the investment in infrastructure for this term, but we cannot borrow indefinitely, and reserves will become exhausted.

1.3. There are also two issues with the tax base recognised by previous Assemblies which should be addressed:

- The narrowness of the tax base (Billet d'État VI, April 2015) (Billet d'État XII, June 2017); and
- The inequities in the current social security contributions system (Billet d'État VI, April 2015) (Billet d'État X, June 2019).

1.4. Personal income tax and social security contributions make up 63% of revenue collected. Broad based consumption taxes, such as GST are entirely absent. This makes Guernsey heavily reliant on the workforce to support public services and vulnerable to the ageing of the population - the erosion of the working age population as more people retire could place a downward pressure on revenues to the value of as much as £30m a year by 2040. It also means that the tax system lacks the resilience that would come with a more diverse tax base.

1.5. The inequities in the social security contributions system mean that individuals with similar incomes can face quite different liabilities and, if reforms are to be considered, this should be addressed (see section 8).

1.6. A structured plan setting a roadmap for how revenues should be raised will ensure that any increase in taxation is done in a way which minimises both the economic and social implications. This Review therefore addresses the question:

If it is necessary to increase revenues to the limit of the Fiscal Policy Framework (24% of GDP) to meet the cost of public services, what is the best way to achieve this?

1.7. The limit placed on government revenues by the Fiscal Framework is set at 24% of GDP (Billet d'État I, Jan 2020), just over 2% of GDP higher than the average amount raised over the three years between 2017 and 2019. This is estimated to allow between £70m and £75m[1] of capacity to cover the requirements of both General Revenue and the Social Security Funds.

1.8. Of the levers available, taxes on income and taxes on consumption (e.g. a GST) offer the greatest potential for raising additional revenues. Other measures such as TRP, environmental and customs duties may contribute but are not practical options for meeting the scale of the challenge presented. The focus of this report is therefore the choice between taxing income and taxing consumption.

1.9. Corporate income tax rates are under global consideration and parallel work is underway to identify what the OECD's[2] work to reform the international corporate tax framework will mean for Guernsey in practice. This report includes an assumption that changes to the corporate tax system may contribute £10m a year, but this is subject to the progression of a large and complex international workstream, the timing of which is largely outside of Guernsey's control.

1.10. The identified issues with the narrowness of the tax base make the inclusion of a GST in Guernsey's toolkit of tax measures an obvious, if uncomfortable, choice for both raising revenues and diversifying the tax base. On its own, a GST is regressive for those on low incomes. However, the options presented in this report demonstrate how this might be mitigated through changes to the income tax and social security systems combined with additional support provided via the States' pension, income support and other benefit systems.

1.11. This report presents three options:

- **Option 1:** An income only approach which applies a 3% income-based health tax as well as additional revenue raising from a more progressive social security system.

- **Option 2:** A GST only approach which applies a GST gradually increasing over a number of years up to 8% combined with a net neutral progressive restructure of the social security system, an increase in the personal income tax allowance and a variety of measures targeted at providing relief to low-income households.

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[1] This is lower than the value quoted in the Review of the Fiscal Policy Framework and Fiscal Pressures report in January 2020, because the economic impact of COVID-19 is expected to result in a permanent reduction in GDP equivalent to between 0.5% and 1.5%. This effectively represents the loss of one to two years of growth opportunities.

[2] The Organisation for Economic Co-operation and Development

- **Option 3:** A combined GST and income-based approach which applies a a GST gradually increasing up to 5% with additional revenue raising from a more progressive social security system and a similar selection of mitigating measures as option 2.

1.12. The economic analysis appended to this report presents a persuasive case for including a GST within Guernsey's tax base (Appendix 1). Not only does this present the best opportunity to diversify the tax base, raising revenues from a GST is likely to be less economically damaging than income-based taxes. Combined with effective mitigation, this could place Guernsey's tax based on a more sustainable footing.

1.13. Some provisional engagement has been undertaken on this matter and the Steering Group recommends that direction from the States is sought ahead of more detailed engagement and the development of a complete and detailed proposal.

1.14. **The Steering Group therefore recommend that the Policy & Resources Committee seek direction from the States on the following:**

- **That in order to address the inequity of the existing social security contribuions system it should be restructured such that all contributors are subject to a personal assessment on the same definition of income and with the same access to allowances.**

- **That any restructure of the Tax system should include the introduction of a GST and that this should be a broad-based system similar to that applied in Jersey and New Zealand.**

- **That the impact of any GST should be mitigated by a range of measures targeted at those households considered most at risk of adverse consequences of a GST, including but not limited to consideration of;**

    - **an increase in the personal tax allowance;**
    - **a pre-emptive increase in the States' pension at a rate consistent with the anticipated impact on inflation;**
    - **a pre-emptive increase in Income Support, at a rate consistent with anticipated impact on inflation or higher; and,**
    - **The provision of additional cost support measures, such as a low-income pension supplement and a cost support scheme to reach low-income individuals not supported via income support.**

1.15. **Subject to the States approval of the above direction, the Steering Group proposes to undertake a period of detailed consultation and development before returning firm proposals to the Policy & Resources Committee.**

2. Review Terms of Reference

2.1. The terms of reference of this project, as agreed in January 2020 are as follows:

- To present options for restructuring the tax base so that it has the capacity to raise revenues up to the limits of aggregate revenues agreed in the Fiscal Policy Framework.

  - To investigate mechanisms for raising additional revenues including;

  - The taxation of company profits with due regard to the need to maintain a tax system which is competitive, internationally acceptable and maintains tax neutrality[3];
  - Extension or modification of the existing income tax and social security contributions system;
  - A health tax; and,
  - The addition of general or limited consumption taxes to the tax base.

- To investigate options for the implementation of these measures in such a way as to minimise the economic impact of changes to the tax structure.

- To provide analysis of the financial, economic, and social implications of any options presented.

2.2. Subsequently the following direction has been added:

To direct the Policy & Resources Committee to include consideration of the impact of duty free on its review of the tax base (amendment to 2021 budget)

2.3. The following Resolutions also have high priority within the consideration of this workstream:

To acknowledge that there are risks and challenges associated with the States' considerable reliance – by international standards – on direct personal taxes and social insurance contributions; and to agree in principle that it would be advantageous to diversify sources of States' income in ways which take account of the principle of 'ability to pay'.

Billet d'État IV, 2015, Planning a Sustainable Future: The Personal Tax Pensions & Benefits Review.

[3] Tax neutrality is important for the continuing operation of the finance sector in Guernsey, enabling Guernsey to competitively facilitate the movement of international capital flows in the absence of the extensive network of double tax agreements available to larger jurisdictions. Tax neutrality ensures that the products and clients of the finance sector are taxed appropriately in the jurisdictions of origin, residence or investment, as appropriate, without any additional tax cost being imposed in Guernsey. Tax neutrality does not generally impede the taxation of profits on the regulated providers of services in the finance sector as is currently the case under the 0/10 regime.

To direct the Policy & Resources Committee, in developing its proposals for income measures from 2018 onwards, to consider the merits and disadvantages of any new forms of taxation, with the exception of taxes on capital; this recognises that there will be a clear presumption that over this period (in light of the island's changing demographics) the tax base will broaden and diversify consistent with the principles of seeking a greater contribution from those individuals and entities most able to bear the burden.

Billet d'État XII, 2017, Policy & Resource Plan – Phase 2.

2.4. It should be noted that work to review the corporate income tax regime is underway but this is tied to the OECD's work to reform the international corporate tax framework. This is likely to require changes to the tax system but the outcome is not yet clear. This is a large and complex international workstream, the timing of which is largely outside of Guernsey's control. This report includes an assumption that changes to the corporate tax system may contribute £10m a year. Because this work is still ongoing this value is still uncertain. Corporate taxes are discussed in more detail in section 7.

3. Review Principles

3.1. It was agreed by the Policy & Resources Committee that the review be conducted in accordance with the following principles.

The tax system should:

- be capable of raising revenues of up to 24% of GDP in a way that is economically and socially sustainable;
- be diversified between different forms of taxation;
- be transparent, simple and credible;
- be resilient to demographic change and economic shocks;
- support and facilitate sustainable economic growth and employment;
- comply with international tax standards;
- maintain alignment on corporate tax policy with Jersey and the Isle of Man;
- overall, reflect people's ability to pay and be generally progressive, while accepting that a balanced tax system will include some elements (such as excise taxes) which are considered regressive in nature;
- not discriminate on the basis of age, gender, marital status or employment status in assessing or determining the amount an individual must pay; and,
- support the delivery of environmental and social objectives if there are opportunities to do so without breaching the previous principles.

4. Supporting Analysis

4.1. This report is presented with supporting financial and economic analysis. Appended to this document is an "Economic Impact Study of the States of Guernsey Tax Review" (Deloitte LLP, August 2021), which examines the potential impact of changes to the tax system on the Islands' economy and a comparison of the options presented by the Steering Group (see Appendix 1).

4.2. This analysis also includes comparisons with key benchmark jurisdictions. These were selected as having some general similarities with Guernsey's economy in that they are small jurisdictions with economies heavily focused on the financial services sector. Broadly, this group includes those jurisdictions which might be considered Guernsey's closest competitors. The benchmark jurisdictions selected were:

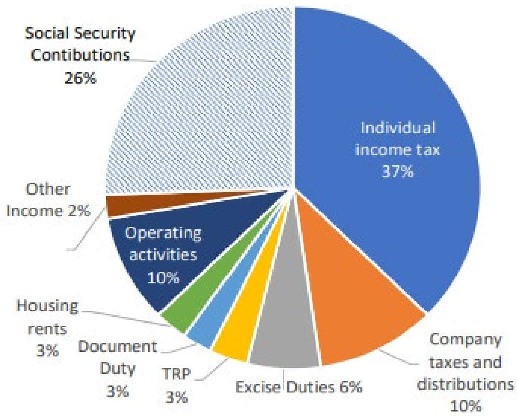
- Jersey
- Isle of Man
- Luxembourg
- Singapore

5. Sources of Revenues

5.1. In 2019 (the latest point at which States revenues might be considered uninterrupted due to the pandemic), Guernsey raised £622m in tax and contribution revenues equal to approximately 19% of GDP. A further £100m was raised from other revenue streams such as fees and charges and rent on States owned properties. The average total amount of revenue raised in Guernsey over a three-year period equated to 21.9% of GDP.

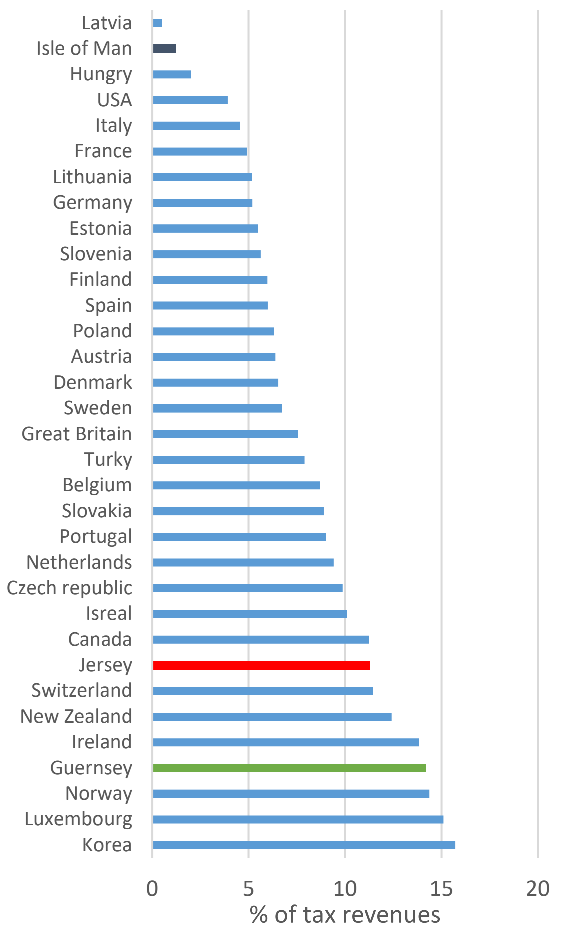
5.2. Income tax charged on individuals' income is the largest component of revenues comprising 37% of the total, closely followed by social security contributions at 26%. This means that almost two thirds of Guernsey's total revenue or 72% of tax revenue is derived from people's income. This is less than it has been in the past, but Guernsey remains unusually heavily reliant on income-based charges and earned income in particular. On average income taxes and contributions comprise 58% of tax revenue in the OECD countries (data.oecd.org) and 67% and 49% of tax revenues in Jersey and the Isle of Man respectively.

Figure 1: Sources of Government Revenues



5.3. Corporate income taxes (and distributions from companies) account for approximately 10% of total revenues or 14% of tax revenues. Corporate income tax receipts are typically highly cyclical, increasing while the economy is performing well and decreasing in times of economic stress to a much greater extent than personal income tax. These taxes are an important part of most countries' tax base. However, because of their potential volatility and competitive nature, most countries gain more revenues from personal taxes and consumption taxes, which are more stable and less economically sensitive. Even though Guernsey applies a 0% headline rate, the proportion of taxes generated from corporate income tax in Guernsey is above the OECD average of 10% (data.oecd.org).

Figure 2: Corporate tax revenues (% of total tax revenues)



5.4. In most jurisdictions a broad-based consumption tax such as a GST, VAT or sales tax (collectively referred to as GST for simplicity) makes up a significant proportion of revenues - the OECD average is for approximately a third of a jurisdiction's tax revenue to be generated from a GST (data.oecd.org). Guernsey is almost unique in not applying these taxes and among the benchmark jurisdictions used in the analysis of this project they comprised between 8% (Jersey) and 40% (Isle of Man) of tax revenues (see Appendix 1).

5.5. Other taxes, both in Guernsey and elsewhere, tend to make up a minority of tax revenues. In total TRP, document duty and excise duties raise just over 10% of the States total revenues. They are not considered able to offer significant enough revenues to be considered as part of the structural reforms discussed in this report. To raise £10m from TRP for example, it would be necessary to increase both commercial and domestic TRP rates by a further 50%.

5.6. While they are not included in this report in detail this does not mean they have no role to play. The Government Work Plan included a Resolution "*To direct the Policy & Resources Committee to include proposals in the annual Budget Report for each of the years 2022, 2023, 2024 and 2025 to generate an additional real-terms increase in revenues for each of these years of £1million per annum*" (Billet d'État XV, July 2021). Measures such as changes to TRP, document duty, excise duty or motor taxes could be considered in the context of the annual Budget setting process.

5.7. Motor taxes, which in Guernsey currently consists of excise duty on fuel with a small amount of revenue from first registration duty, are reducing because of a move to more fuel-efficient vehicles and, more recently, the acceleration of the move towards electric vehicles. This is the subject of an extant Resolution to investigate whether a distance charging model might offer a more sustainable alternative and to conduct a pilot to provide a proof of concept (Billet d'État XII, July 2019). The original direction was given to the Policy & Resources Committee, but discussions are underway for the Committee *for the* Environment & Infrastructure to progress this.

6. Economic Implications of Raising Additional Revenues

6.1. The working assumption used in compiling this report is that it may be necessary to raise revenues to the full extent allowed within the Fiscal Policy Framework. Based on current forecasts and allowing for the expected reduction in income tax revenue as a result of the launch of the Secondary Pension project in 2023, the available headroom is estimated at between £70m and £75m. This would place the aggregate amount of revenues raised from the economy at a level broadly similar to Jersey.

6.2. The economic impact analysis supporting this report (see Appendix 1) suggests that, assuming the additional revenues are spent providing public services and the raising of revenue is timed to match increases in expenditure, the aggregate effect on the economy from an increase in taxation to 24% of GDP should be negligible in the medium- to long-term. However, it may result in a shift in economic activity from the private to public sector.

6.3. The structural changes may include a reduction in the size of sectors such as wholesale, retail, and repair. These currently make up about 8% of total GVA, implying that their impacts on the overall economy are unlikely to be very large. Sectors which provide health and care provision are likely to expand as demand for services increases and an expansion of capital investment beyond what has been achieved in recent years may benefit the construction sector.

6.4. There will inevitably be some timing differences between the raising and spending of revenues. For example, the intention to borrow to support the current capital portfolio may bring forward economic growth, but the economic loss arising from the repayment will be spread over a number of years. The provision of funding for the States Pensions and Long-Term care services is also planned over an extended period, diverting revenues in the short-term to provide for benefits payable over several decades. This implies a small economic cost now to support greater levels of consumption in the future.

6.5. There is potential for short term impacts from changes to the tax structure, but how these manifest will depend on what changes are made.

6.6. Taxes on income, which reduce the amount of money an individual might take home in recompense for their labour, are more likely to have an impact on employment decisions and consumption than a GST. This means they have the potential to create a short-term suppression of employment and GDP growth. However, they are unlikely to impact inflation.

6.7. By contrast a GST is not expected to influence employment or GDP growth in the short term but may bring forward some consumption and will have a temporary impact on inflation.

7. Corporate Income Tax

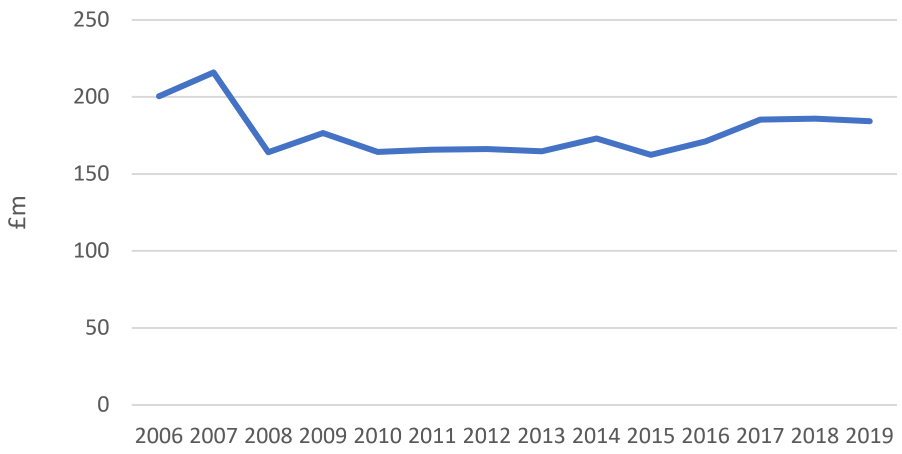
7.1. The standard rate of tax for companies is 0%, with an intermediate 10% rate applying predominantly to income from regulated financial services business and a higher 20% rate applying predominantly to income from land and property in Guernsey (both rental income and income from property development). This regime is known locally as "Zero-10".

7.2. The regime is under-pinned by strong general anti-avoidance rules (GAAR) and is based on (i) the principle of non-discrimination between resident and non-resident owned companies; and (ii) the principle of tax neutrality combined with transparency. As an international finance centre, Guernsey facilitates the investment of funds drawn from around the world into European and other financial markets. The return to the investors should be taxed in their home country and the business activity generated by the investment should be taxed in the jurisdiction where that activity takes place. That is why Guernsey has given its full support for the transparency principles central to the current G20, OECD and EU tax initiatives.

7.3. Corporate income tax receipts are typically highly cyclical, increasing while the economy is performing well and decreasing in times of economic stress to a much greater extent than personal income tax. These taxes are an important part of most countries tax base but, because of their potential volatility and competitive nature, most countries gain more revenues from personal taxes and consumption taxes, which are more stable and less economically sensitive.

7.4. Prior to the introduction of Zero-10, corporate income tax accounted for approximately 23% of government revenues and up to 33% of tax revenues. Currently, corporate income tax (and distributions from companies) account for approximately 10% of total revenues and up to 13% of tax revenues. This is comparable to the OECD average of 10% of tax revenues being generated by corporate income taxes (data.oecd.org). Much of this lost revenue was replaced by increases in commercial TRP rates and increases in social security contributions from employers. Figure 3 shows the changes in total revenue collection from corporates over this period.

Figure 3: Total contribution from corporates at 2019 prices (incl corporate income tax, commercial TRP and employer contributions to social security)



7.5. Guernsey introduced Zero-10 in 2008 following the EU Code of Conduct Group (Business Taxation) (the 'Code Group') finding aspects of the previous regime harmful. It is therefore not possible to revert to the corporate regime that was in place before Zero-10, as this would not meet international tax standards, a key principle of the review.

7.6. Zero-10 was deemed compliant with the Code of Conduct in 2012, following the repeal of the deemed distribution element of the system with effect from January 2013. It was reviewed again in 2017, when the EU compiled its list of non-cooperative jurisdictions at which point Guernsey committed to the introduction of legislation on economic substance to meet the required standards to be deemed a co-operative jurisdiction. This was concluded in March 2019. As a third country in scope of this EU process, Guernsey's corporate tax regime is under ongoing monitoring requirements against these standards. In July 2019, the OECD's Forum for Harmful Tax Practices confirmed that, following its own review, it concurred with the EU's assessment that Guernsey's corporate income tax regime including the new economic substance regime, was not harmful.

7.7. In accordance with the States Resolution from 2015[4], the Policy & Resources Committee continues to monitor the appropriateness of the corporate tax regime, having due regard for the need to retain an internationally acceptable and competitive tax environment for the islands' businesses. Officers therefore monitor developments at the OECD and also developments with regard to the EU list of non-cooperative jurisdictions for tax purposes.

7.8. Most recently the EU Economic and Financial Affairs Council (ECOFIN has approved guidance on foreign source income exemption (FSIE) regimes, also known as territorial

[4] Billet d'État IV, of 2015 the Personal Tax, Pensions & Benefits Review – "To direct the Treasury and Resources Department, having due regard for the need to provide a stable platform, maintain business confidence, support and encourage financial services and to retain an internationally acceptable and competitive tax environment for the islands' businesses, to continue to closely monitor the appropriateness of the corporate tax regime, and to report back to the States should it consider any changes are necessary."

regimes, which acknowledge that they are a legitimate approach to prevent double taxation but identify potentially harmful elements that could be present in such regimes. It is understood that the Code Group has screened jurisdictions with FSIE regimes, and in May 2021 wrote to those jurisdictions from which it would seek commitments to repeal or amend their harmful FSIE regimes. This indicates that territorial regimes are subject to the same type of international pressure as the Zero-10 regimes employed by the Crown Dependencies.

7.9. The Code Group also concluded that Guernsey (along with Anguilla, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Isle of Man and Jersey) should extend their economic substance requirements to all relevant partnerships that were identified to fall out of the scope of existing legislation. Guernsey, together with Jersey and the Isle of Man, introduced relevant legislation that took effect from 30 June 2021.

7.10. Corporate income tax rates are under global consideration. The OECD has been working to establish a global solution to reform the international corporate tax framework, impacting how large multi-national enterprises (MNEs) are taxed around the world[5]. That framework is based on two broad work streams which seek to address issues that are linked to the increasing globalisation and digitalisation of the economy:

7.11. Pillar 1 aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest 100 (or so) MNEs which are the largest beneficiaries of globalisation. This will be achieved through the partial re-allocation of taxing rights to the market or user jurisdiction, broadly ensuring profits are taxed where the customers are based.

7.12. Pillar 2 aims to ensure that MNEs, those with group revenues of at least Euro 750m, pay a minimum effective rate of tax on their profits. This will be achieved through the imposition of a "top-up tax" on a parent company in respect of any of its subsidiaries where the jurisdictional minimum effective tax rate paid is not at least 15%, or an equivalent adjustment if the jurisdiction the parent company is in does not implement the Pillar 2 rules.

7.13. At the recent Inclusive Framework meeting in July, an overwhelming majority of jurisdictions (which included Guernsey) reached agreement on the proposals. Technical discussions will now continue, developing a detailed implementation plan by October. Guernsey continues to work closely with Jersey and the Isle of Man on this.

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[5] Highlights brochure: Addressing the tax challenges arising from the digitalisation of the economy, July 2021 (oecd.org)

7.14. The number of companies headquartered in Guernsey who would meet the criteria for an MNE under international rules is very limited. As technical discussions continue, it is not yet clear how these rules will be applied and therefore whether Guernsey would implement aspects of Pillar 2 that were not a minimum standard. Nor is it clear what the behavioural effects of the changes might be. As a result, the revenues which might be generated from the implementation of the OECD proposals are uncertain but they will be limited due to the scope of the OECD rules.

7.15. **The working assumption the Steering Group has used is that changes to the corporate income tax system may generate £10m a year of additional revenues.** Each option presented therefore assumes that £10m of the net gain in revenues, will be raised from changes to the corporate tax system.

7.16. In the longer term it may prove to be more or less than this figure if, for example, the rules are applied in such a way that some portion of the expected tax is paid elsewhere or if later discussions include the extension of the rules to include a wider range of companies. **It is therefore recommended that any implementation plans for other tax measures are flexible enough to allow for changes in the corporate landscape.**

8. Taxing Income

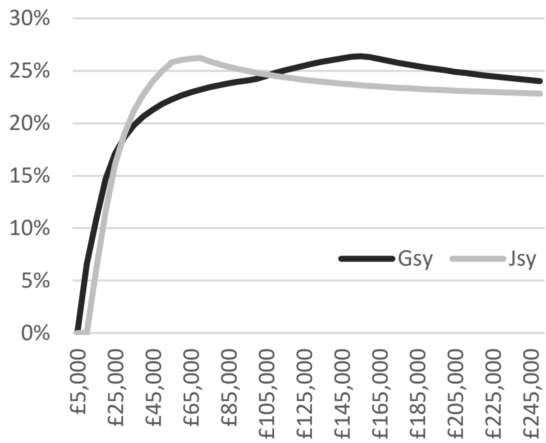
8.1. Income taxes are generally made progressive because of the availability of a personal allowance, which means people on lower incomes tend to pay less tax as a proportion of their gross income than those with higher incomes. In Guernsey, the phased withdrawal of allowances for those with an income over £100,000 makes it more so. However, as it does not have higher rates for higher earners, Guernsey's income tax system is less progressive than those applied in some other jurisdictions.

8.2. The structure of the social security contributions system is complex and discussed in more detail in section 8. At its inception it began as a broadly "insurance" based scheme with contributions liability capped at a level which approximated to the eventual benefit an individual might be expected to receive in the form of income replacement benefits (primarily a pension). The contributions for those not reaching this upper earnings limit were then "topped-up" by way of a grant from General Revenue.

8.3. The link between the upper earnings limit place on contribution and the value of expected benefits was broken when the upper earnings limit placed on contributions for both individuals and employers was increased between 2006 and 2013 from £36,000 to £132,000 (now £153,000). The grant from general revenue was then reduced which compensated for some of the revenues lost due to the changes to the corporate income tax structure. As a result, higher income individuals pay more into the scheme than they might be expected to receive in benefits from it and the insurance principle has been lost.

8.4. In general, for the majority of working age households, the system is proportional (that is people pay the same proportion of their gross income). Because contributions are subject to an upper earnings limit, above which you are no longer liable for contributions, the total tax and contributions liability for the top 2% of earners falls. However, because the upper limit on contributions in Guernsey is applied at £153,000 - much higher than in other jurisdictions (UK: £50,000; JSY £55,000) – this feature is less pronounced than similar schemes in the UK and Jersey. Overall, this means that Guernsey's current income tax and social security system is progressive to a higher level of income than in Jersey.

Figure 4: Income tax and social security contributions for a single adult (Guernsey and Jersey)



8.5. Approximately 75% of income taxes and contributions are paid by working age households. This means that Guernsey's revenues are particularly vulnerable to the ageing of the population**.** With the central projection, the reduction of the working age population as more people retire could place a downward pressure on revenues of as much as £30m a year by 2040. Increasing revenues from direct taxes on income increases this risk and may make Guernsey's finances more vulnerable to the ageing of the population and more reliant on maintaining (or increasing) the size of the working age population to sustain revenues.

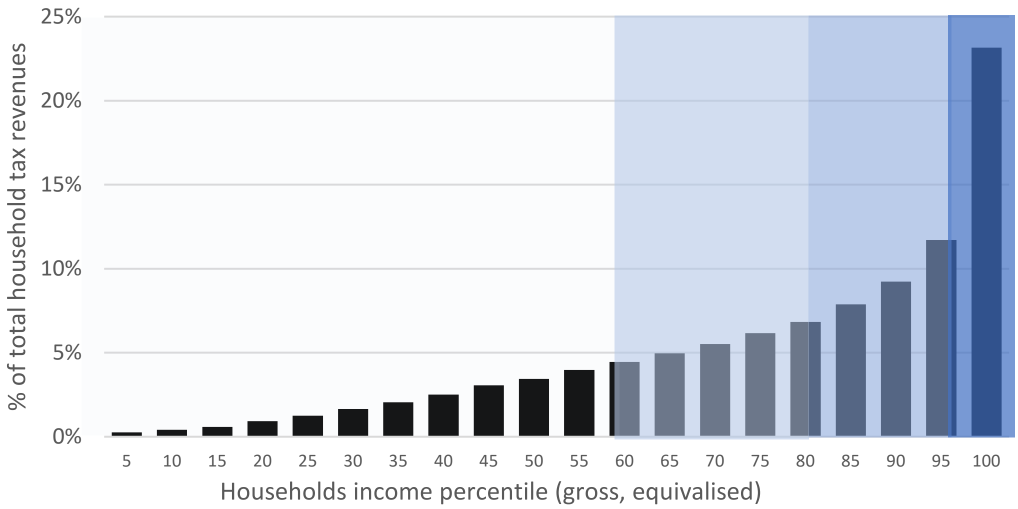
8.6. Solutions which focus solely on income (and particularly earned income) will rest more heavily on the younger members of the community. With cost pressures focused on provision of services for older people, this means a lot of the cost of providing services is transferred to younger generations. While generations are of equal size this is not a significant problem but, since the 1970s each generation has been progressively smaller than the one before. This means the tax burden can become increasingly focused on a younger household supporting a larger number of older people. This shift between generations, known as intergenerational equity, is a common theme in discussion around issues of ageing populations. This means that while income-based solutions may meet the principles of simplicity, transparency and progressiveness, their resilience to economic and demographic changes is less than other taxes.

8.7. The analysis provided in the appended report (Appendix 1) also suggests that income-based taxes are more likely to have a negative impact on employment and GDP in the short term, although the aggregate economic effects are expected to be temporary. The sectors most reliant on domestic consumption, primarily retail activity, are most likely to experience short term negative impact resulting from a loss of consumption as people have less money to spend.

8.8. Guernsey is also heavily reliant on the income from the top 5% of households (for a couple without children this means an income in excess of £150,000) who provide almost a quarter of household tax revenues.

8.9. The majority of households in the top 5% have been resident in Guernsey for at least 10 years. They are well established, employed largely in the Finance and Professional sectors and unlikely to choose to leave Guernsey if faced with moderate increases in their tax liability. However, there are a small group of households at the upper end of this group but without an income large enough to be protected by the tax cap who may be particularly sensitive to their tax liability. These households are highly mobile, tend to own businesses and employ staff which means that they have a significant economic value beyond their direct contribution to the tax base. Changes which increase the focus of the tax liability on this group increase the risk that it will be difficult to attract or retain the households in this group.

Figure 5: Distribution of tax revenues by Household income



Shaded areas each represent 25% of total houshold tax revenues

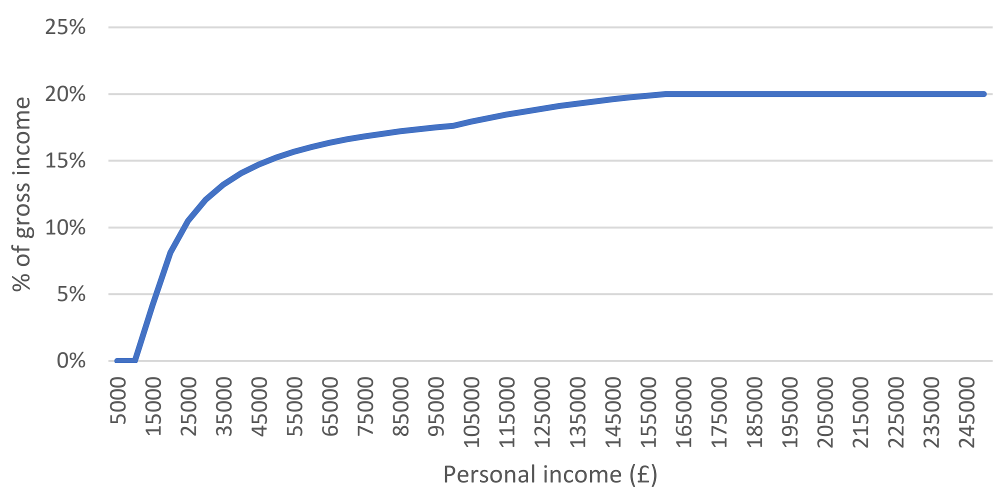
Income tax

8.10. Tax on personal income is Guernsey's primary source of revenues. Guernsey's existing system is very simple. It applies a single 20% rate to all income above an individual's allowances. These allowances are relatively few, and all are withdrawn at a rate of £1 for every £5 of income above £100,000 and primarily include:

- A personal allowance of £11,875.
    - This is transferable between married couples or couples with children.
- A charge of child allowance of £8,075.
    - Primarily available to single parents
- Mortgage interest relief.
    - In the process of a phased removal by 2025.
- Relief on pension contributions.
    - Provided up to a maximum of £35,000 of contributions per year

8.11. Tax liability in Guernsey is capped for very high-income individuals at £130,000 for non-Guernsey income and £260,000 for all income including that arising in Guernsey (excluding income from land and property in Guernsey which is taxed at 20% even when the tax cap is reached)[6]. A lower £50,000 cap is applied to qualifying individuals in Alderney between 2016 and 2025 and for individuals purchasing a qualifying Open Market property[7]. Between 30 and 45 individuals are subject to one of these tax caps in any given year.

Figure 6: Income tax liability by income for a single adult (% of gross income)



[6] Note that unlike the upper limit on social security contributions, which applies at a set level of earnings or income, the tax cap is applied at a set level of tax liability. For example, an individual subject to the £130,000 cap on their non-Guernsey income would be expected to have an income of at least £650,000

[7] [Tax Cap - States of Guernsey (https://gov.gg/taxcap)](https://gov.gg/taxcap)

8.12. The application of allowances and their withdrawal for higher earners makes the system progressive (those with higher incomes paying a larger percentage of their income), although the absence of higher rates for those with higher incomes mean it is less progressive than systems applied in some other jurisdictions.

Increasing headline rates

8.13. The headline rate of tax is one of the most well understood and transparent elements of Guernsey's tax system. Each 1% increase in the headline rate of income tax could raise up to £13m per year of additional revenues. As an approach to raising revenues an increase in the headline rate would perform well against the principles of simplicity and transparency and would retain the same progressive profile of the current tax structure.

8.14. It performs less well against the principle that the tax base should be resilient to demographic change and economic shocks, given that it further focuses revenue raising in Guernsey on to income-based taxes and intensifies Guernsey's reliance on its working age population. It also has greater potential to create larger short-term impacts on employment and GDP growth than other measures (Deloitte LLP, August 2021). The loss of some take home pay by employees, and the resulting reduction in consumption implies this has the potential to impact the retail sector.

8.15. The loss of the 20% headline rate, which would place Guernsey out of step with its closest comparators, also has the potential to impact Guernsey's ability to attract employees with key skills from outside the jurisdiction.

8.16. These impacts are less obvious than the impact that a consumption tax may have on inflation and more difficult to mitigate.

Higher rate tax banding

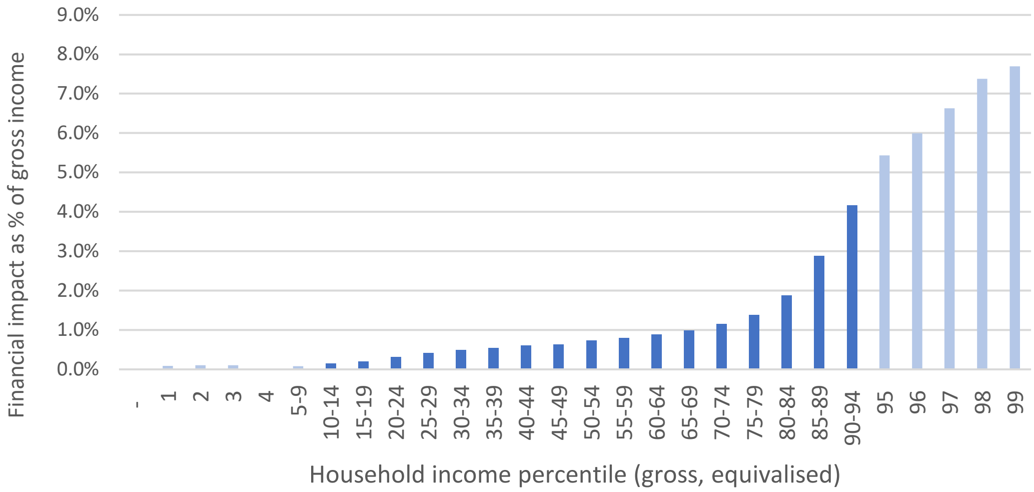
8.17. Higher rates of tax for income above a threshold level are common in larger jurisdiction but are not currently applied in Guernsey or Jersey. In the Isle of Man, the headline rate of tax is 10% with a 20% rate applied as a higher rate. The two other benchmark jurisdictions examined in the appended report both apply higher rates. In Luxembourg rates range from 0% to 42% in a series of narrow tax bands, the highest being applied to income above €200,004 (about £170,000). In Singapore rates scale to a maximum marginal rate of 22%, on income above 320,000 SGD (about £170,000).

8.18. Higher rates on income above a threshold level would make Guernsey's tax system more progressive. However, because such increases exclude a significant proportion of income the capacity to raise revenue from such structures is much lower than increases in the headline taxes. This means that to raise the same revenues the increased rate applied would need to be three or more times as large.

Figure 7: Estimated revenue raised by each 1% of tax on income above threshold value

Higher rate threshold	Revenue generated by 1% additional tax rate
£50,000	£5.0m
£60,000	£4.0m
£70,000	£3.5m
£80,000	£3.1m
£90,000	£2.7m
£100,000	£2.4m
Increase in headline rate	£13m

Figure 8: Impact of higher earners rate: 30% above £60,000 (raising approximately £40m)



8.19. As a result, to raise significant revenues from a higher tax band would require higher marginal rates than the Steering Group believe would be appropriate for Guernsey when combined with the high limit on social security contributions and the withdrawal of allowances for higher earners. For illustration a 30% rate on income above £60,000 would raise about £40m. Such a structure would focus more than half of the additional revenue raised into the top 5% of earners, making Guernsey increasingly dependent on this group while potentially undermining Guernsey's ability to attract or retain employees to senior positions. **Based on the above factors, the Steering Group does not propose the introduction of higher earners rates.**

Tax allowances

8.20. As a mechanism for raising revenues tax allowances are a poor option. Guernsey could raise significant revenues from removing or lowering the personal income tax allowance, but to do so would be a highly regressive step. Tax allowances have a better role in increasing the progressiveness of the system and acting as part of a package of measures to balance the distribution of impacts across the community.

8.21. Increases in income tax allowances are generally most beneficial for middle and lower middle-income earners, with sufficient income to be liable for taxes, but whose income is low enough that the reduction in their tax liability represents a meaningful portion of their income.

8.22. Changes to the scheme to withdraw tax allowances from those with an income above £100,000 has some limited capacity to raise additional revenues either by changing the threshold or rate (currently £1 in £5) at which these are withdrawn, but the scale of available revenues from this area is not sufficient to be considered as part of the structural reforms discussed in this report. Reducing the threshold to £90,000 or £80,000 is estimated to raise £0.7m or £1.6m respectively. This may be an option Members may wish to consider as part of the annual budget process.

Social Security Contributions

8.23. The social security contributions system as it exists today has evolved over time as a result of successive changes, each independently justifiable, but which in succession have resulted in some marked inequities.

8.24. At present people with different employment classifications and income sources are assessed differently for contributions. Some people are assessed on only their earned income, while others are assessed on all income and some benefit from an allowance (like the personal income tax allowance), but most do not.

Figure 9: Overview of current Social Security Contributions structure

	Employee	Self-employed	Non-employed	Over SPA
Initial payment threshold	£7,696	£7,696	£19,240	£19,240
Allowance	-	-	£8,695	£8,695
Tax on employed/SE income	6.6% (plus 6.6% from employer)	11.0% (part of which represents a contribution as their own employer)	n/a	3.4%
Tax on unearned income	0%	0%	10.4%	3.4%

8.25. The result is a system where people with the same income can pay markedly different amounts depending on their personal circumstances. For example, if an individual has £50,000 of income, the following social security would be payable depending on the type of income:

- All of it is employed income: £3,300 (+£3,300 from employer)
- £10,000 employed, £40,000 unearned: £660 (+£660 from employer)
- All of it is unearned: £4,300
- All of it is self-employed: £5,500
- Over State Pension Age: £1,400

8.26. These differences had a basis in differing entitlements and had justification when the basic insurance principle was still in place. However, subsequent changes, including the increase in the upper limits on contributions and the addition of more universal benefits, mean the justification for such significant variances has been largely lost. Benefits for which entitlement might vary based on someone assigned contributions class cover about 12% of the total annual cost of benefits and services supported by contributions. The potential discrepancy in liability is far greater than this.

8.27. The lack of an allowance also creates very high marginal rates as individuals pass the initial payment threshold. For example, an employed person earning £641 a month would have no contributions liability. However, just £2 more and they would face a 6.6% liability on their entire earnings of more than £40 for that month. The number of people this affects is limited but it can be an issue for those in part time or casual employment if their income tips over the threshold in a given pay period.

8.28. Furthermore, the difference in the treatment of employed and non-employed, people means that those living off a private income (such as rental income) are able to protect their private income from liability by engaging in just enough employed work to qualify as an employed individual. This is believed to be relatively common practice among people who choose to retire (or semi-retire) before they reach the State pension age.

8.29. There are two extant resolutions to look at issues around equity of the system (Billet d'État VI, April 2015) (Billet d'État X, June 2019). Resolving these issues is expensive, but there is a unique opportunity to address them as part of a wholesale restructure of the tax system making it fairer and easier to administer. The actuarial reviews of the Guernsey Insurance and Long-Term Care Funds suggest that if funded in full an additional £34m of revenue is required to make these sustainable. To raise further revenues from a scheme known to have such inequities only exacerbates these issues. **The Steering Group is recommending that all options being put forward include a restructure of the contributions system.**

8.30. The restructure could:

- Give all contributors (not employers) an allowance aligned with income tax.
- Charge all individuals below pension age the same "personal" rate on both earned and unearned income, with a reduced personal rate for those over pension age (reflecting that they no longer need to contribute to a pension but are typically the largest users of health and care services).
- Apply a reduced "employer" contribution to self-employed income[8].

[8] This is necessary to reduce attempts to avoid contributions by making employees self-employed contractors to reduce liability

8.31. Employers' contributions make up 43% of social security contribution revenues. Increases in the contribution rates charged for employers from 6.6% to 7.5% has been included in the options presented. This is in line with a general policy applied in relation to social security system that where appropriate the cost should be split between employers and employees. It also contributes to a more even balance of the revenue raised between households and corporate entities.

8.32. The application of the allowance would make the system more progressive, but costs £19m in isolation – so an increase in the rate charged is needed to bring the system to a net neutral position. At the current value of the tax allowance the personal rate needed to make this net neutral rate is about 8% (compared to the current 6.6% for employees), if combined with the increase in the employers rate to 7.5. Once restructured it is possible to raise revenues in a more progressive manner than from the existing system. However, because the current system favours some groups, there are cohorts who will benefit while others will be disadvantaged by the proposed changes.

8.33. In the absence of raising more revenues, the resulting system may change the liability of the individual used in the example as follows[9]:

Figure 10: Comparison of liability before and after restructure

Personal rate 8% (4% if over pension age), employer rate 7.5% (5% for self-employed), allowance alligned with personal income tax allowance

Income composition	Current liability (figures in brackets represent employer contribution)	Liability after restructure (figures in brackets represent employer contribution)
£50,000 employed income:	£3,300 (+£3,300)	£3,050 (+£3,750)
£10,000 employed, £40,000 unearned:	£660 (+£660)	£3,050 (+£750)
£50,000 unearned income:	£4,300	£3,050
£50,000 self-employed income:	£5,500	£3,050 (+£1,906)
£50,000 income over State Pension Age	£1,400	£1,525

8.34. In general, the following groups will be benefited:

- Low- and middle-income employed and self-employed individuals without any significant other sources of income.
- Non-employed individuals below State Pension Age with an income of more than £19,240.

[9] This example assumes: an 8% personal rate, a £7.5% employer rate (5% if self-employed), an allowance aligned with the current personal income tax allowance (not applicable for employers)

8.35. The following may pay more:

- Higher income individuals of all classes.
- Pensioners with an income between the proposed Personal Income Tax Allowance and the current £19,240 threshold for liability.
- Middle- and higher-income pensioners.
- People who have significant non-earned income but have sufficient employed or self-employed income to meet these definitions (usually semi-retired).

8.36. **All three options presented include restructured contributions. These either maintain or increase the total net revenue from contributions.**

8.37. The Steering Group considered whether it would be appropriate to apply a reduced rate charge (up to 2%) to individuals' income above the upper earnings limit, as is done in the UK. Given that Guernsey's upper earning limit (£153k) is already high relative to similar schemes this would impact only the top 2% of earners raising approximately £2-3m.

8.38. This would be similar to the UK approach where a reduced Employee National Insurance rate of 2% is applied to earning above the upper earnings limit of £4,189 a month (£50,270 a year). **However, given that the extension of contributions to cover all income and the increase in the rate will impact the liability of this group, the Steering Group is not recommending this.**

8.39. In relation to employer contributions, it is noted that in both the UK and Jersey employers are liable for contributions above the UEL. In Jersey employers pay a 2.5% rate on earnings between approximately £50k and £250k. In the UK no limit is placed on employer contributions. In doing so the overall contribution from higher value employment is increased without placing this liability on individuals directly.

8.40. Removing the UEL on employer contributions in Guernsey (potentially transitioned through reduced rates above the UEL) is an option, although because the UEL is already high its potential to raise revenues is limited to £2-3m. This would create a moderate increase in the cost of employment for those employers with very high salaried posts (in the top 2%). These are expected to be concentrated in the finance sector and professional, business, scientific and technical activities.

8.41. There is limited justification for restricting the contribution from employers for only the top 2% of employees and **the Steering Group is recommending that a removal of the UEL for employers be included within the restructure of contributions.**

Health Taxes

8.42. Health taxes, as presented in the context of this report, are another form of tax on income but issued with a specified purpose. They are not common, but Jersey opted to fund their long-term care scheme in this way which allowed them to create benefit from the progressive nature of their income tax system, while enabling the charge to be hypothecated in the same way their social security contributions are.

8.43. Guernsey already operates a long-term care scheme and provides part of its health funding through the social security system. However, these are collected as part of the total social security contributions and subject to the weaknesses of that system describe previously.

8.44. Given the extent to which the immediate and longer-term pressures arise from the provision of health services, the presentation of additional income-based taxes as a health tax might be appropriate. However, health and care services in Guernsey cost more than £200m a year, any health tax applied would only fund the incremental costs of services – most of the cost of the services would continue to be funded through general taxation.

9. Taxing Consumption

9.1. GST revenues are generally relatively stable and more so if they are applied with a broad base and low rate as they are in more modern schemes such as that in Jersey. In Jersey GST receipts for 2020 proved more resilient to the economic stress caused by COVID-19 than personal income tax receipts (States of Jersey; Annual Report, 2020). The reverse was true in the UK (www.statista.com) although to some extent this may reflect the UK's decision to reduce VAT rates on hospitality services to 5%. Jersey offered the option for firms to defer payment during 2020 and issued stimulus vouchers but these appear not to have impaired receipts significantly.

9.2. Because the tax is applied when money is spent, it applies equally to those who support their spending with savings or capital (typically those close to or above pension age) and those who are spending income as they earn it (typically younger people). As a result, the distribution of the tax across the generations is more even than taxes on income. It also raises revenues from the spending of visiting tourists and other non-residents.

9.3. However, a GST will create a short-term pressure on the inflation rate because it will increase prices. As modelled, the overall impact on the headline RPIX is estimated to be approximately 60% of the headline rate charged (about 5% for a GST at 8% or 3% for a GST at 5%).

9.4. Because those with lower incomes tend to save less and spend more of their income on taxable products within the jurisdiction than wealthier people, this inflation effect tends to rest more heavily on lower income households. This means a GST would tend to be regressive at low incomes. That is, as a percentage of gross income, low-income households would tend to pay more in tax. As a result, those jurisdictions who have introduced a GST in recent years, including Jersey (2008), Singapore (1994) and India (2017 GST replacing a raft of other taxes), have done so with a range of mitigating measures to protect low-income households.

9.5. GST also requires additional administration by both government and businesses. This can be limited by careful design: a high registration threshold, limited exemptions and Zero rating and a single rate.

9.6. The various design elements considered are covered below. These are important because they can significantly change how the application of the tax affects different households and businesses. The full details of what these would look like will be a key part of any further development stages.

Taxable Goods

9.7. The GST modelled in this report is based on that applied in Jersey (which itself was based on that applied in New Zealand). Unlike VAT applied in the UK and most European regimes, this works on a low-rate/broad base principle. The system has very few exemptions or zero-rated items, the primary of which are rents and mortgages and financial services (exempt) and exports (zero-rated). This creates a highly efficient system which creates limited distortions in people's purchasing decisions, which is economically desirable. The literature review presents evidence that the New Zealand GST, on which Jersey's system is based, is twice as efficient as the VAT system in place in the UK (Appendix 1).

9.8. The broad base reduces the complexity of accounting, removing the need for most businesses to identify what portion of their supplies need to be allocated to taxable and non-taxable goods. It also generates less appeals because the boundaries between what is and is not taxable is clearer. This creates a system which is simpler for both government and businesses to administer and less open for challenge.

9.9. The exclusion of items such as food from the tax is generally considered to make it less regressive because low-income households tend to spend a larger proportion of their income on food. The exclusion of food from a GST at 8% (as presented in option 2) could reduce the impact on low-income households by between 1% and 1.5% (or between 0.6% and 0.9% for a 5% GST) compared to 0.3% to 0.6% for higher income households.

9.10. However, excluding food would reduce the expected revenues by about 13%. The rate on everything else would therefore need to increase to recover the lost revenues (to 9.2% from an 8% GST or to 5.7% from a 5% GST). Once this increase in the tax on other items is incorporated the net benefit to the lowest income households is estimated at less than 0.2%.

9.11. The gain for low-income households is therefore limited relative to the added complexity of administering a greater number of exemptions and the loss of economic efficiency. Increases in tax allowances, the restructure of the social security contributions system, increases in benefits and other measures specifically targeted at low-income households are more effective at reaching lower income households and could do so without complicating the administration of the system.

9.12. A suite of mitigation measures is included in the options presented in this report including;

- reductions in tax and contributions for lower income households by way of the restructure of the social security contributions system and/or an increase in personal allowance which are most beneficial for lower and middle-income households;
- Pre-emptive adjustments to the States pension which will bring forward the normal inflation linked increase in the pension by up to 12 months;
- Pre-emptive adjustments to Income Support at a level above the estimated impact on inflation reflecting the greater impact on lower income households; and
- Cost support schemes specifically targeted at reaching low-income households who are not eligible for Income Support.

9.13. In consultation with representatives in Alderney, concern was raised that because goods are believed to be more expensive in Alderney than in Guernsey, any consumption tax would have a greater impact in the smaller island. Work is planned for the next stage to establish the price gap between the two islands so this concern can be examined in more detail.

Registration Thresholds

9.14. One of the key criticisms of GST schemes is that some of the cost of collection falls on businesses. The literature review conducted suggests that this is higher in the first year, when new processes are needed to administer the GST (estimated at up to 3% of turnover) but should reduce to an average of less than 1% of business turnover after the first year.

9.15. Inevitably the complexity and burden of administration is different for different businesses. For smaller companies, without internal accounting functions and sophisticated systems it is likely to be more challenging than it may be for larger companies. A compulsory registration threshold can be applied to manage this, removing smaller businesses from the need to collect GST on their sales (although they would still need to pay GST on their supplies). As well as benefiting small businesses a higher threshold can make the government administration simpler by reducing the number of returns.

9.16. In the UK the registration threshold is set at £85,000. Jersey opted to introduce a much higher threshold at £300,000 to limit the administrative impact on smaller businesses. It is estimated that a similar threshold applied in Guernsey might exclude between 30% and 50%[10] of businesses from being required to register. Those businesses not required to register would be subject to GST on any taxable supplies, but they would not be obliged to charge GST on their sales, complete quarterly returns or make any remittance to the States. This removes any administration requirements for smaller businesses although the increase in supply cost is likely to impact their prices.

[10] These estimates are based on the submission of claims to the Covid Business support scheme which may over represent small businesses and are therefore presented with a wide range

Import De Minimis and Taxing Online Purchases

9.17. Another concern with a GST is the potential for people to evade the tax by purchasing online. The application of the tax to personal imports is therefore important.

9.18. The collection of tax on personal imports is relatively labour intensive. As a result, there is a tipping point at which the tax costs more to collect than the amount it generates. Jersey originally introduced a relatively high de minimis value (the value below which the payment of GST on imports is not compulsory) at £240. This caused issues with the importation of white goods and electronics and the value has subsequently been reduced to £135 in line with the UK VAT de minimis.

9.19. The feedback in Jersey is that the tax is still cost effective to collect at this level and there may be potential to opt for a lower level than this in the design stage when the administrative cost of collection is clearer.

International Services Entity (ISE) Fee

9.20. The International Services Entity Fee is an unusual feature of Jersey's GST. Financial services are exempt from almost all GST and similar systems because the transactional nature of the business makes it too complex to administer efficiently[11].

9.21. In a finance sector like Guernsey's this is of greater consideration because most financial services are exports provided to non-resident beneficiaries. Exports are almost always Zero-rated. This means businesses charge 0% GST on their services, although are still required to register and file quarterly GST returns if their turnover of taxable goods exceeds the registration threshold. They would then claim back any GST paid on their inputs in their quarterly return. For financial service providers administering many separate entities, completing quarterly return and reclaiming GST on their inputs could be time consuming and costly.

9.22. To simplify matters, Jersey offers an optional scheme in which an ISE can pay a fixed fee to be issued with an End User Relief Certificate (EURC). Suppliers providing goods and services to a company or other entity with a valid EURC would not charge GST. Registered ISE's are then not required to register for GST in the normal way, relieving them of the administrative burden of completing quarterly returns[12].

9.23. As well as providing a significant reduction in administration costs for financial service providers this reduces the number of quarterly returns to be processed by the administering body. Further details of Jersey's scheme are available at About International Service Entities (gov.je)

[11] For example, a large proportion of retail banking profits are not made directly from the provision of services to their consumers, but from the interest rate differential between deposits and loans. A service has been provided, turnover is generated, but no "sale" has taken place which would be easily taxed.

[12] A light touch portal for ISE's to reclaim any GST that they do incur is provided online

9.24. Applied in a similar manner to Jersey it is estimated that an ISE scheme of this nature would raise approximately £6m.

10. Other Taxes and Considerations

TRP

Domestic

10.1. In 2015 a decision was taken to apply a policy of above inflation increases in domestic TRP which would seek to double TRP rates in real terms over 10 years (Billet d'État VI, April 2015). At the time TRP rates were exceptionally low relative to the UK and Jersey. This would have reached completion in 2025, but the decision was made in the 2021 budget to pause this policy given the economic conditions at the time.

10.2. In the 2019 budget, proposals were agreed to introduce a tiered system of TRP which would apply higher rates on larger properties. These changes were implemented in two stages in 2018 (on the largest properties with a TRP above 400) and 2019 (on properties with a TRP above 200). The introduction of these tiers has made the TRP system more progressive (to the extent that the size of a property owned is related to someone's income) but also means that for those in the higher tiers the increase in their rate may significantly exceed the targeted two-fold increase over 10 years.

10.3. Despite the stability of TRP revenues (which are among the most predictable in the current suite of revenues raised), as a measure to raise very significant level of revenues, domestic TRP is not considered an appropriate option. To raise £10m it would be necessary to raise rates by as much as 100%, which is not palatable given the increases already made. Any potential revenue raised from domestic TRP is therefore of a scale more appropriate for consideration in the annual budget process.

Commercial

10.4. Commercial TRP rates have also undergone significant changes in recent years. Commercial rates were increased very significantly between 2007 and 2010 as one of the measures employed to recoup some of the revenue lost in the move to Zero-10.

10.5. Subsequently further changes have been made, the most significant of which is the transition to move all office accommodation to the same rate as regulated finance begun in 2019. Once complete this will have increased the rates for this group by approximately 200% raising a total of approximately £4m.

10.6. Again, this quite clearly illustrates the scale of increases required to raise significant amounts of revenues, which make it an inappropriate choice for a primary revenue raising measure, although it may be appropriate to consider as a budget measure.

Excise Duties and Duty Free

10.7. Excise duties present challenges as a revenue raising measure, since (regardless of their original intent) their modern application is a way of discouraging damaging consumption behaviours and recognising the cost of these to the community or environment. Environmental taxes, more broadly present similar challenges when considered solely for revenue raising.

10.8. Like other taxes the potential gains available are limited - excluding motor fuels, excise duties raised a total of £24m in 2019[13]. They are further limited because increasing them to any significant extent may reduce consumption and erode the financial gain. This means that while they may be an effective lever in helping to manage negative behaviours, and may be appropriate if considered in that context, they offer little sustainability as revenue raising measures.

10.9. An amendment was laid to the 2021 Budget: "To direct the Policy & Resources Committee to include consideration of the impact of duty free on its review of the tax base."

10.10. 2020 was an exceptional year for excise duty receipts, with revenue driven upwards by a combination of some known and significant stockpiling of goods (tobacco products) ahead of the end of the Brexit transition period in January 2021, the lack of access to duty free products because of the travel restrictions in place and an apparent increase in alcohol consumption among the local community when under lockdown restrictions.

10.11. These effects are difficult to disaggregate, and the effects seem to be different across different excise streams. This makes any accurate estimation of the impact of the lack of access to duty free difficult, but it is likely that there has been some positive impact on excise revenues in 2020. Estimates suggest a maximum of £5m but in reality, it is likely to be considerably less.

10.12. The impact on excise revenue for beers and ciders appears very limited. The impact on wines and spirits appears greater, with a combined maximum impact of £1.7m and the largest impact may be on tobacco products with a maximum impact of £3m.

10.13. This implies there may be some limited potential for raising additional revenues by reviewing access to duty free, and there are potentially public health grounds to support this approach.

10.14. Guernsey is subject to a treaty obligation under the Kyoto Convention and this forms the basis for Guernsey's current allowances. World Customs Organisation's Revised Kyoto Convention contains a series of standards which all contracting parties must

[13] Revenues in 2020 were distorted by a combination of stockpiling ahead of the close of the Brexit transition period and the disruption to travel and spending habits caused by COVID-19

incorporate into their National Customs legislation. The Convention standards are further supported with recommended practices.

10.15. Annex J of the Kyoto Convention concerns standards and practices relating to travellers. Chapter 1, paragraphs 16 and 17 cover recommended practices concerning Duty Free Goods which sets out the minimum recommended allowances:

Recommended Practice:

The quantities of tobacco goods, wine, spirits and perfume allowed to be imported free of import duties and taxes by travellers should be not less than:

- *200 cigarettes or 50 cigars or 250 grams of tobacco, or an assortment of these products of a total weight not exceeding 250 grams;*
- *2 litres of wine or 1 litre of spirits;*
- *¼ litre of toilet water and 50 grams of perfume.*

10.16. These are recommended practices, not requirements so there is some freedom for jurisdictions to vary from these. With regards to wines and spirits these recommendations are applied consistently in the majority of OECD countries at or above the recommended levels. There are a small number of exceptions where lower limits are applied including Canada (1.5ltr wine or 1.14ltr spirits) and some island jurisdictions such as St Lucia, Barbados and BVI.

10.17. There is greater precedent for lower allowances (or no allowance) to be applied on tobacco products on public health grounds, but generally not on the grounds of raising revenue. Examples include Singapore (no allowance), Australia (25 cigarettes) and New Zealand (50 cigarettes).

10.18. The Committee *for* Health & Social Care has previously noted the potential to review the allowance on tobacco products for public health grounds although this is not prioritised in the Combined Substance Use Strategy 2021-2026. There may be some scope to revise duty free allowances, however further investigation is required to ensure that moving to a position where duty free allowances are set below the levels recommended by the Kyoto convention is compatible with Guernsey's Customs Arrangement with the UK Government and its inclusion in the UK's WTO membership.

10.19. It should also be noted that any changes to duty free allowances will also need to consider the potential impact on the commercial carriers, who sell much of the duty-free goods brought into Guernsey.

10.20. This could be progressed further, but it is not a priority for the Tax Review. If there is a desire to progress this, engagement should be sought with the Committee *for* Health & Social Care, the Committee *for* Home Affairs, the States' Trading Supervisory Body, and the relevant UK government agencies.

Motor Taxes and Distance Charging

10.21. The States is under the following Resolutions in relation to motor taxes:

1. To agree, in principle, that a distance charging mechanism should be introduced as soon as possible and direct the Policy & Resources Committee to report back to the States with detailed proposals to introduce a distance charging mechanism.

2. To note that the Policy & Resources Committee intends to use its existing delegated authority to approve funding from the Budget Reserve to carry out further detailed research and a pilot exercise / trial to collect comprehensive data which could be used to calculate and model an appropriate charging structure for a distance charging mechanism, together with an assessment of the effect of any potential changes in behaviour.

Billet D'État XIII, July 2019

10.22. The pilot project to look at suitable mechanisms for applying distance charging was deferred at the outbreak of COVID-19 . The original direction was given to the Policy & Resources Committee, discussions are underway but discussions are underway for the Committee *for the* Environment & Infrastructure to progress this.

10.23. The need for an alternative to fuel duty has increased. Previously the gradual decline in motor fuel sales has been primarily been driven by advances in the fuel efficiency of internal combustion engines (ICEs), but globally the sale of Electric Vehicles (EVs) has accelerated, and Guernsey would appear to be no exception. Without any form of tax on motoring other than that on motor fuel the tax contributions from such vehicles is currently limited to their first import duty.

10.24. At present the direction for this workstream is to design a net neutral solution which raises a similar amount to the current structure in a more sustainable way. As that policy is advanced it may be appropriate to consider whether that position is still supported.

Online Taxes

10.25. The issue of an online tax was raised with Steering Group members by external parties and some investigation has been undertaken to test its feasibility. It was raised in response to the UK call for evidence on Business rates which suggested that such a tax might be used to balance the perceived unfairness between the business rates payable by those operating from prime retail outlets relative to those providing online retail based in less expensive locations. Alternative suggestions include a fee chargeable on parcel delivery which could support the cost of disposing of packaging.

10.26. For Guernsey the idea is superficially attractive in that it provides an opportunity to address competition from online retailers, but in reality that in itself poses an issue.

10.27. In November 2018, the State of Guernsey signed a Customs Arrangement with the UK Government (here). The Customs arrangement was agreed to ensure that at the point the UK left the EU, the customs arrangements between Guernsey and the UK were protected. The agreement primarily ensures the Bailiwicks customs arrangement is correspondent with the UK scheme and avoids a hard border between the UK and Guernsey for the trade in goods. Paragraph 4 of the Agreement ensures that no arbitrary import duty, or other levy, (having equivalent effect relating to the movement of goods between the UK and Guernsey) shall be applied. It could be considered that a levy on online purchases or on certain postal packages destined from the UK to Guernsey and applied to domestic/personal packages at the border would be considered as a customs duty and therefore the Islands would not be compliant with the Islands customs arrangements which forms the basis of both our domestic and international trading relationships. Without such an agreement, the islands would potentially face a 'hard' border for all goods trade between UK-Guernsey.

10.28. Further, The UK's World Trade Organisation (WTO) Membership was extended to the Bailiwick on 1st Jan 2021. There are 164 countries that make up the WTO, whose primary functions include negotiating international trade negotiations, and administering and presiding over international trade disputes and reviewing countries compliance with WTO rules. It is the international trade rules developed at the WTO which form the basis of global Free Trade Agreements (FTA). As part of the Bailiwicks WTO obligations, the Island is required, amongst other international trade principles, to adhere to the Most-Favoured-Nation (MFN) and National Treatment (NT) commitments. The NT Principle applies to goods movements and in particular market access and cross border movement of goods. The MFN obligation requires that where countries agree to provide preferential market access provision or reduced barriers to trade, these concessions and privileges will be granted to all other WTO member countries and denotes equal access to all countries.

10.29. The NT and MFN obligations do not stop countries from applying taxes as they see fit, but they have to align with appropriate policies and must be applied in an open, fair and transparent manner. Failure to meet these obligations would be internationally challengeable at the WTO through either a trade review or directly by a partner country. Therefore, should Guernsey consider that a taxation at the border be applied either as an "online" tax or to postal or Express Delivery Services (EDS) packages destined for personal customers/consumption, this would be discriminatory and non-compliant with the MFN/NT principles. To achieve compliance, any taxation would have to be applied to all goods, including those destined for personal or commercial use irrespective of their origin (including domestic goods) or destination and aligned to appropriate policies which meet both our International and UK obligations.

10.30. If the States of Guernsey did apply taxation on Postal services and EDS, for domestic/personal packages, this would be considered a technical barrier to trade, and trade distorting. The result would be that Guernsey would have to declare this non-compliance to trade partners, which could put Guernsey inclusion in the UKs FTAs at risk, potentially leaving Guernsey subject to unfair and restrictive trade barriers on export which are applied to non-FTA countries.

10.31. While such charges could be considered quasi-environmental charges, relating to the potential cost of disposal of packaging, this would be less likely to be a cause of concern if it was applied at the point of disposal rather than at the point of import.

10.32. The UK introduced a Digital Services Tax (DST) in April 2020 which is turnover tax of 2% tax on the revenues of search engines, social media services and online marketplaces which derive value from UK users. However, the longer-term future of the DST is subject to international agreements within the context of the OECD/G20 work to reform the international corporate tax framework and will need to be removed as part of the unified approach. The UK have delayed any further discussion around the potential introduction of an Online Sales Tax (OST), which would be based on revenues like the DST model, until the Autumn in anticipation of further information on the international position being made available.

10.33. If the UK were to introduce an online tax and create a precedent for it this may change but given that Guernsey does not have the same domestic drivers to address a perceived imbalance in the internal application of business rates, it would still be difficult to argue that the intent of such a tax is not to discriminate in favour of local businesses at the expense of external trade partners.

10.34. Administratively, such a tax also comes with some of the same administrative challenges as a GST- in particular the need to increase the resources dedicated to the Border Agency, who would be responsible for collecting taxes on imported goods. The much narrower application of the tax means that revenues are likely to be much smaller than a GST, making its collection expensive and inefficient.

10.35. **The Steering Group cannot recommend progressing this idea further. If the UK do opt to move in this direction it may be appropriate to reconsider.**

Other Matters Discussed

10.36. In the course of discussions, the Steering Group also discussed options beyond public service reforms which might mitigate the need to raise revenues to some extent. These included discussions about whether there may be flexibility in some of the benefits provided via the Social Security Funds to reduce the required revenues. Possibilities raised by the President of the Committee *for* Employment & Social Security include a review of the eligibility criteria for the Long-Term Care Scheme to require a greater period of residency (already being progressed by that Committee), and investigation of whether a supplementary pension for lower income households might be a mechanism by which the uprating policy of the scheme as a whole might be reduced, lessening the pressure on the Guernsey Insurance Fund.

10.37. The Steering Group supports these investigations as contributing to the overall financial wellbeing of the island.

11. Options to be Considered

> **Notes on the data:** The analysis presented in this section is based on the Rolling Electronic Census which includes real data about households' incomes and other circumstances. The full data set covers all households in Guernsey, but the impact analysis is based on households whose circumstances have been consistent for the reported tax year. Other exclusions have been made where it is evident that income data is missing or otherwise doesn't represent a household's real circumstances.
>
> The final data set used for impact analysis covers more than 17,000 households and has been used to support the design of both tax and mitigation measures. A selection of real example of the application of the three options is presented in appendix 2. Appendix 3 provides a definition and explanation of income equivalisation and a translation of income percentiles into household incomes for different household compositions

11.1. Having considered the available options, the Steering Group is presenting three options for consideration. These options comprise a suite of proposals, combining various elements into what the Steering Group feel could be a workable way to address the issues presented. They are not, and could not be, exhaustive, but they present a range of approaches which could form a target model for ongoing fiscal policy to work towards.

11.2. Each option presented would result in a similar net gain in revenue (between £70 and £75m). Each assumes that £10m of this will be raised from changes to the Corporate tax system. Furthermore, the restructure of contributions included in all three options incorporates increases in employer contributions and the removal of the UEL for employers which distributes the burden of additional revenue raising between the corporate sector and households.

Option 1: an income only approach

- Focuses on revenue raising from income based sources and incorporates a 3% income-based health tax.
- Raises £20m with a 9% personal rate within a reformed social security contributions system; an allowance aligned with the personal income tax system; an increase in the employer's rate to 7.5%; and, removes the UEL for employers.
- Assumes that £10m of revenue might be generated from changes to the corporate tax structure.

Option 2: A GST approach

- Focuses primarily on a GST increasing over a number of years to 8%.
- Increases personal income tax allowance to £14,000.
- Includes a broadly net neutral restructure of the contributions system with an 8% personal rate; an allowance aligned with the personal income tax system; an increase in the employer's rate to 7.5%; removes the UEL for employers; and, assumes that £10m of revenue might be generated from changes to the corporate tax structure.

- Diverts up to £4m of the revenue raised to further measures to mitigate the regressive impact of the GST including a pre-emptive increase in the States Pension at the expected rate of inflation (up to 12 months ahead of normal policy); a pre-emptive increase in income support rates above the expected rate of inflation; and, a cost support grant intended to reach low-income households who do not benefit from Income Support.

Option 3: A combined GST and income approach

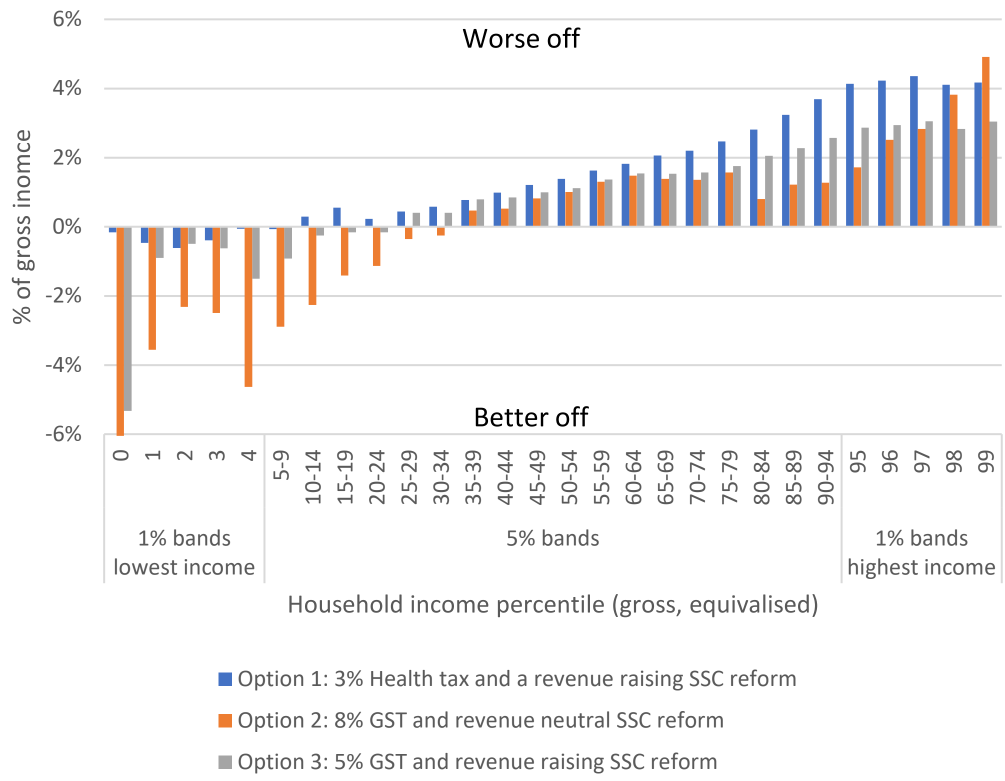
- Applies GST increasing over a number of years to 5%.
- Increase in the personal income tax allowance to £12,700.
- Raises £17m with a 9% personal rate within a reformed social security contributions system; an allowance aligned with the personal income tax system; an increase in the employer's rate to 7.5%; and, removes the UEL for employers.
- Diverts up to £4m of the revenue raised to further measures to mitigate the regressive impact of the GST including a pre-emptive increase in the States Pension at the expected rate of inflation (up to 12 months ahead of normal policy); a pre-emptive increase in Income support rates above the expected rate of inflation; and, a cost support grant intended to reach low-income households who do not benefit from Income Support.

11.3. Figures 11 and 12 provides a high-level comparison of how revenues are raised under each of these options and how they are expected to impact households. each is discussed in more detail in the following sections.

Figure 11: Financial comparison of options

Revenue Element	Option 1	Option 2	Option 3
Health/income tax	£39m	-	-
GST	-	£87m	£57m
PITA	-	(£20m)	(£9m)
Social security contributions	£20m	£2m	£17m
CIT	£10m	£10m	£10m
Total revenue raised	**£69m**	**£79m**	**£74m**
Administration and mitigation cost (on going only)	(<£1m)	(£4m)	(£2m)
Net Revenue Raised	**£69m**	**£75m**	**£72m**
From Households	£45m	£39m	£37m
From Tourists	-	£10m	£6m
From Corporates	£25m	£31m	£31m

Figure 12: Comparison of average impact of options by household income



Option 1: an income only approach

3% income-based health tax	£39m
A restructured social security contribution system	
• Personal rate: 9% for working age adults; 4.5% for pensioners	
• Employer's rate: 7.5% (5% for self-employed)	
• Remove limit for Employer contributions	£20m
Corporate income tax:	£10m
Total Revenue Raised:	**£69m**
Corporate Income Tax Administration	-£0.3m
Income Support ***reduction*** on net assessments	£0.5m
Net change	**£69m**

Revenue from households: £45m

Revenue from corporates: £25m

11.4. This option is arguably the simplest of the options presented. Revenue raising is split between a 3% health tax modelled to align with Income tax and a £30m increase in the revenue generated from the contributions system.

Figure 13: Option 1: High level assessment

Impact area	Provisional assessment
Household consumption	Short term decrease
GDP growth	Short term decrease
Employment	Short term decrease
Inflation	No impact
Annual cost implication	<0.5m pa

11.5. While the restructure of the contributions system requires some explanation, it has the advantage of offering a slight reduction in liability for the lowest income households. Revenue raising from this source also recognises that a significant portion of the emerging pressures are arising from the pension, long-term care and health provision.

11.6. The presentation of the revenue raising within General revenue as a health tax also recognises the provision of health services as a primary driver of expenditure. However, health and care services in Guernsey cost more than £200m a year, any health tax applied would only fund the incremental costs of services – most of the cost of the services would continue to be funded through general taxation.

11.7. As demonstrated by Figures 14 and 15 below, this option is generally progressive without mitigation, with lower income households being on average better off (thanks to the availability of an allowance on social security contributions) with households in highest income groups paying on average approximately 4% more.

11.8. The more detailed analysis presented in Figure 16 shows that pensioner households of low and middle income on average benefit less from the changes than working age households with similar incomes (a breakdown of the approximate incomes represented by household income percentiles is included in Appendix 3). This is because pensioner households are, in general more favourably treated in the existing social security set up, and therefore gain little benefit from the restructure. The allowance they have access to may be slightly larger if aligned with income tax, but the benefit is limited.

11.9. Under this model a middle-income household would be on average, just over 1% worse off relative to their income, equivalent to about £850 a year (about £16 a week).

11.10. However, this model is the least economically efficient of the options presented. The analysis presented in Appendix 1 show that this option is most likely to have short term (up to 3 years) effects on employment and GDP levels and the retail sector is likely to be impacted by a reduction in household consumption. This is expected to dissipate over time, as the tax raised is spent by the public sector and longer term the overall impact is expected to be minimal.

11.11. It is the weakest of the options presented in terms of Guernsey's competitive position, with taxes on income playing a much larger role in location decisions for potential employees than taxes like a GST. This is particularly true for higher income individual who pay a significant proportion of both the current tax take and the anticipated revenues. Given that at the very top end of the income profile, such individuals also generate employment opportunities and economic growth, a strategy which may discourage such individuals from locating or remaining in Guernsey is not without risk.

11.12. It also perpetuates the existing weaknesses in the current tax base, amplifying the reliance on earned income. This does little to mitigate the risk that shocks to the labour market, either through short term disruption or the ongoing ageing of the population. A significant restructure of the tax base without addressing these risk factors would be a lost opportunity.

11.13. As a result, while the Steering Group accepts that many in the community feel that taxing income is fairer than a GST, it recommends that any restructure of the tax base should include a diversification away from revenues to mitigate some of the existing issues.

Figure 14: Option 1- Average impact by household income (% of gross income)

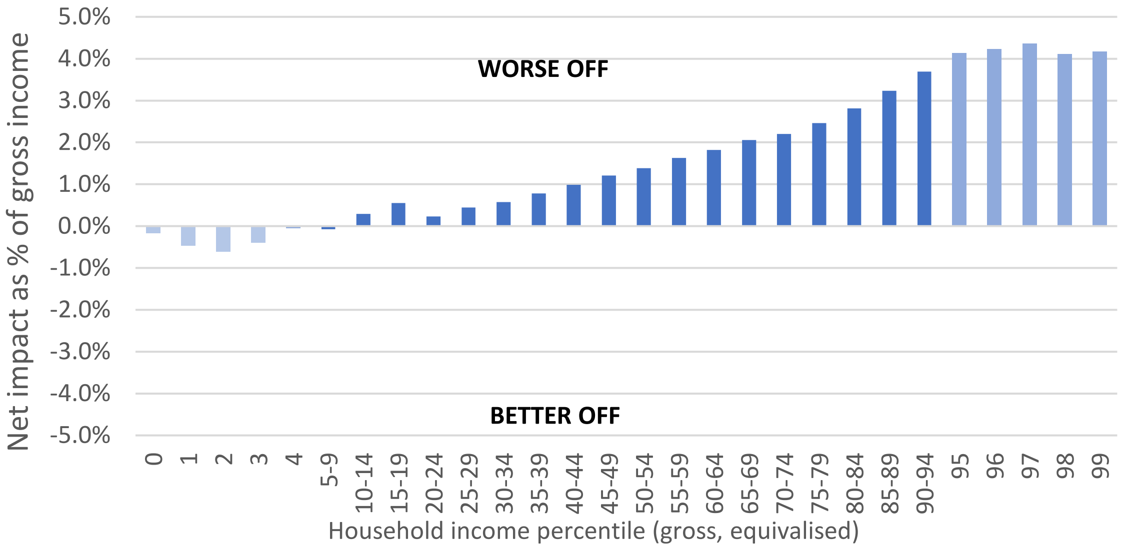


Figure 15: Option 1- Average impact by household income (£)

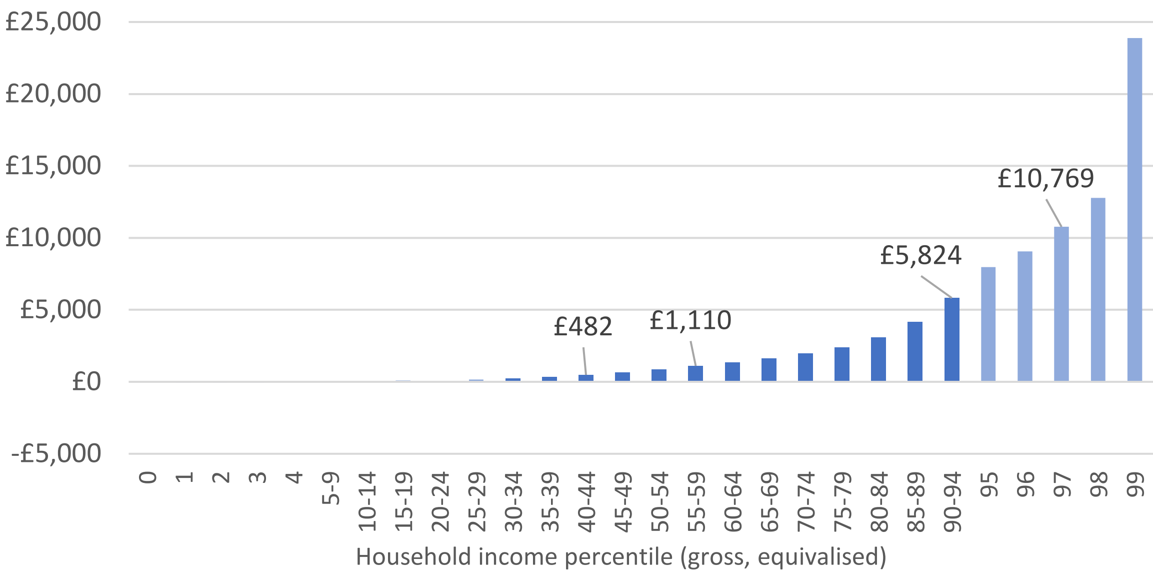


Figure 16: Option 1- Average impact by household income and household composition (as % of gross income)

	Household income percentile (gross, equivalised)																											
	0	1	2	3	4	5-9	10-14	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-54	55-59	60-64	65-69	70-74	75-79	80-84	85-89	90-94	95	96	97	98	99
One adult (16-64)	0%	-2%	-3%	-3%	-6%	-1%	-2%	-1%	-1%	-1%	0%	0%	1%	1%	1%	2%	2%	2%	3%	3%	3%	3%	4%	5%	5%	5%	5%	5%
One adult (16-64 with children)	-1%	-1%	-1%	0%	0%	0%	-1%	-1%	0%	0%	1%	1%	1%	2%	2%	2%	2%	3%	3%	3%	3%	4%	4%		4%	4%	4%	
One adult (65 and over)	0%	0%	0%	0%	0%	0%	1%	2%	1%	1%	2%	2%	2%	2%	2%	3%	3%	3%	3%	3%	3%	3%	3%	4%	4%	4%	4%	3%
Two adults (16-64 with children)	0%	-1%	0%	-2%		0%	0%	0%	0%	0%	0%	1%	1%	1%	2%	2%	2%	2%	3%	3%	3%	4%	4%	4%	5%	4%	4%	5%
Two adults (16-64)	0%	0%	-1%	-1%	0%	-1%	-1%	-2%	-1%	-1%	0%	0%	0%	0%	1%	1%	1%	2%	2%	2%	2%	3%	3%	4%	4%	5%	4%	5%
Two adults (65 and over)	0%	0%	0%	0%		0%	0%	1%	1%	1%	1%	2%	2%	2%	2%	2%	2%	3%	3%	3%	3%	3%	3%	4%	4%	4%	3%	3%

Option 2: GST Option

GST 8%	£87m
PITA increased to £14,000:	-£20m

- A restructured social security contribution system
    - Personal rate: 8% for working age adults; 4.0% for pensioners
    - Employer's rate: 7.5% (5% for self-employed)
    - Remove limit for Employer contributions — £2m

CIT:	£10m
Total revenue raised	**£79m**

• CIT administration	-£0.3m
• GST administration	-£0.8m
• Income support reduction on net assessments	£2.3m
• Above inflation increase in income support	-£2.4m
• Additional low-income support measures	-£2.5m
Net change	**£75m**

Revenue from households: £39m
Revenue from non-residents: £10m
Revenue from corporates: £31m

Figure 17: Option 1- High level assessment

Impact area	Provisional assessment
Household consumption	Some consumption brought forward
GDP growth	No significant impact
Employment	No significant impact
Inflation	5% for 1 year
Annual cost implication	Est £4m pa

11.14. Option 2 makes a GST the primary focus of revenue raising applying a rate of 8%. In this context the restructure of the social security system to a more progressive structure is designed to be largely net neutral (other than the removal of the employer's UEL) and serves largely to mitigate the impact of the GST on lower- and middle-income earners.

11.15. Of the options presented this is the most economically efficient. It is expected to have very limited short-term impact on GDP or employment, although some very limited impact may arise from the 0.9% increase in the employer contribution proposed.

11.16. For households this option creates the most limited distortion in behaviours. GST plays little part in people's location decisions and this option carries less risk in competitive terms than the other options presented.

11.17. It also presents the largest diversification of the tax base allowing a net reduction in tax on income. Different taxes respond in economic conditions in different ways and diversifying the tax base can help limit the impact these shifts in revenues have on States finances. This could reduce Guernsey's susceptibility to labour market shocks and the ageing of the population. A GST also adjusts automatically to changes in inflation (something that can take some months for income-based revenues) which also provides some mitigation against inflation risk within the States revenues.

11.18. A GST will cause a one-off increase in prices. This will be evident in headline inflation rates for a period of 12 months from first introduction (or any increase in the rate). As modelled, it is estimated that a GST at 8%, if introduced in a single stage, would increase inflation by approximately 4.5%. This increase in prices will not be felt equally by all households. Those who spend a significant proportion of their income on exempt or Zero-rated items such as rents, mortgages and financial services or who spend money outside Guernsey will face less tax on their total expenses than those who face tax on a greater proportion of their consumption.

11.19. Generally, but not universally, the result is that low-income households are more impacted by inflation than higher income households. This option applies a number of measures to mitigate this;

- increasing the tax allowance and restructuring the contributions system which tends to benefit lower and middle-income households;
- bringing forward the normal inflation uprating of pensions and benefits to match the timing of introduction, so households are not subject to a 12-month delay in the adaptation of their income;
- applying above inflation increases to income support benefits recognising the larger impact on these households; and,
- recommending an additional support grant (modelled at £800 a year) targeted at households with an income below £25,000 (bottom 15%[14]) who are not in receipt of income support.

11.20. With sufficient resources dedicated to mitigation the overall impact of this option could be progressive, providing a benefit to low-income households. However, they come at a cost, requiring a net additional spend (in addition to administration costs) of more than £2m per annum.

11.21. While every effort has been made to design mitigations which reach those most likely to be vulnerable to these changes, it is impossible to design a system that covers every eventuality. As shown in Figures 18 to 20 while overall the scheme is beneficial to low-income households in general, there are some pockets of low-income households who may still pay slightly more. These cluster around households in specific circumstances. For example, households who own their home without a mortgage and support a

[14] The 15% threshold (approximately £25,000) was chosen on examination of detailed households' data which showed that the households who appeared to require additional support were primarily below this threshold. Households above this threshold are more likely to benefit from changes in the social security structure and increases in the tax allowance

significant proportion of their spending with capital or savings. Relative to their income (but not their expenditure, and not necessarily their wealth) such households may have a higher exposure to a GST than others, and the mitigation for such groups may be incomplete.

11.22. At the opposite end of the income scale this option places slightly more burden on the very highest income households than option 1. However, generally GST and similar taxes play a lesser role than taxes on income in the location decisions of higher income households so the impact of these decision may be less.

11.23. Of the three options presented this is the only one which does not incorporate revenue raising via the social security system to any significant extent.

Figure 18: Option 2- Average impact by household income (% of gross income)

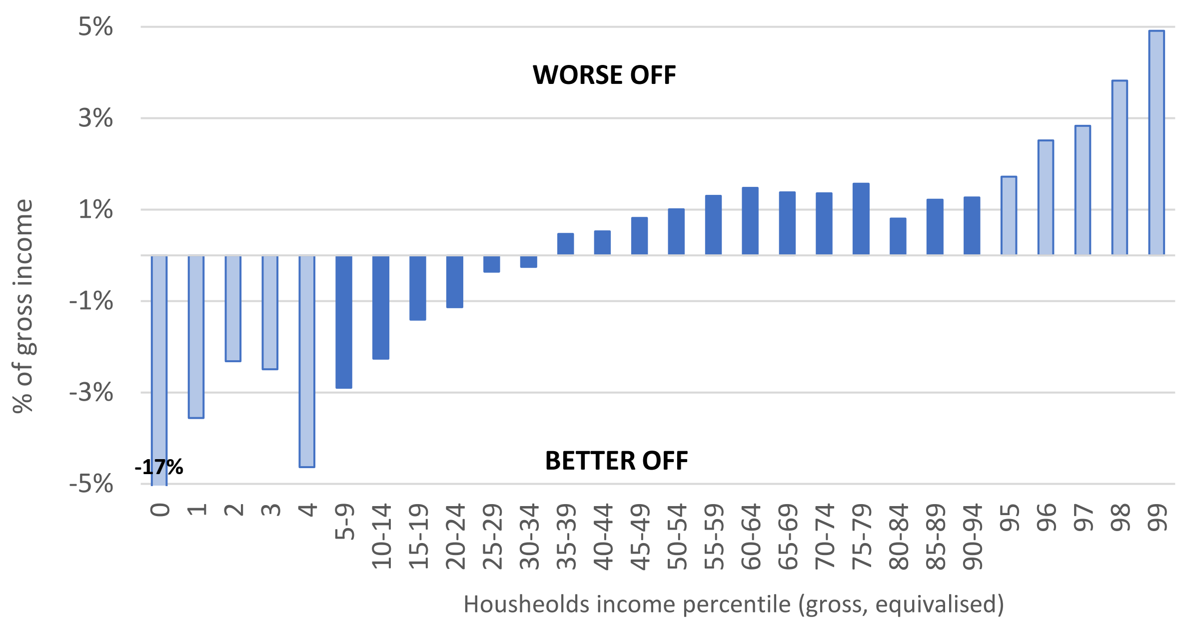


Figure 19: Option 2- Average impact by household income (£ per annum)

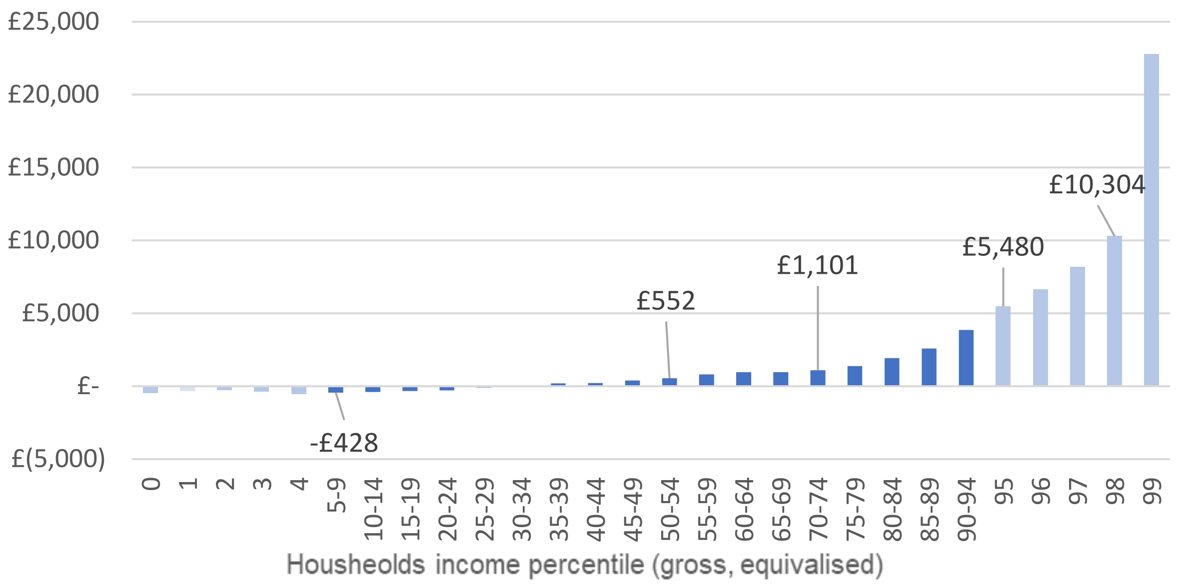


Figure 20: Option 2- Average impact by household income and household composition (% of gross income)

	Household income percentile (gross, equivalised)																											
	0	**1**	**2**	**3**	**4**	**5-9**	**10-14**	**15-19**	**20-24**	**25-29**	**30-34**	**35-39**	**40-44**	**45-49**	**50-54**	**55-59**	**60-64**	**65-69**	**70-74**	**75-79**	**80-84**	**85-89**	**90-94**	**95**	**96**	**97**	**98**	**99**
One adult (16-64)	-24%	-4%	-3%	-3%	-4%	-2%	-3%	-3%	-2%	-1%	-2%	-1%	0%	1%	1%	2%	2%	2%	2%	3%	3%	2%	2%	3%	3%	3%	3%	3%
One adult (16-64) with children)	-15%	-1%	-1%	0%	-1%	0%	-1%	-1%	-1%	-1%	1%	2%	2%	3%	2%	2%	3%	3%	3%	3%	3%	4%	3%		3%	3%	3%	
One adult (65 and over)	-20%	-6%	-5%	-4%	-5%	-5%	-4%	-2%	-3%	-1%	-2%	0%	1%	1%	2%	2%	2%	2%	3%	3%	4%	4%	4%	3%	3%	3%	3%	3%
Two adults (16-64 with children)	-1%	0%	-1%	-2%		-2%	-2%	-1%	-1%	0%	0%	0%	1%	1%	1%	2%	2%	2%	2%	2%	2%	3%	3%	3%	4%	4%	4%	4%
Two adults (16-64)	-11%	0%	2%	0%	-1%	2%	1%	-2%	-1%	0%	0%	0%	0%	0%	0%	1%	1%	1%	1%	1%	2%	2%	2%	3%	3%	3%	3%	4%
Two adults (65 and over)	-11%	-7%	-5%	-4%		-3%	-1%	-1%	0%	1%	1%	2%	2%	2%	2%	3%	3%	2%	2%	2%	2%	2%	3%	3%	3%	3%	3%	3%

Option 3: GST/income combination

GST 5%	£57m
PITA increased to £12,700:	-£9m
A restructured social security contribution system	
Personal rate: 9% for working age adults; 4.5% for pensioners	
Employer's rate: 7.5% (5% for self-employed)	
Remove limit for Employer contributions	£17m
CIT:	£10m
Total revenue raise	**£74m**
CIT administration	-£0.3m
GST administration	-£0.8m
Income Support reduction on net assessments	£1.5m
Above inflation increase in income support	-£1.3m
Additional low-income support measures	-£1.2m
Net change	**£72m**

Revenue from households: £37m
Revenue from tourists: £6m
Revenue from corporates: £31m

Figure 21: Option 3- High level assessment

Impact area	Provisional assessment
Household consumption	Some consumption brought forward, some reduced consumption
GDP growth	Limited short-term decrease
Employment	Limited short-term decrease
Inflation	3% for 1 year
Annual cost implication	Est £2m pa

11.24. Option 3 presents a hybrid between options 1 and 2. It offers the same benefits as option 3 but to a lesser extent. It provides some diversification of revenues away from the reliance on income which could improve Guernsey's resilience to economic shock and the ageing of the population. The short-term economic cost of this option may be greater than option 2 (but less than option 1) but with a lower impact on inflation.

11.25. The lower impact on inflation means that the measures needed to mitigate the effect on low-income households is also lower. The resulting system (as modelled) is generally progressive but arguably less so than option 2 because the measures required to address the more moderate impact on low-income households results in more moderate positive impacts as well.

11.26. The mitigating measure proposed under option 2 are applied here with but to a more moderate extent, including:

- increasing the tax allowance and restructuring the contributions system which tends to benefit lower and middle-income households (noting that the inclusion of revenue raising applied through the social security contributions system shift the point at which this is beneficial to a lower income);
- Bringing forward the normal inflation uprating of pensions and benefits to match the timing of introduction, so households are not subject to a 12-month delay in the adaptation of their income (which represents a one-off real cost);
- applying above inflation increases to income support benefits recognising the larger impact on these households; and
- recommending an additional support grant (modelled at £500 a year) targeted at households with an income below £25,000 (bottom 15%[15]) who are not in receipt of income support.

11.27. This offers a scheme which could provide a net benefit to, low-income households in general, with the distribution of the impact more evenly spread across middle- and high-income households.

11.28. As with option 2, the mitigation for the impact of GST is beneficial for most low-income households, but it is not perfect. Some low-income households in specific circumstances might be worse-off although the majority would benefit.

[15] The 15% threshold (approximately £25,000) was chosen on examination of detailed households' data which showed that the households who appeared to require additional support were primarily below this threshold. Households above this threshold are more likely to benefit from changes in the social security structure and increases in the tax allowance

Figure 22:Option 3- Average impact by household income (% of gross income)

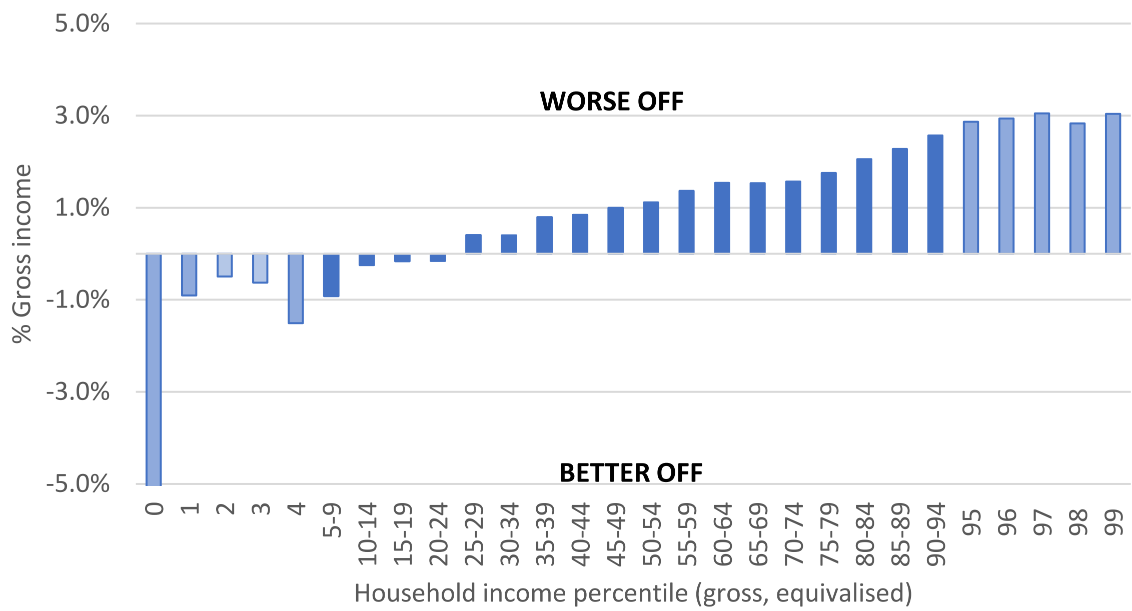


Figure 23: Option 3- Average impact by household income (£)

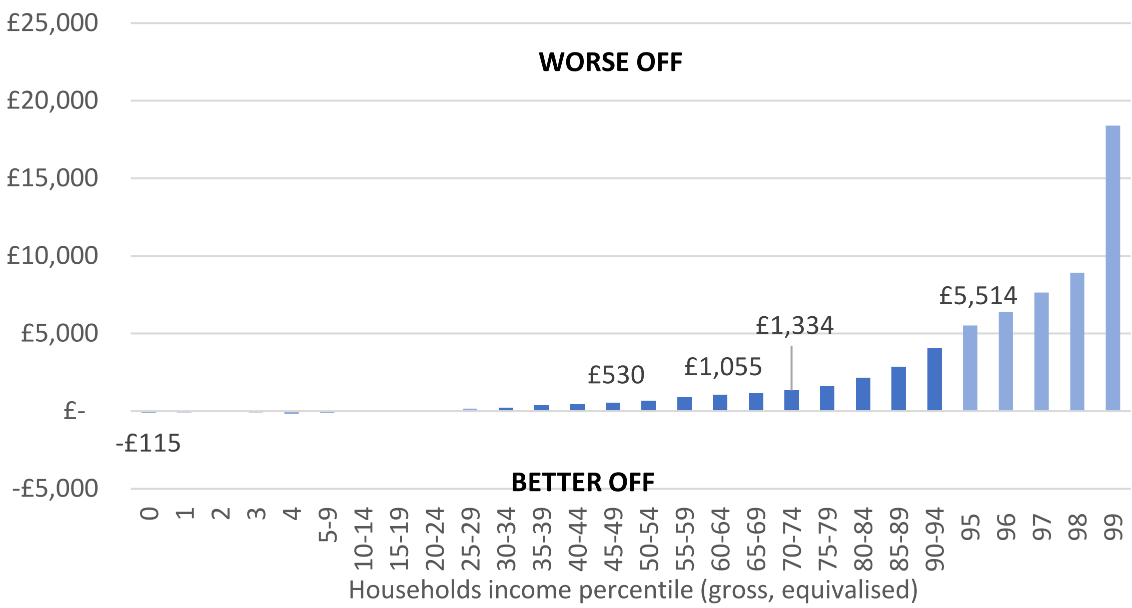


Figure 24: Option 3- Average impact by household income and household composition (% of gross income)

	Household income percentile (gross, equivalised)																											
	0	1	2	3	4	5-9	10-14	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-54	55-59	60-64	65-69	70-74	75-79	80-84	85-89	90-94	95	96	97	98	99
One adult (16-64)	-7%	-1%	-1%	-2%	-3%	-2%	-2%	-1%	-1%	0%	-1%	0%	0%	1%	1%	2%	2%	2%	2%	3%	3%	3%	3%	3%	3%	3%	3%	3%
One adult (16-64) with child(ren))	-5%	-1%	-1%	0%	0%	0%	-1%	-1%	0%	0%	1%	2%	2%	3%	2%	2%	3%	3%	3%	3%	3%	3%	3%		3%	3%	3%	
One adult (65 and over)	-7%	-2%	-1%	-1%	-2%	-2%	-1%	0%	0%	1%	0%	1%	1%	1%	2%	2%	2%	2%	2%	3%	3%	3%	3%	2%	2%	2%	2%	2%
Two adults (16-64 with child(ren))	1%	0%	-1%	-2%		-1%	-1%	-1%	-1%	0%	0%	1%	1%	1%	1%	2%	2%	2%	2%	2%	2%	3%	3%	3%	4%	3%	3%	4%
Two adults (16-64)	-2%	1%	2%	0%	0%	2%	1%	-2%	-1%	0%	0%	0%	0%	0%	0%	1%	1%	1%	1%	1%	2%	2%	2%	3%	3%	3%	3%	3%
Two adults (65 and over)	-3%	-1%	0%	0%		0%	1%	0%	1%	1%	1%	2%	2%	2%	2%	3%	3%	2%	2%	2%	2%	2%	2%	3%	2%	3%	2%	2%

12. Assessment of Options

12.1. Figure 25 presents a comparison of the three options and the Steering Group's assessment of these against the stated principles of the Review.

12.2. It should be noted that the three options brought forward were chosen because the Steering Group felt they offered a reasonable fit with these principles. Analysis was undertaken on other options (including options which included a higher tax rate for higher earners), but these were not progressed because it was felt they did not sufficiently meet the principles of the review.

12.3. Of the options presented the Steering Group is of the view that option 1 (the income-based approach), performs less well than the other two options. To further concentrate revenues into taxes on income would place an unnecessary competitive pressure on Guernsey's economy and miss an opportunity to address some of the fundamental weaknesses in our tax base.

12.4. It is possible to mitigate the primary concerns raise against a GST. The regressive impacts can be successfully addressed for most low-income households if the package as a whole is designed to do so. It is possible to design a change in the tax system which would include a GST and benefit most low-income households. Given that such systems are applied in almost all other jurisdictions, including our nearest neighbour, examples of good practice are widely available.

12.5. The accounting and Point of Sale systems needed to minimise the administrative burden on business are widely available and, in many cases, already in use by local businesses. Measures like high registration threshold and the ISE scheme could mitigate this further.

12.6. The distinction between options 2 (GST approach) and option 3 (the GST /income combination) is less clear. Were the decision to be made on economic grounds only, the efficiency of option 2 would be preferable, but other considerations, including the higher cost of mitigation apparent in option 2 may influence the outcome.

12.7. The Steering Group concluded that to intensify the reliance on income-based taxes by following an approach like option 1 is unsustainable. As a result, the Steering Group's recommendation at this stage is that the way forward should include a GST. While a higher rate of GST is economically the strongest option and has the potential to be the most progressive if it is combined with significant levels of mitigation, it is acknowledged that this may not reflect the preference of the community.

12.8. More engagement is required to establish which of these options, or variations on them might be implemented in practice.

Figure 25: Assessment of options

Review principle	Option 1: Health tax/ SSC		Option 2: 8% GST		Option 3: 5% GST and contributions	
Capable of raising revenues of up to 24% of GDP…	Pass/fail criteria	Y	Pass/fail criteria	Y	Pass/fail criteria	Y
…in a way that is economically sustainable;	Long term economic impact minimal but with potential to create competitive issues in attracting higher income individuals to live in Guernsey. This may also create some recruitment issues for more senior posts	3	Long term economic impact minimal with very limited competitive issues	5	Long term economic impact minimal with limited competitive issues. Some limited potential to make attracting higher income individuals more difficult via increase in social security liability	4
…and socially sustainable	Progressive, with income-based taxes likely to be less controversial than GST	5	Overall, impact progressive with significant mitigation. Potential for net gain for lower income in general with some exceptions who may remain vulnerable. Higher rate of GST likely to be controversial and unpopular	3	Progressive with moderate mitigation. Potential for net gain for lower income in general with some exceptions who may remain vulnerable. Moderate rate of GST likely to be controversial but less so than higher rate	4
Be diversified between different forms of taxation	No diversification	0	Maximum diversification	10	Some diversification	5
Transparent, simple and credible	Social security restructure is complex but creates a simpler system. Income based taxes well understood by the public	4	Social security restructure is complex but creates a simpler system. Broad based consumption tax is simple, transparent, and applied widely in almost all jurisdictions	4	Social security restructure is complex but creates a simpler system. Broad based consumption tax is simple, transparent, and applied widely in almost all jurisdictions	4
Resilient to demographic change and economic shocks	Exaggerates existing reliance on income bases taxes and does not diversify risk to economic shocks or demographic change	1	Diversification spreads revenue risk between a wider range of revenue streams	5	Some diversification to spread revenue risk but with ongoing reliance on income-based tax	4
Support and facilitate sustainable economic growth and employment	Potential for short term impact on employment and economic growth which	3	Least potential for short term impact on employment and economic growth	5	Some potential for short term impact on employment and economic growth via increase in contribution revenues	4

	should recede in the medium term				which should recede in the medium term	
Comply with international tax standards	Subject to outcome of corporate tax workstreams	na	Subject to outcome of corporate tax workstreams	n	Subject to outcome of corporate tax workstreams	na
Maintain alignment on corporate tax policy with Jersey and the Isle of Man	Subject to outcome of corporate tax workstreams	na	Subject to outcome of corporate tax workstreams	na	Subject to outcome of corporate tax workstreams	na
Overall, reflect people's ability to pay and be generally progressive, while accepting that a balanced tax system will include some elements (such as excise taxes) which are considered regressive in nature	Progressive, although some elements of social security restructure will impact some groups more than others	4	Overall, most progressive outcome with mitigation. Low-income households may overall be better off than in income-based scenario but the impact of a higher rate of GST is difficult to mitigate for some low-income groups	4	Overall, moderately progressive outcome with mitigation. Low-income households may overall be better off than in income-based scenario but the impact of a higher rate of GST is difficult to mitigate for some low-income groups	4
Not discriminate and factors such as age, gender, marital status or employment status should not affect the way in which you are assessed or the amount you pay	Discrimination via the social security contributions system removed	5	Discrimination via the social security contributions system removed	5	Discrimination via the social security contributions system removed	5
Support the delivery of environmental and social objectives if there are opportunities to do so without breaching the previous principles	Reform of the social security contributions system benefits low income working households which supports objectives in relation to in work poverty	3	Reform of the social security contributions system benefits low income working households which supports objectives in relation to in work poverty	3	Reform of the social security contributions system benefits low income working households which supports objectives in relation to in work poverty	3
Total		**28**		**43**		**37**

13. Development Transition and Phasing

13.1. This Review is intended to inform plans to meet long-term revenue requirements. It may not be necessary to make an immediate jump to raise revenues to the full extent implied by the options discussed, particularly if other priorities to mitigate expenditure and grow the economy are successful.

13.2. The introduction of any major structural changes is likely to need at least 2 years of development. This means implementation of larger elements is not likely to take place until 2024 at the earliest, although some elements might be progressed sooner. During this time, it will be necessary to confirm finer points of detail, such as the exact application of any GST, and the relative timing of changes if there is a desire for these changes to be phased.

14. Consultation and Engagement

14.1. The Steering Group has undertaken some engagement on the proposals presented to date, both with States Members and with industry and community representatives. However, further engagement is needed on the details of a scheme before final proposals are presented to the States for consideration.

14.2. Developing the level of detail required to progress this analysis to full and detailed proposals will require a further investment of staff resources and require the public discussion of topics on which there is likely to be significant political debate.

14.3. **The Steering Group recommends that the States be asked to confirm the direction outlined in this first report. Subject to this confirmation, the Steering Group proposes to undertake a six-month period of detailed engagement and development before returning with firm proposals to the Policy & Resources Committee.**

15. Conclusions

15.1. Having reviewed the analysis undertaken to date, the Steering Group concludes that structural changes to the tax base are necessary. The current social security contributions System has evolved a long way from its origins and in its current form is inequitable. There is an opportunity to reform it which can make it both more equitable and more progressive and this should be pursued further.

15.2. Furthermore, the current heavy reliance on income-based taxes should not be continued. If more revenues are required, it should be from a more diverse tax base and introducing a GST represents the most effective way of achieving this.

15.3. The concerns about the regressive impact of a GST on lower income households are valid. However, the analysis suggests that the inclusion of a GST within a package including measures designed to mitigate the impact on lower income households can address these concerns and make the change to the tax base overall progressive. The relatively recent introduction of a GST in Jersey and other jurisdictions also provides examples of how the scheme can be designed so as to reduce the administrative burden on companies.

15.4. More engagement with stakeholders is needed before final recommendations can be made. To ensure that engagement is effective in producing a successful outcome for this project the Steering Group recommends in principle endorsement from the States is sought about the key elements before this is undertaken.

15.5. With direction from the States the Steering Group offers to conduct a period of more detailed engagement and development before presenting formal proposals for consideration.

MAJ Helyar

DJ Mahoney

PJ Roffey

M Thompson (Non-States Member, Committee *for* Employment & Social Security)

Appendix 1: Economic Impact Analysis Report (Deloitte LLP)

Deloitte.

Economic Impact Study of the States of Guernsey Tax Review

Final Report

10 August 2021

Important Notice from Deloitte

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

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

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

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Contents

1 Executive Summary

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

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

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

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

[1] The States of Guernsey Accounts 2020.

Table 1: Policy options overview

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

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

Benchmarking analysis

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

Total tax revenue as a share of GDP

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

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

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

[4] Self-employed are currently subject to 11% charge on income from self-employment (SE) up to the upper earnings limit (UEL). This would change to a 9% personal rate on all income up to the UEL less an allowance, plus a 5% reduced employers rate on income from SE. The non-employed rate for those under State Pension Age (SPA) would fall from 10.4% to 9.0% and the non-employed rate for those of SPA and older would increase from 3.4% to 4.5%.

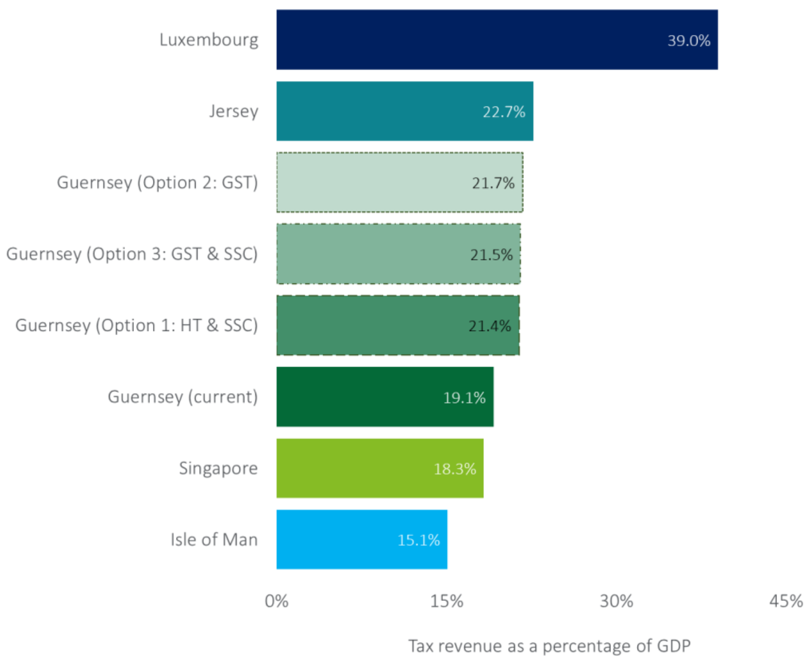
[5] Self-employed are currently subject to 11% charge on income from SE up to the UEL. This would change to a 9% personal rate on all income up to the UEL less an allowance, plus a 5% reduced employers rate on income from SE. The non-employed rate for those under SPA would fall from 10.4% to 8% and the non-employed rate for those of SPA and older would increase from 3.4% to 3.5%.

[6] Self-employed are currently subject to 11% charge on income from SE up to the UEL. This would change to a 9% personal rate on all income up to the UEL less an allowance, plus a 5% reduced employers rate on income from SE. The non-employed rate for those under SPA would fall from 10.4% to 9.0% and the non-employed rate for those of SPA and older would increase from 3.4% to 4.5%.

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

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

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



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

Income Taxation (PIT, Health Tax and SSCs)

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

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

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

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

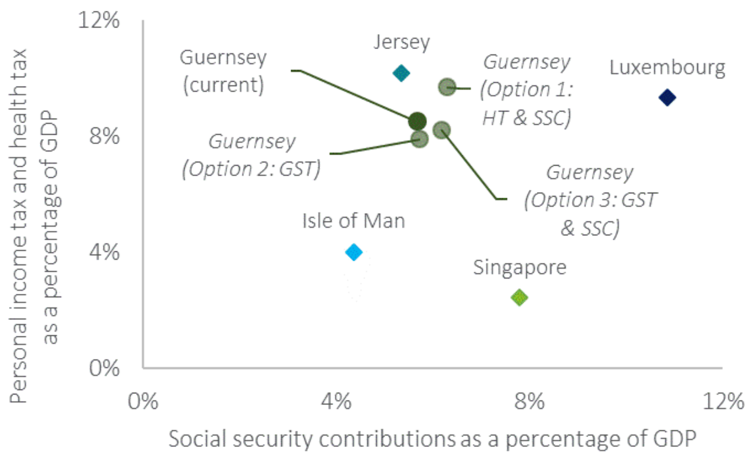
[10] Marginal rates are applied in line with Jersey's PIT

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

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

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

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



Source: As in Appendix A2 Figure 7

GST

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

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

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

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

Reliance on direct tax revenue

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

Economic impacts

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Key Findings

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

2 Introduction

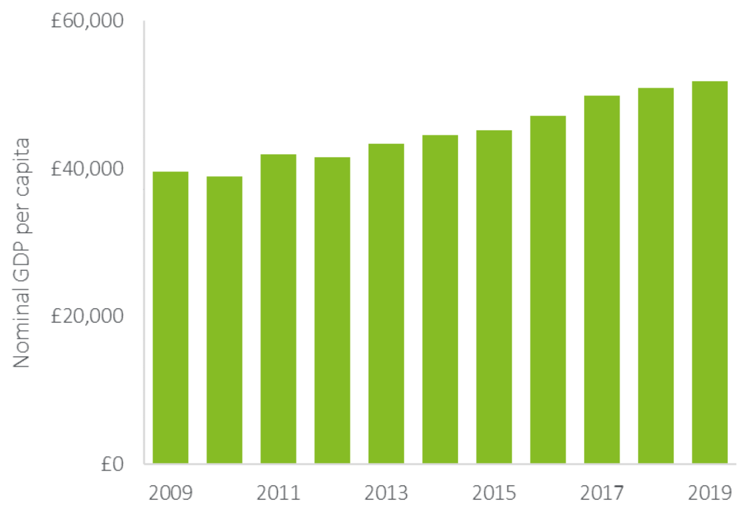
Guernsey's economy has grown considerably over the last decade, but an ageing population and the fiscal impacts of the Covid-19 pandemic have led to a need to increase spending to maintain current service levels

2.1. Background and context

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

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

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



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

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

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

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

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

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

2.2. Fiscal context

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

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

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

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

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

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

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

2.3. Tax Options

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

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

Corporate Income Tax (CIT)

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

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

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

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

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

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

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

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

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

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

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

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

2.3.2. Social Security Contributions (SSC)

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

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

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

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

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

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

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

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

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

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

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

2.3.3. Goods and Services Tax (GST)

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

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

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

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

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

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

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

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

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

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

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

Table 2: Current Guernsey Tax Regime and Tax Options

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

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

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

Source: The States of Guernsey

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

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

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

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

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

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

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

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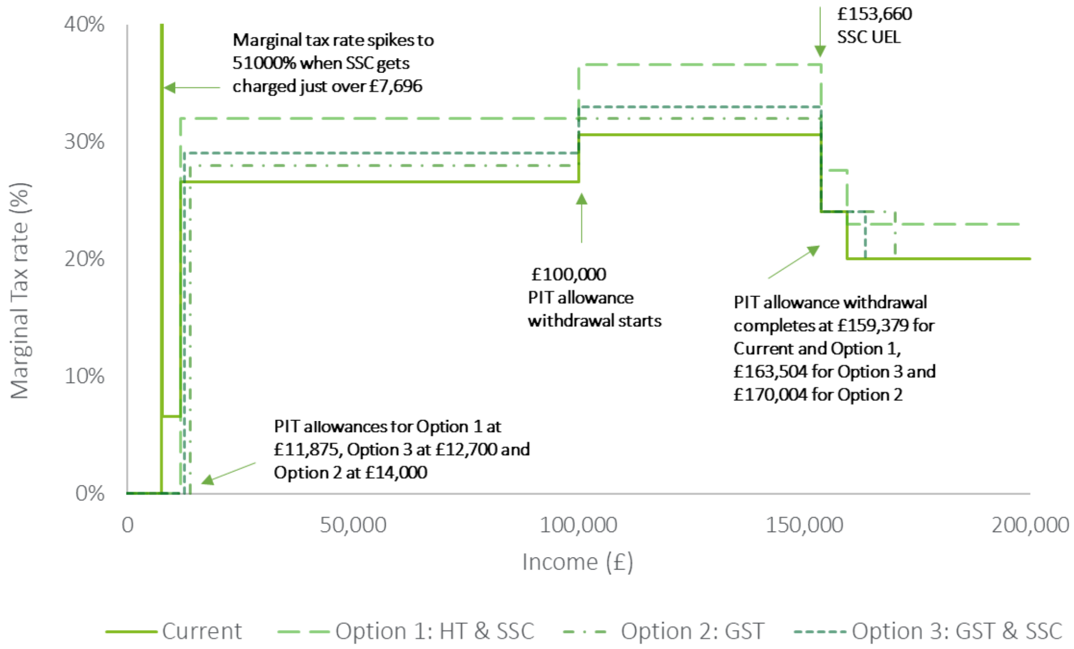
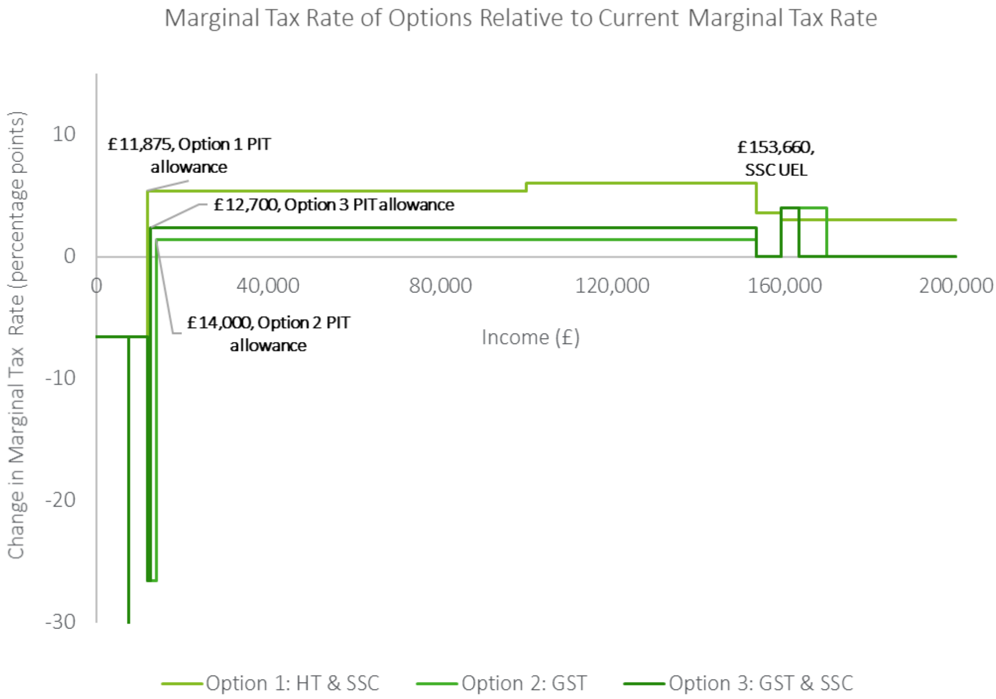
Figure 5: Marginal Tax Rates for Current Regime and Options (PIT, Class 1 employee SSCs and Health Tax)





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

Key Insights

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

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

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

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

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

2.4. Scope of this Report

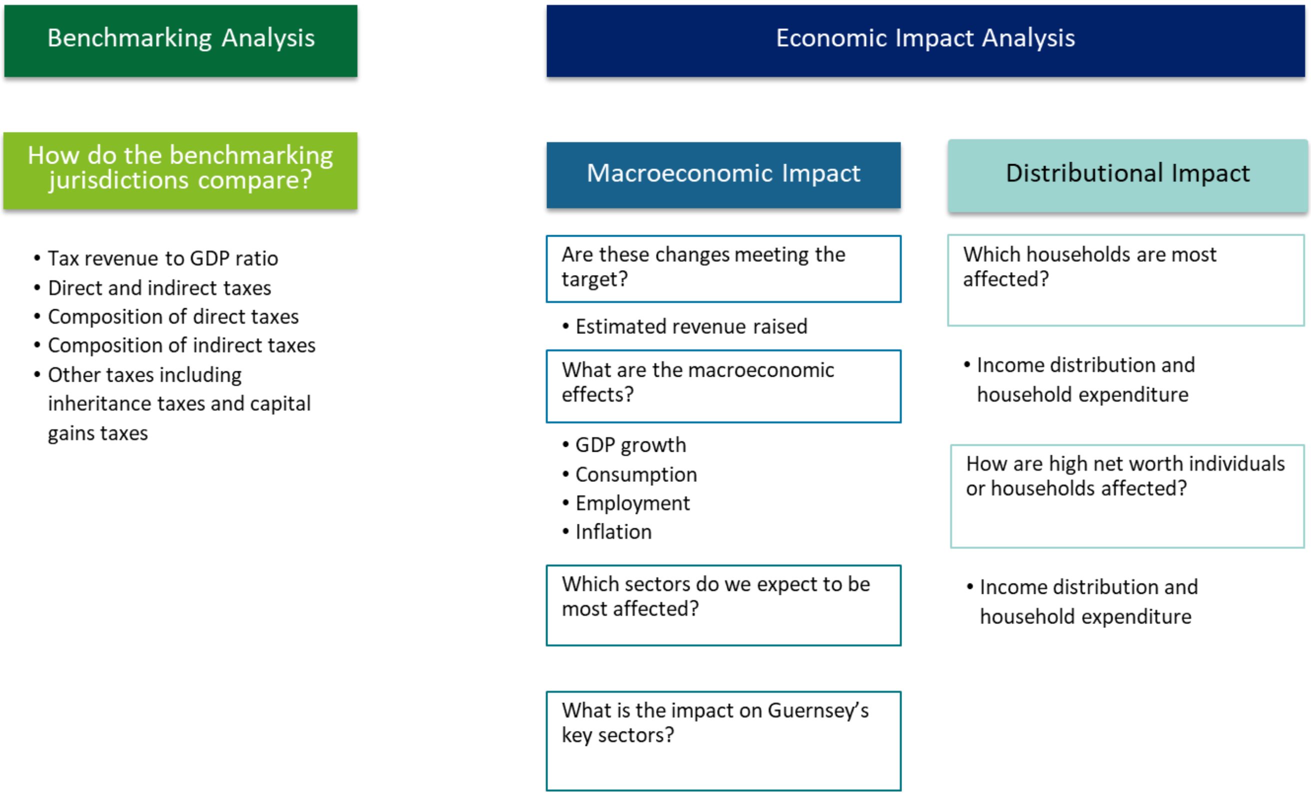
Given the wider context and the levers under consideration, the States have contracted Deloitte LLP to provide economic analysis to support the delivery of the Tax Review. As outlined in the Request for Proposal, the States' Tax Review is to ensure that Guernsey's tax base can raise necessary revenues.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

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

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

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

Figure 6: Benchmark and economic impact analysis overview



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

The rest of this Report is structured as follows:

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

3 Benchmarking analysis

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

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

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

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

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

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

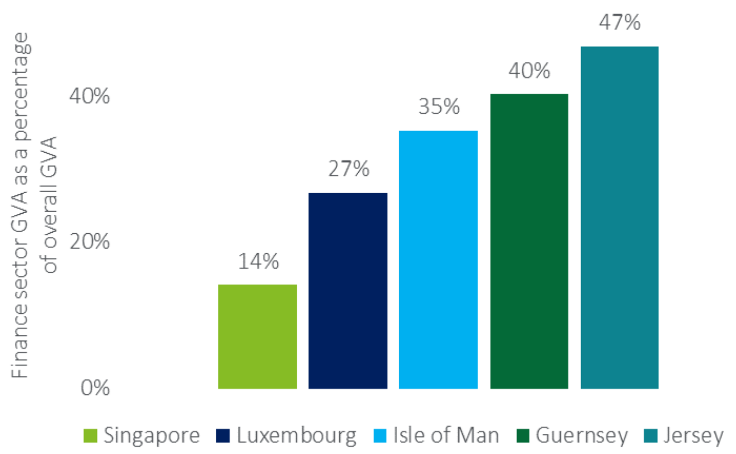
3.1. Economic rationale for chosen jurisdictions

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

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

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

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



Source: See Appendix A2

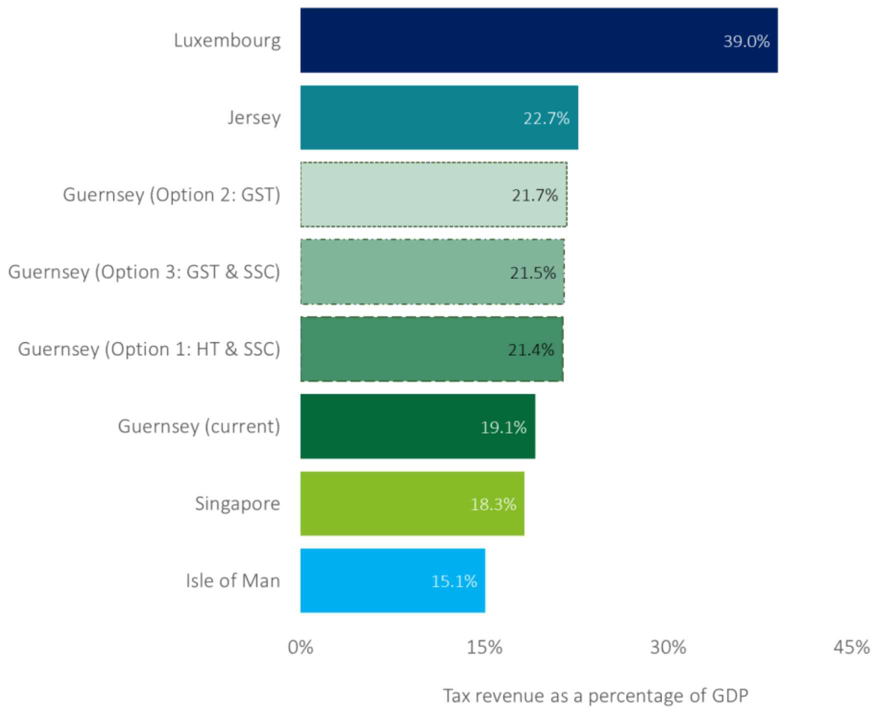
3.2. Comparison of tax components across jurisdictions

3.2.1. Tax revenue as a percentage of GDP

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

[54] Guernsey - https://www.gov.gg/CHttpHandler.ashx?id=133038&p=0 ; Jersey - https://opendata.gov.je/dataset/national-accounts
Isle of Man - Banking, Insurance and Other Finance and Business Services computed to make up the Finance Sector https://www.gov.im/about-the-government/departments/cabinet-office/economic-affairs-division/national-income/
[55] Luxembourg – National accounts, Annual aggregates https://statistiques.public.lu/en/economy-finances/index.html
[56] Singapore - https://www.tablebuilder.singstat.gov.sg/

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



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

3.2.2. Core tax levers

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

Personal Income Taxation (PIT) & Health Tax

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

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

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

Social Security Contributions (SSC)

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

GST

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

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

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

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

Table 3: Tax rates across jurisdictions

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

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

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

3.2.3. Direct and indirect tax revenue

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

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

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

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

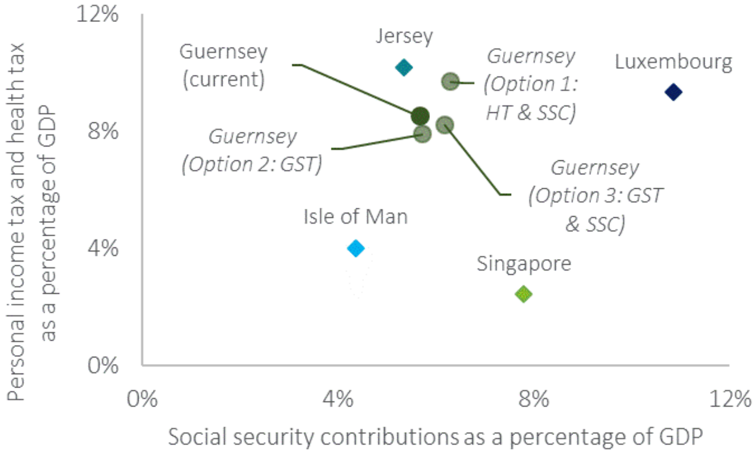
Note: Remaining 5% of Jersey's tax revenue classified as 'Other income'
Source: As in Appendix A2 Figure 7

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

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

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

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



Source: As in Appendix A2 Figure 7

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

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

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

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

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

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

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

3.2.3.1. Low rate and broad-based GST

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

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

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

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

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

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

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

3.2.4. Other taxes

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

CIT

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

Other Taxes

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

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

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

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

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

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

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

3.3. Key changes in comparators taxation and impacts overview

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

Figure 10: Overview of relevant tax changes in benchmark jurisdictions

Introduction of GST in Jersey in May 2008

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

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

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

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

Increase in Jersey GST in June 2011

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

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

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

Introduction of Long-Term Care Charge in Jersey in 2015

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

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

Raised £8.4 million in 2015, 0.2% of GDP

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

Increase in Singapore Top Tax Rate in 2015

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

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

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

Source: See Appendix A2

Key Insights

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

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

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

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

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

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

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

4 Economic impacts

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

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

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

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

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

4.1.1. Macroeconomic Impact

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

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

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

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

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

4.1.2. Distributional Impact

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

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

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

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

4.1.2.1. Impact on Higher Earners

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

4.2. Impacts on revenue

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

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

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

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

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

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

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

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

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

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

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

Source: Based on tax impact data provided by the States

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

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

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

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

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

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

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

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

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

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

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

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

4.3. Macroeconomic impact

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

4.3.1. Impact of Individual Income Tax Increase

4.3.1.1. GDP Growth

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

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

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

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

[99] OECD working paper, "Taxation and Economic Performance", available at: https://www.oecd-ilibrary.org/economics/taxation-and-economic-performance_668811115745
[100] The same paper conducts a bottom up simulation approach which finds that a reduction in tax to GDP ratio of 10 percentage points is estimated to increase growth by 0.5-1 percentage points
[101] "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks", available at: https://www.nber.org/system/files/working_papers/w13264/w13264.pdf
[102] "How Large Are the Effects of Tax Changes", available at: https://www.researchgate.net/publication/46474949_How_Large_Are_the_Effects_of_Tax_Changes
[103] "Optimal Taxation of Top Labour Incomes: A Tale of Three Elasticities", available at: https://www.nber.org/system/files/working_papers/w17616/w17616.pdf

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

4.3.1.2. Sectoral impacts

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

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

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

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

4.3.1.3. Employment

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

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

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

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

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

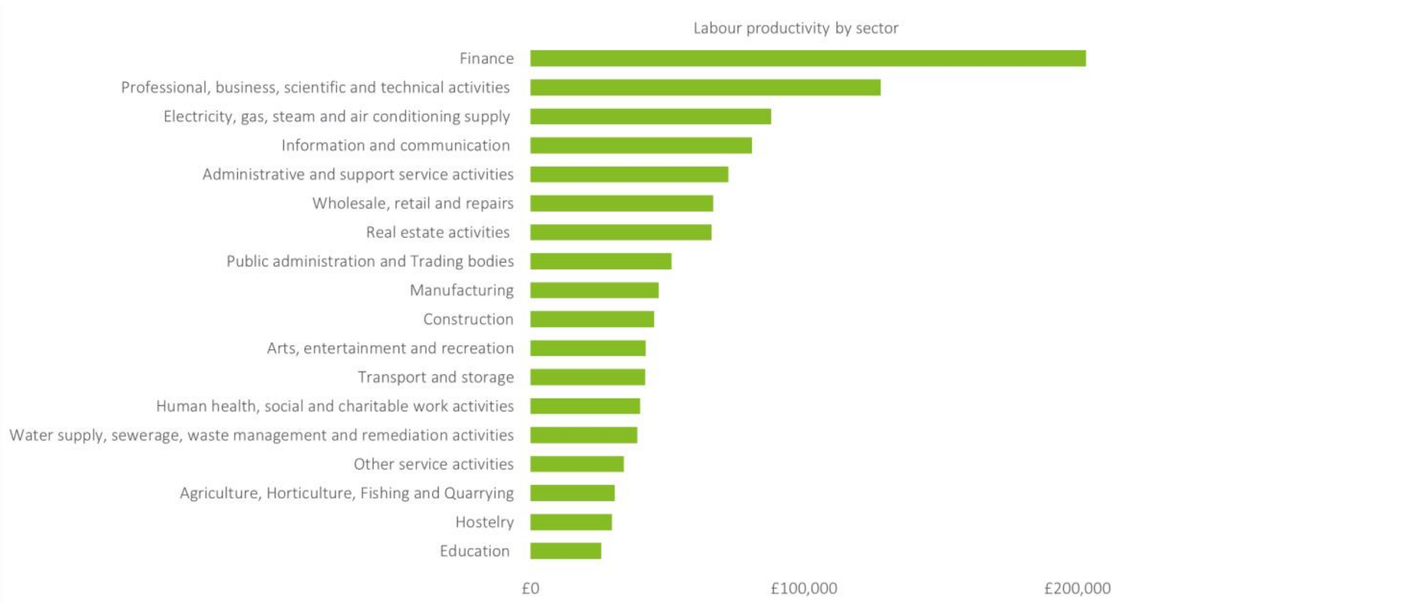
Adverse impacts on employment are most likely to be felt in the sectors that may have larger decreases in GVA. Some of the largest sectors (by employment) that are likely to be more adversely impacted are construction, wholesale, retail and repairs, hostelry, transport and storage, and administrative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

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

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

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

Figure 11: Labour productivity by sector (£)



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

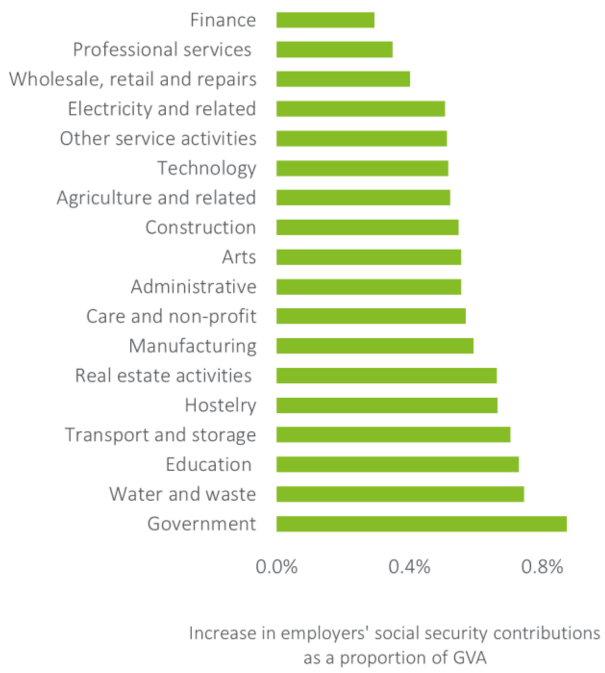
By applying the considered SSC restructure to the data provided on remuneration by sector, we can estimate the change in the social security burden on sectors. As overall remuneration is highest in sectors such as finance and professional,

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

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

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

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



Source: Latest sectoral renumeration data provided by the States

4.3.3. Impact of GST

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

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

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

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

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

4.3.3.1. Impact of GST introduction on price levels

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

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

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

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

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

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

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

4.3.3.2. Impact of GST introduction on sectors

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

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

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

4.3.4. Overall macroeconomic impacts

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

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

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

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

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

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

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

Table 9: Impacts of tax policy options

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

4.4. Distributional Impact

4.4.1. Impact by quintile and household composition

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

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

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

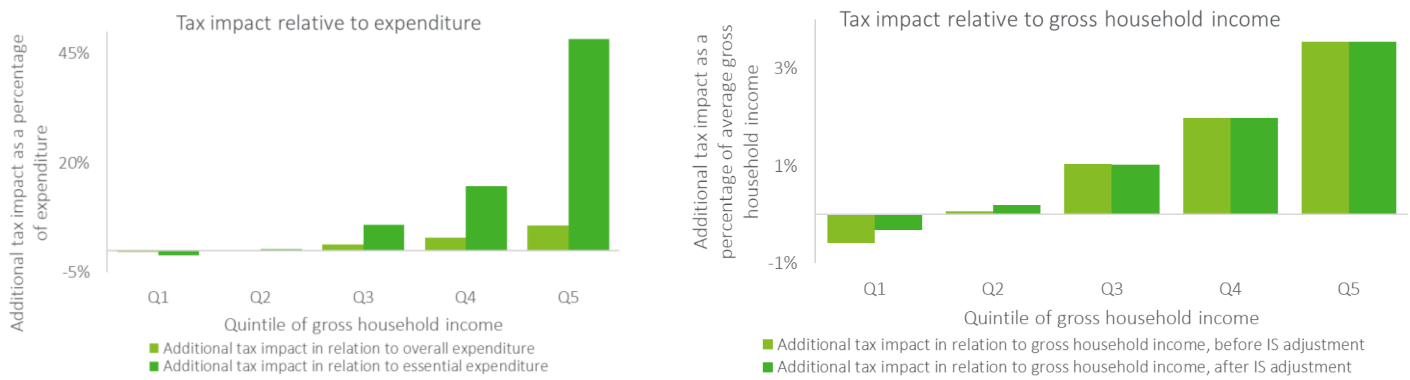
Figure 13 shows the impact of Policy Option 1 by income quintile relative to expenditure in the leftmost panel and relative to gross household income in the rightmost panel. The lighter bars in the left panel shows the impact by quintile relative to *overall* expenditure, the darker bars illustrate the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

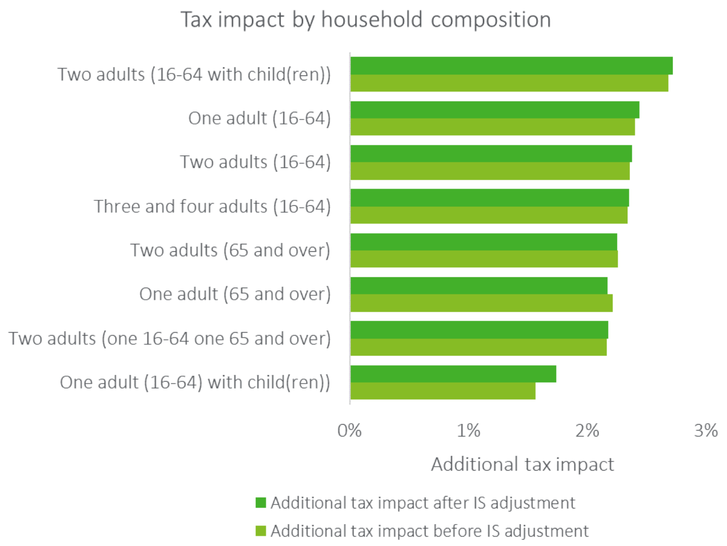
The lighter bars in the right panel show the impact as a share of gross household income before the adjustment in income support whereas the darker bar shows the impact after this adjustment. While residents only observe the impacts after the income support adjustment, it is useful to understand the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

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

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

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





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

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

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

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

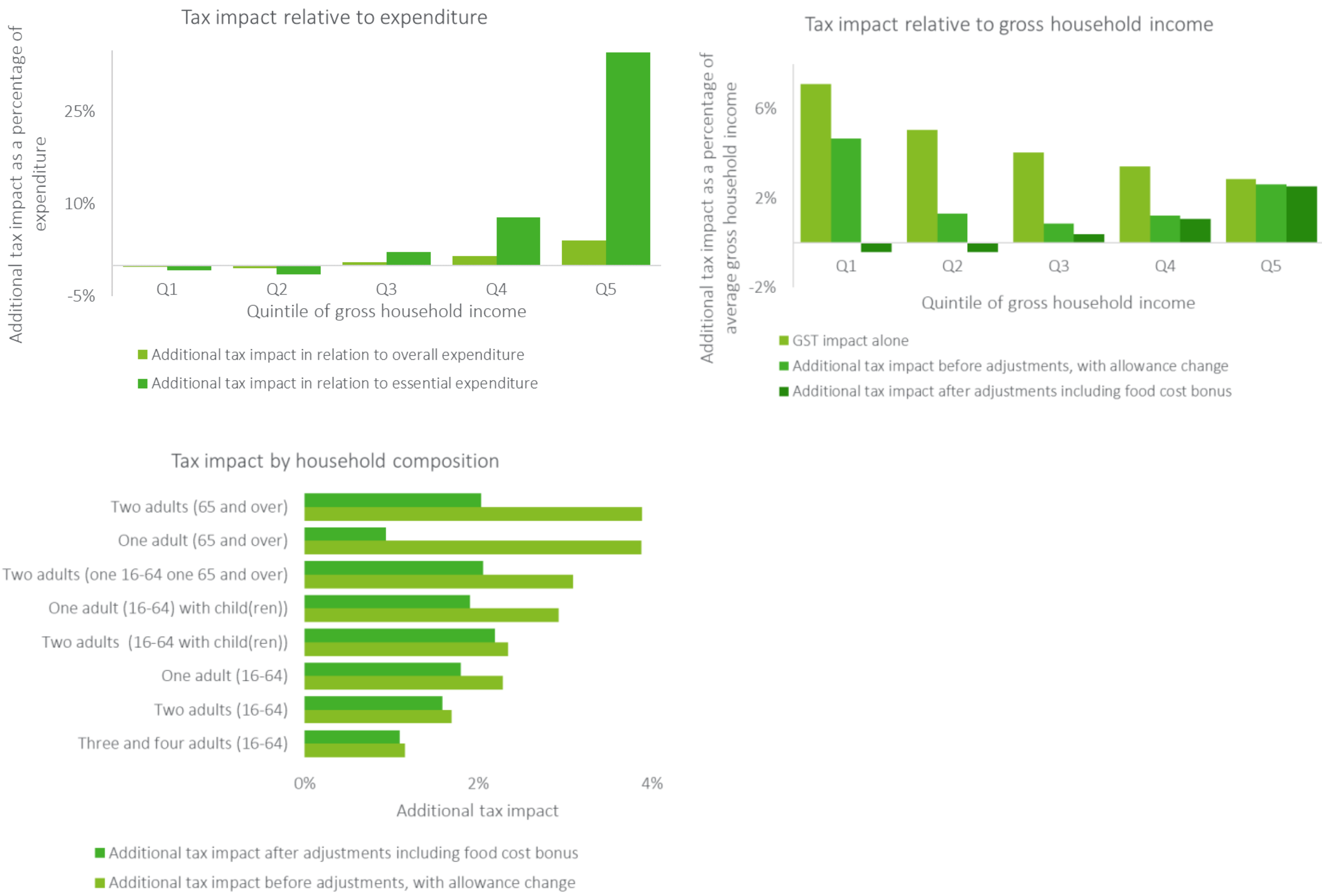
4.4.1.2. Policy Option 2: 8% GST, PIT allowance increase and SSC restructure

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

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

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

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



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

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

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

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

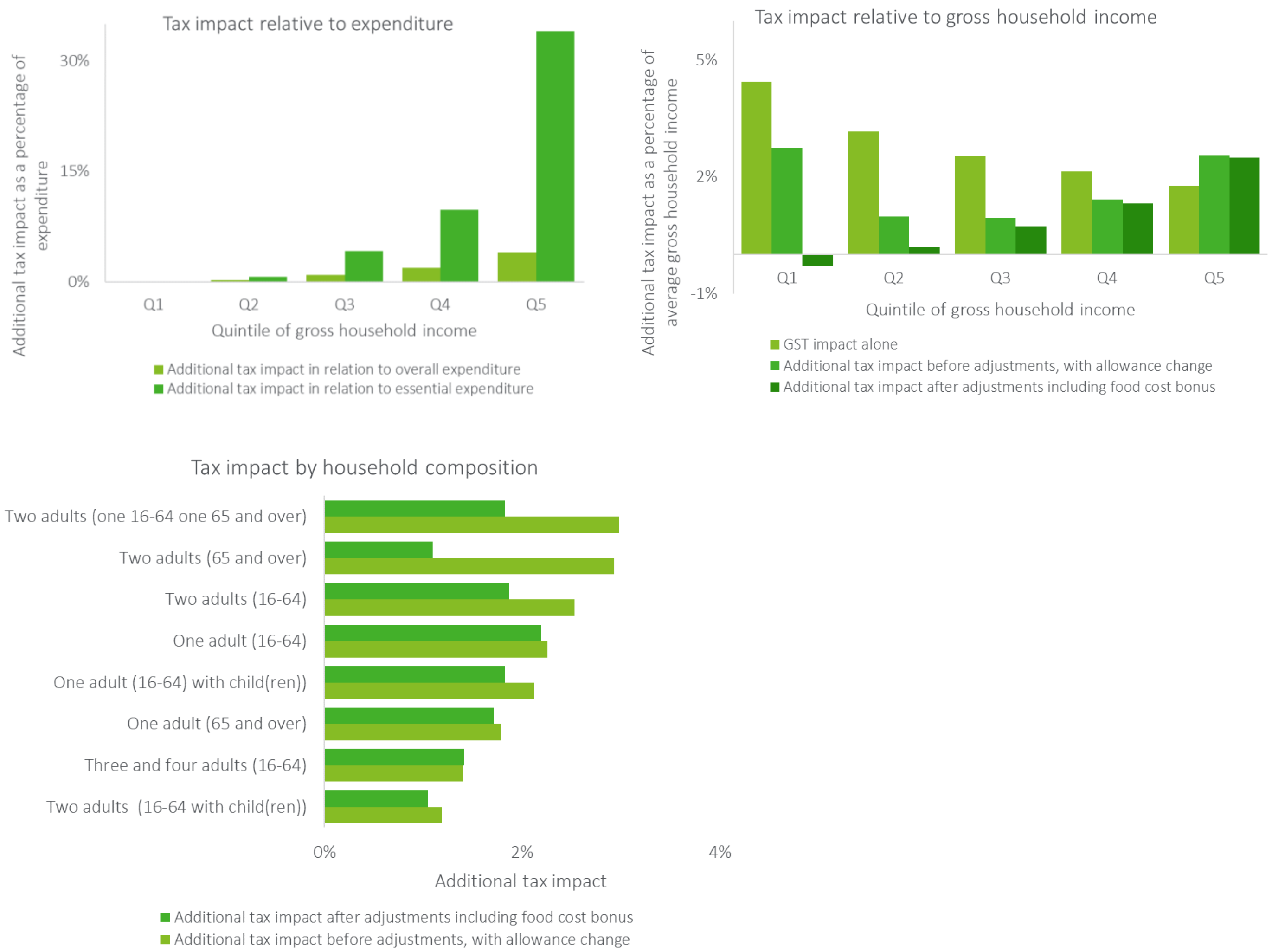
The final chart in Figure 14 shows the impact of Policy Option 2 across household types before adjustments (lighter bar) and post-adjustment (darker bar). The tax impacts before the adjustments are greatest for households containing adults aged 65 and over. However, these households benefit most from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

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

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

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

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



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

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

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

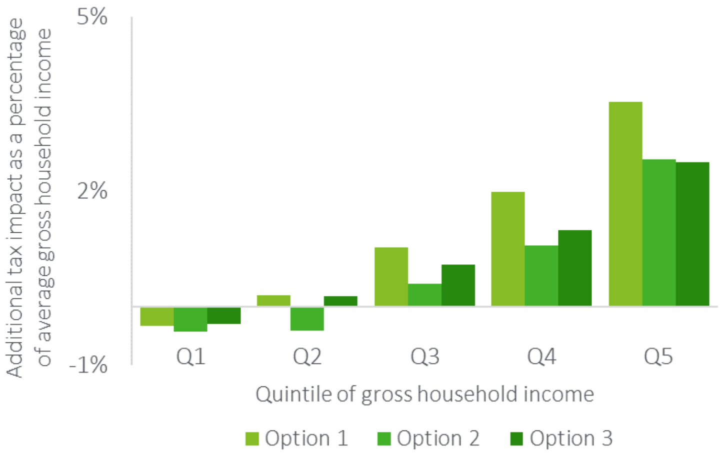
When the tax impact of Policy Option 3 is assessed relative to gross household income, the GST in isolation (the lightest bar) is regressive. This regressivity means that on a proportionate basis those in the first income quintile are more affected than those in the second, who are more affected by those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

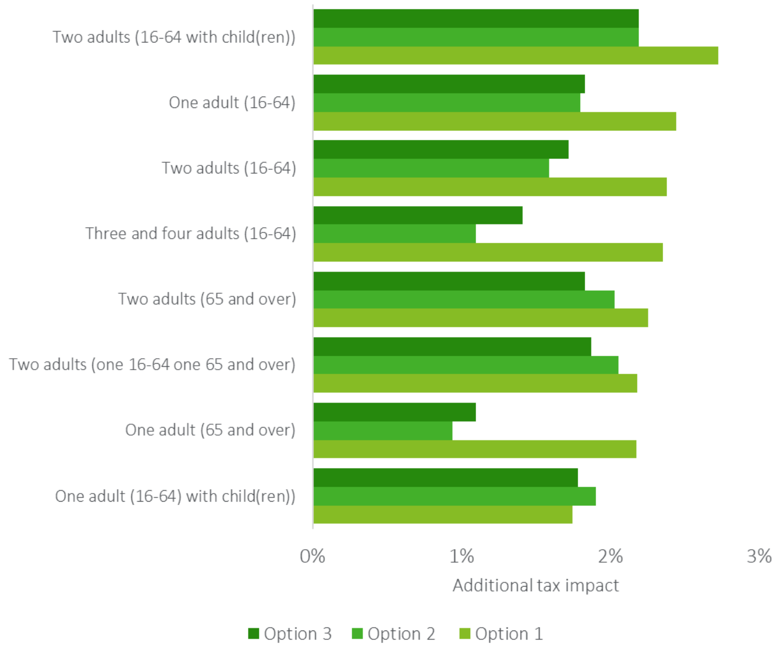
The final chart in Figure 15 shows the impact of Policy Option 3 across household types before adjustments (lighter bar) and post-adjustment (darker bar). The impact before the adjustments is greatest for multi-adult households containing individuals aged 65 and over. Two working-age adult households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

4.4.1.4. Overall impacts of policy option, by income quintile

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

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





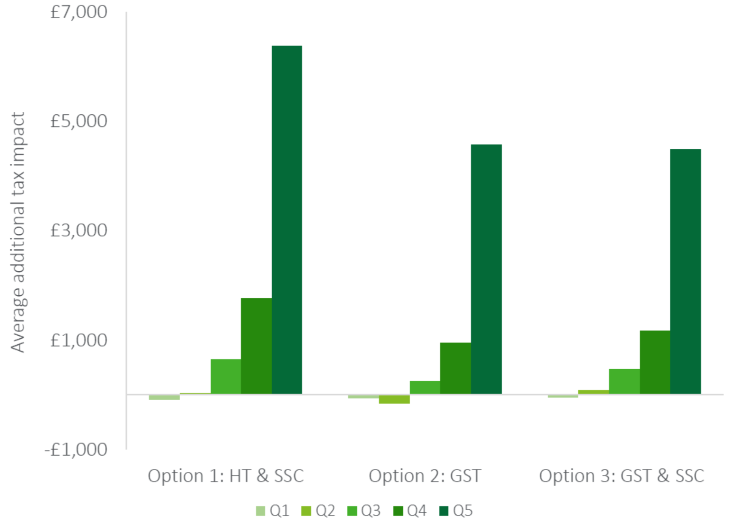
Source: Household income data and tax impact data as provided by the States

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

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

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

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



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

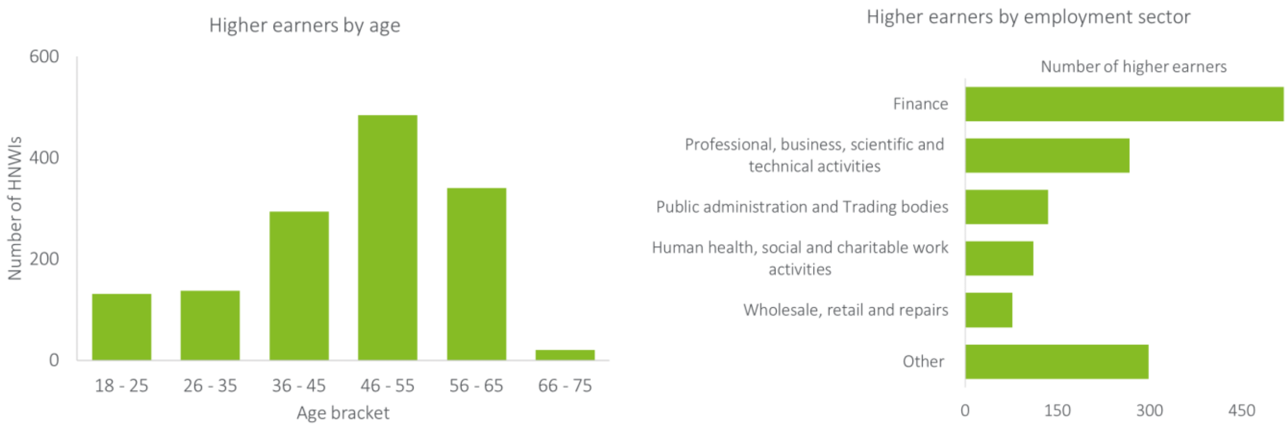
4.4.2. Higher Earners (Part of Top 5%)

Of the illustrative tax changes being considered, the PIT changes would be most likely to impact higher earners. Impacts on higher earners are therefore considered in the context of the different policy options under consideration. Furthermore, the demographics of these higher earners are studied to discuss impacts to specific sectors in the scenario that these individuals move out of Guernsey.

4.4.2.1. Demographics of Higher Earners

Overall, a total of 1,406 higher earners have been identified from data on the top 5% of households in the income distribution, as provided by the States. These higher earners are employed and self-employed individuals in 1 to 4 person households and employed and self-employed individuals chosen from 5 to 6 person households based on aggregate household income reflecting a high number of higher earners. Almost 80% of these individuals are between 45 and 65 years of age. Furthermore, 56% of these higher earners are employed either in the finance sector or in the professional, business, scientific, and technical activities sectors. Their distribution by age and employment sectors is shown in Figure 18.

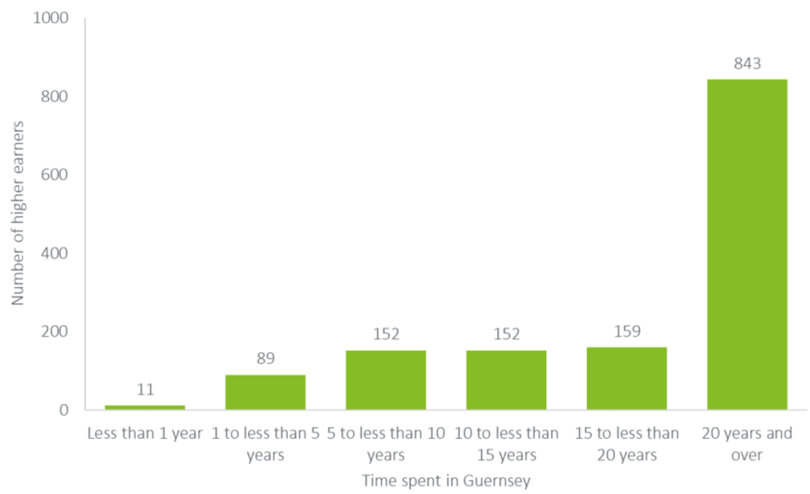
Figure 18: Distribution of higher earners by age and employment sectors (five largest)



Source: Household income data for the top 5% of households as provided by the States

When looking at time spent resident in Guernsey, 60% of higher earners have spent over 20 years in Guernsey, and 82% of higher earners have spent over 10 years in Guernsey. Figure 19 shows the distribution by the amount of time spent in Guernsey.

Figure 19: Higher earners by time spent in Guernsey



Source: Household income data for the top 5% of households as provided by the States

4.4.2.2. Impact on income of higher earners as a result of proposed changes in income taxation

Overall, it is seen that the largest proportion of those individuals who are categorised as higher earners would see an **impact of 3% to 4% on their household income under Option 1 and impact of between 2% and 3% of household income under both Option 2 and Option 3.**[123] For the small number of individuals who make use of the States' tax cap this impact will be zero. Under each policy option the impact on higher earners is 5% or less for at least 80% of households. In the event that these tax changes are large enough to incentivise higher earners to relocate to minimise their income tax

[123] As individual income is not available, household income is used as a proxy. This is declared household income as individuals who pay the personal income tax (PIT) cap are not obligated to declare their full income. Thus, the impacts calculated may be an overestimation.

burden, the finance and professional activities sectors may be adversely impacted as they employ over 50% of the higher earners.

However, given the PIT ranges seen in comparable jurisdictions in the benchmarking analysis in Section 3, it is **unlikely that the tax changes illustrated here will lead to a material change in factors that make Guernsey an attractive location for some higher earners. For the few high net worth individuals who make use of the tax cap, their location choice is more likely to be sensitive to changes in the tax cap and capital taxes, which are unchanged for each of the options under consideration in this report**. Further, higher earners generally tend to be more adversely impacted by increases in capital gains taxes, which are not currently applied in Guernsey.

Considering the distribution of time spent in Guernsey, this may suggest that about 82% of higher earners have ties to the island which could make them less sensitive to tax reform. On this basis, the improvement of the health and care sector, as a result of the planned expenditure, relative to the counterfactual where the spending does not take place, will help to retain Guernsey's attractiveness as a jurisdiction of residence. This still leaves 18% of this group who may have a more limited local connection and could be fairly mobile and sensitive to their direct tax burden. Given their large contribution to the tax base, the loss of even a small number could be significant for the States. This also does not consider whether the changes in direct taxation may impact Guernsey's ability to attract such individuals in the first place. Higher earners differ from the high net worth individuals (HNWIs), which are much smaller in number, more mobile and would be most influenced by the tax cap and any taxes on capital.

Key Insights

Government revenue in Guernsey, before 2020 and the impacts of COVID-19, was 21.9% of GDP, which is lower than the States' target of 24%. The first element of the economic impact study presented in this report is to consider whether the illustrative tax reforms considered in this Interim Report would lead to a sufficient increase in government revenue.

The three tax reforms under consideration include changes to existing tax policy as well as the introduction of new forms of taxation. The first option involves the introduction of a 3% Health Tax administered in a similar fashion to PIT along with restructured (increased) SSC rates. The second option involves the introduction of an 8% GST administered in a manner similar to the GST in place in Jersey, along with a marked increase in the PIT allowance and restructured (increased) SSC rates. The third option involves the introduction of a 5% GST administered in a manner similar to the GST in place in Jersey, along with an increase in the PIT allowance and restructured (increased) SSC rates.

Implementing Policy Option 1, which is based on the Health Tax, would increase the ratio of tax revenue to GDP to 23.8% by 2026. If Policy Option 2, which is based on the GST, were implemented, it would increase the ratio of tax revenue to GDP to 24.1% by 2026. If Policy Option 3, which is a balance between relying on the GST and changes in SSCs, were implemented, it would increase the ratio of tax revenue to GDP to 24.0% by 2026. While the analysis presented in this report suggests that the policy options under consideration may be sufficient to lead to an increase in government revenue, there are also likely to be wider economic impacts associated with their introduction.

Increases in individual taxation (PIT, social security and Health Tax) will lead to a short-term decrease in household consumption, a short-term decrease in GDP growth, a short-term decrease in employment and have no impact on price levels. The introduction of a GST will lead to household consumption being brought forward but not with any significant total impact, no significant impact on GDP growth, no significant impact on employment and a short-term increase in inflation.

While the aggregate impacts of changes in taxation may be somewhat limited, the impacts for individual sectors and the distributional consequences of reform may be greater. Changing the higher rate of PIT is most progressive, while the impact of changing social security contributions and introducing a Health Tax is limited for those in the top income quintile as a result of the tax cap.

The GST is least progressive as the burden falls predominantly on lower income households; this impact has been mitigated in other jurisdictions by introducing accompanying compensatory policies. **When the impact of mitigations is included all policy options under consideration are found to be progressive in terms of expenditure or income and in absolute terms.**

82% of higher earners have spent more than 10 years in Guernsey, which, when combined with the position of Guernsey's tax regime relative to its benchmark jurisdictions, suggests that the reforms considered in this report are unlikely to be sufficient to result in a material change in the incentives of such higher earners. However, it could be the case that some individuals who are more mobile and have less significant ties or time spent in Guernsey may consider their position, and this would have wider consequences for the people that such individuals employ as well as their overall contributions to Guernsey's tax base.

5 Conclusion and next steps

Guernsey's current tax regime is broadly comparable to those of its benchmark jurisdictions and would continue to be so after accounting for the tax policy options considered in this report. Nevertheless, the options analysed will cause changes to Guernsey's tax regime across the different dimensions considered. The direction of these changes is specific to each option. The economic impacts of the tax policy options are likely to be transitory but may have important repercussions for certain sectors.

The States currently have an expected operating deficit of £64 million in 2020. The States are considering three tax policy options to increase revenues such that the States meet the future needs of their ageing population and are capable of the 24% of revenue to GDP target. This Report analyses the options put forward by the States, which include changes to their key tax levers. It does so by first benchmarking Guernsey's current tax regime and the tax regime that would prevail under each of the three options, relative to comparable jurisdictions, and second considering the economic impact of implementing these options to increase revenues.

The first tax policy option involves the introduction of a 3% Health Tax and a restructured social security contribution system with rate increases. The second option involves the introduction of a GST at a rate of 8% along with a social security contributions restructure. The third option involves the introduction of a GST at a rate of 5%, a social security contribution system restructure with rate increases. Outside the tax policy options analysed in this report, the States have provided the assumption applicable to MNEs in line with the OECD work-stream on corporate taxes, that changes to the CIT would raise an additional £10m in revenue. Importantly, with regard to Jersey and the Isle of Man, the States are likely to seek to maintain alignment and the comparative position would remain broadly the same.

The States have posited that the revenue raised by any one of the options chosen will be reinvested in the economy as a result of increasing demand for health and aged care. Based on this and the empirical evidence, **the considered tax levers' overall impacts on GDP growth may be limited and transitory in nature.** However, there may be impacts in the short term that are associated with government expenditure being delayed, for example as a result of a labour shortage for healthcare professionals required to increase capacity in the sector. It is also likely that the **economy will experience structural change** resulting from both changes to the tax system and increased government expenditure. Sectors such as **wholesale, retail, and repairs, and transport and storage may be negatively affected**, as household consumption is adversely impacted. By contrast, sectors such as **health and care and public administration may expand in line with increased spending necessary to maintain existing service levels.** Consideration may need to be given to investing in upskilling labour to support the labour market in transitioning to a restructured economy.

Any tax reforms are likely to be accompanied by adjustment costs, these costs will be more pronounced where new systems are being introduced, such as a GST in the case of Guernsey. Furthermore, the introduction of a GST itself **may increase price levels in the short-term** increasing prices by approximately 3 percentage points for Option 3 and even more so for Option 2, based on impacts observed in Jersey. However, this is expected to **not have any long-term impacts on inflation** as prices settle to a new baseline after a year.

As discussed in Section 3, **Guernsey currently raises less tax as a proportion of its GDP relative to some of the benchmark jurisdictions**. **Guernsey's position remains the same when all three options are considered**. Amongst the benchmark jurisdictions, **Guernsey is the only one that does not currently have a GST in place. However, Options 2 & 3 present a**

change to this as a result of introducing GST at different rates. Guernsey's GST contribution to total revenue would increase with both options, bringing Guernsey to the lower end of the benchmark range.

Guernsey's share of direct tax as a proportion of total tax revenue is currently the highest amongst the benchmark jurisdictions considered in this report. Option 1 would increase Guernsey's direct tax reliance, maintaining its position across the range. This is largely driven by the introduction of a 3% Health Tax charged in the same way as PIT but also by the increase in SSC rates and the broader SSC restructure. Options 2 & 3 would reduce Guernsey's direct tax reliance as a result of introducing a GST, with Option 2 causing change of a higher magnitude due to its higher GST rate.

Furthermore, depending on the taxes implemented, the impacts on different parts of the income distribution will vary. **Option 1 with the 3% Health Tax is the most progressive of the three tax policy options, with impact increasing from the first to fifth quintile.** This is a result of Guernsey's current PIT structure and the SSC restructure as part of Option 1 to match the current PIT structure.

The introduction of a GST could be regressive in nature without any accompanying mitigations, particularly as no essentials are being zero-rated or taxed at a lower rate. Attempts to mitigate this regressivity in other jurisdictions have been made by providing means-tested benefits to lower income households. **The States have included a change in the PIT and SSC allowance as well as mitigation measures such as a food cost support bonus to Options 2 and 3. As a result, the options involving a GST as presented by the states are progressive after making these adjustments.**

The impacts on higher earners have been studied in the context of each individual option. It is seen that higher earners are mostly employed in high-skilled sectors such as finance and that a large majority of them have spent over 10 years in Guernsey. Given the nature of their high-skilled employment, it is unlikely that the employment status of these individuals will be adversely impacted as a result of the structural changes in the economy given that changes in the marginal personal income tax rate are unlikely to be a significant factor when companies choose where to locate. **Furthermore, given that Guernsey's structures for capital gains tax, inheritance tax, and corporate tax are comparable to those of its benchmark jurisdictions, it is unlikely that the tax changes illustrated here will lead to a material change in factors which make Guernsey an attractive location for some higher earners. For some of the more mobile higher earners who may have weaker ties to the Island, the changes under consideration may cause them to reconsider their residence in Guernsey.** For the few high net worth individuals who make use of the tax cap, their location choice is more likely to be sensitive to changes in the tax cap and any taxes on capital.

Appendix

A1. Identification of higher earners

The States have provided us with household-level data for the top 5% of households by household income. To further classify these individuals as higher earners:

- The household income data provided by the States is first filtered by quintile 5 households only.
- This subset is then filtered by large household sizes and these households are examined to determine the validity of their inclusion in this sample.
- For the 7 to 11 person households in the distribution, when income per working individual was calculated, the values were quite small. These households therefore have a large household income as a result of several adults living in one household. These individuals from these households were all removed from the sample.
- For 5 and 6 person households, all individuals with employment status “Full Time Education”, “Incapacitated”, “Non-Employed”, “Other”, or “Unemployed” were removed. The remaining individuals were then manually categorised as higher earners or not based on household income.
- For 1 to 4 person households, all individuals with employment status “Full Time Education”, “Incapacitated”, “Non-Employed”, “Other”, or “Unemployed” were removed. The rest were all classified as higher earners as the remaining dataset was too large to manually sort.

A2. Figures and source data

- Figure 7:
    1. **Department of Statistics Singapore**, ‘Gross Domestic Product at Current Prices, By Industry (SSIC 2015 Version 2018), Annual’, available at: https://www.tablebuilder.singstat.gov.sg/
    2. **Statistics Portal Luxembourg,** ‘National Accounts: Annual Accounts - Aggregates by branch: Gross value added by activity’, available at: https://statistiques.public.lu/en/economy-finances/index.html
    3. **Isle of Man’s National Income**, ‘National Income Report 2018-19’ - Banking, Insurance and Other Finance and Business Services computed to make up the Finance Sector, available at: https://www.gov.im/about-the-government/departments/cabinet-office/economic-affairs-division/national-income/
    4. **The States government website**, ‘Supplementary GVA and GDP Data 2019’, available at: https://www.gov.gg/gdp
    5. **Jersey’s Open Data Website**, ‘GVA in real terms in constant 2019 values’, available at: https://opendata.gov.je/dataset/national-accounts

- Figure 8:
    1. **Department of Statistics Singapore**, ‘Gross Domestic Product at Current Prices, By Industry (SSIC 2015 Version 2018), Annual’, available at: https://www.tablebuilder.singstat.gov.sg/ & **Singapore Public Data**, ‘IRAS’ Collection by Tax Type Annual’ and Singapore CPF website, ‘CPF Statistics’, available at: https://data.gov.sg/dataset/iras-collection-by-tax-type-annual & https://www.cpf.gov.sg/Members/AboutUs/about-us-info/cpf-statistics
    2. **Statistics Portal Luxembourg,** ‘National Accounts: Annual Accounts- Main aggregates: three approaches (filter by production approach)’ & ‘Economy and finance: Public finances: Taxes and social benefits – Total General Government, available at: https://statistiques.public.lu/en/economy-finances/index.html
    3. **Isle of Man National Income webpage**, available at: https://www.gov.im/about-the-government/departments/cabinet-office/economic-affairs-division/national-income/ **& Isle of Man in Numbers**, ‘Isle of Man in Numbers 2020: Treasury Receipts’, available at: https://www.gov.im/about-the-government/government/open-data/economy/

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5. States **Jersey's Open Data Website**, 'Annual income, expenditure and reserves', 'Contributions and the States Grant to the Social Security Fund' & 'GDP in real terms in constant 2019 values', available at: https://opendata.gov.je/organization/statistics

- Figure 10:
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  2. **Increase in Jersey's GST in June 2011: Jersey government website tax receipts**, available at: https://www.gov.je/Government/JerseyInFigures/GovernmentAccounts/Pages/TaxReceipts.aspx#anchor-1 , **Jersey June 2012 Retail Prices Index Report**, available at: https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20RPIJune2012%2020120720%20SU.pdf
  3. **Introduction of Long-Term Care Charge in Jersey in 2015: Jersey government website long-term care scheme page**, available at: https://www.gov.je/Benefits/LongTermCare/Pages/LongTermCareAbout.aspx, **General information on Jersey's long-term care scheme**, available at: https://www.gov.je/SiteCollectionDocuments/Benefits%20and%20financial%20support/LTC%20General%20Information%20Booklet%2020170417%20JJ.pdf, **Combination of Long-Term Care Fund data from States of Jersey Financial Report and Accounts 2015, States of Jersey Annual Report and Accounts for 2017, and 2019 Annual Report and Accounts**, available at https://www.gov.je/Government/PlanningPerformance/BudgetAccounts/Pages/StatesofJerseyAccounts.aspx, **Jersey 2018 review of the long-term care scheme**, available at: https://statesassembly.gov.je/scrutinyreports/2018/report%20-%20long-term%20care%20scheme%20-%2028%20march%202018.pdf
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- Table 3:
  1. **The States: PIT rate** https://www.gov.gg/tax, **social security rate** https://www.gov.gg/SScontributions, **CIT rate** https://www.locateguernsey.com/your-business/tax/
  2. **Jersey: PIT rate** https://www.gov.je/TaxesMoney/IncomeTax/Individuals/PayingTaxEarnings/Pages/CalculatingTaxAssessment.aspx , **social security** https://www.gov.je/Working/Contributions/Pages/ContributionLevels.aspx, **Health Tax (long-term care charge)** https://www.gov.je/Benefits/LongTermCare/Pages/LongTermCareContributions.aspx, **GST rate** https://www.gov.je/TaxesMoney/GST/GSTCustomers/Pages/GSTQuickGuide.aspx & https://www.gov.je/TaxesMoney/GST/InternationalServiceEntities/Pages/Understanding.aspx, **CIT rate** https://www.gov.je/taxesmoney/incometax/companies/historiccompanyguidancenotes/pages/2018companytaxreturnguidancenotes.aspx
  3. **Isle of Man: PIT rate and social security (national insurance)** https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/individuals/residents/rates-and-allowances/, **GST rate**

https://www.gov.im/categories/tax-vat-and-your-money/customs-and-excise/technical-information-vat-duty-and-interest-rates/vat-rates/, **CIT rate** https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/business-and-corporations/

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5. **Luxembourg: PIT rate and social security** https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/tax/lu-individual-pocket-tax-guide.pdf, **GST rate** https://guichet.public.lu/en/entreprises/fiscalite/tva/notions/tva.html**,** **CIT rate** https://guichet.public.lu/en/entreprises/fiscalite/impots-benefices/benefices-soc-capitaux/impot-revenu-collectivites.html & **net wealth tax** https://www.parfigroup.eu/luxembourg-corporate-tax-guide/#_ftn1

- Table 10:
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  2. **Isle of Man government website** 'VAT rates' and 'Registering for VAT', available at: https://www.gov.im/categories/tax-vat-and-your-money/customs-and-excise/technical-information-vat-duty-and-interest-rates/vat-rates/
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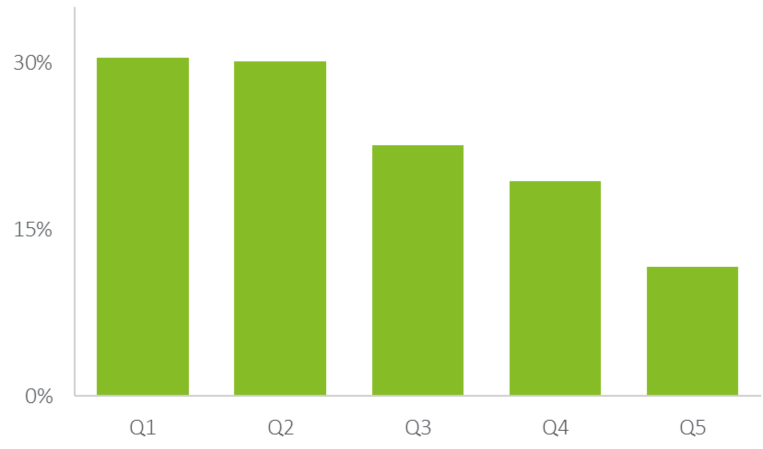
  4. **Singapore government agency website**, available at: https://www.iras.gov.sg/IRASHome/GST/Non-GST-registered-businesses/Learning-the-basics/How-GST-Works/
  5. **New Zealand Inland Revenue website,** available at: https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir300---ir399/ir375/ir375-2021.pdf

A3. Other Figures and Tables

Figure 20: Proportion of total expenditure spent on essentials



Source: Expenditure data from Guernsey Household Expenditure Survey Report, available at: https://www.gov.gg/CHttpHandler.ashx?id=133968&p=0.

Table 10 below details the GST rates applied to each jurisdiction alongside a summary of some other GST treatments. It also highlights the exemption of financial services, which is important to each of these jurisdictions' economies.

Table 10: GST rates, zero ratings, exemptions and business threshold for each jurisdiction

	Jersey	Isle of Man	Luxembourg	Singapore	New Zealand
Standard Rate	5%	20%	17%	7%	15%
Other Rates	-	5% Children's car seats, home energy, domestic property repairs and accommodation provided by hotels	14% - Certain wines, solid mineral fuels, washing and cleaning products 8% - shoes and leather goods, clothing, household linen and hairdressing; 3% - Foodstuffs, soft drinks, children's clothing and footwear		-
Zero rated items	Exports of goods, housing, international services	Exports, most food and children's clothes, books and newspapers	Intra-community supplies, international transport and exports	Exports of goods and provision of international services	Exports, sales of ongoing business, sale of land
Exemptions	Financial services, insurance, postal services, medical and paramedical supplies made by registered professionals or institutions, registered childcare, school fees, supplies by charities, some burial and cremation services	Postage stamps, financial and property transactions	Medical services, health services, supplies of postage, welfare services, education and financial services	Sale and lease of residential land and financial services	Financial services, donations, private rent sale of private property and penalty interest
Business threshold	£300,000	£85,000	€35,000 (£30,435)	SGD 1 million (£543,478)	NZD 60,000 (£31234)

Source: See Appendix A2 Table 10, the exchange rates used for business threshold values were £1 = €1.15, £1 = SGD 1.84, and £1 = NZD 1.92, all calculated on the 28th April 2021

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Appendix 2: Samples of Household Analysis

The following analysis covers real examples extracted from the data set and assessed against all three options presented. They are intended to demonstrate in more detail how the options would be applied.

Note that the analysis presented in the body of the report are averages, and that a household's individual circumstances will affect the extent to which they are impacted by the changes. The examples presented in this appendix are not necessarily representative of all other households with similar incomes and household compositions.

To illustrate Figures A2.1 and A2.2 show a single employed or self-employed adult respectively, each of approximately median earning to illustrate the different outcomes. Figure A2.13 also shows a comparison between two pensioner couples with similar incomes but whose personal circumstances, including their housing status and the amount of their income derived from the States' pension are different.

Single adults no children

Figure A2.1

Gross income (incl benefits)	£38,110	(employed)
Income support recipient	No	
Equivalised income percentile	50-54	
Housing	Owner occupier with mortgage	

	Current	Option 1	Option 2	Option 3
Income tax/social security/health tax liability	£7,222	£7,800	£6,149	£6,766
Est TRP and excise liability	£977	£977	£977	£977
Est GST liability	£-	£-	£1,836	£1,147
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust IS for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£-	£-
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	**£-**	**£578**	**£763**	**£691**
		1.5%	**2.0%**	**1.8%**
		worse off	**worse off**	**worse off**

Figure A2.2

Gross income	£35,639	(self-employed)
Children	-	
Income support recipient	No	
Equivalised income percentile	50-54	
Housing	Private renter	

	Current	Option 1	Option 2	Option 3
Income tax/social security/health tax liability	£7,858	£7,895	£6,263	£6,919
Est TRP and excise liability	£555	£555	£555	£555
Est GST liability	£-	£-	£1,342	£839
Adjusted Income Support for direct tax changes	£-	£-	£-	£-
Adjusted IS for GST	£-	£-	£-	£-
Adjusted pensions for GST	£-	£-	£-	£-
Cost support	£-	£-	£-	£-
Net change in circumstances	**£-**	**£37**	**-£253**	**-£100**
		0.1%	**-0.7%**	**-0.3%**
		worse off	**better off**	**better off**

Single adults no children (cont)

Figure A2.3

Gross income (incl benefits)	£16,816
Income support recipient	No
Equivalised income percentile	15-19
Housing	Private renter

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£2,158	£1,677	£788	£1,194
Est TRP and excise liability	£572	£572	£572	£572
Est GST liability	£-	£-	£1,123	£702
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£-	£-
Cost support (max modelled)	£-	£-	£800	£500
Net change in circumstances	**£-**	**-£481**	**-£1,047**	**-£262**
		-2.9%	**-6.2%**	**-1.6%**
		better off	**better off**	**better off**

Figure A2.4

Gross income (incl benefits)	£63,508
Income support recipient	No
Equivalised income percentile	80-85
Housing	Owner occupier with mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£12,632	£14,349	£11,889	£12,761
Est TRP and excise liability	£1,378	£1,378	£1,378	£1,378
Est GST liability	£-	£-	£2,764	£1,727
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust IS for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£-	£-
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	**£-**	**£1,717**	**£2,021**	**£1,856**
		2.7%	**3.2%**	**2.9%**
		worse off	**worse off**	**worse off**

Couples with 1 child

Figure A2.5

Gross income (incl benefits)	£65,958
Income support recipient	No
Equivalised income percentile	50-54
Housing	Private renter

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£12,634	£13,360	£10,332	£11,455
Est TRP and excise liability	£927	£927	£927	£927
Est GST liability	£-	£-	£2,356	£1,473
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£-	£-
Cost support	£-	£-	£-	£-
Net change in circumstances	**£-**	**£726**	**£54**	**£294**
		1.1%	**0.1%**	**0.4%**
		worse off	**worse off**	**worse off**

Figure A2.6

Gross income (incl benefits)	£31,019
Income support recipient	Yes
Equivalised income percentile	15-19
Housing	Affordable

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£3,288	£2,157	£724	£1,411
Est TRP and excise liability	£483	£483	£483	£483
Est GST liability	0	0	£1,511	£944
Adjust Income Support for direct tax changes	0	-£1,131	-£2,564	-£1877
Adjust Income Support for GST	0	0	£2,218	£1,387
Adjust pensions for GST	0	0	0	0
Cost support	0	0	0	0
Net change in circumstances	**0**	**0**	**-£707**	**-£443**
		0.0%	**-2.3%**	**-1.4%**
		no change	**better off**	**better off**

Couples with 1 Child (cont)

Figure A2.7

Gross income (incl benefits)	£113,345
Income support recipient	no
Equivalised income percentile	80-85
Housing	Owner occupier with mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£23,042	£26,945	£22,227	£23,822
Est TRP and excise liability	£1,840	£1,840	£1,840	£1,840
Est GST liability	0	0	£3,645	£2,278
Adjusted Income Support for direct tax changes	0	0	0	0
Adjust Income Support for GST	0	0	0	0
Adjust pensions for GST	0	0	0	0
Cost support	0	0	0	0
Net change in circumstances	**0**	**£3,903**	**£2,830**	**£3,058**
		3.4%	**2.5%**	**2.7%**
		worse off	**worse off**	**worse off**

Single Pensioners

Figure A2.8

Gross income (incl benefits)	£38,242
Income support recipient	No
Equivalised income percentile	50-54
Housing	Owner occupier without mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£6,336	£7,322	£5,808	£6,248
Est TRP and excise liability	£995	£995	£995	£995
Est GST liability	£-	£-	£1,549	£968
Adjust Income Support for direct tax change	£-	£-	£-	£-
Adjust IS for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£556	£347
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	**£-**	**£986**	**£465**	**£533**
		2.6%	**1.2%**	**1.4%**
		worse off	**worse off**	**worse off**

Single Pensioners (cont)

Figure A2.9

Gross income (incl benefits)	£16,603
Income support recipient	No
Equivalised income percentile	15-19
Housing	Private renter

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£1,000	£1,076	£619	£950
Est TRP and excise liability	£458	£458	£458	£458
Est GST liability	£-	£-	£1,081	£676
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£556	£347
Cost support (max modelled)	£-	£-	£800	£500
Net change in circumstances (per year)	**0**	**76**	**-£656**	**-£221**
		0.5%	**-4.0%**	**-1.3%**
		worse off	**better off**	**better off**

Figure A2.10

Gross income (incl benefits)	£63,069
Income support recipient	No
Equivalised income percentile	80-85
Housing	Owner occupier without mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£12,146	£14,150	£11,767	£12,331
Est TRP and excise liability	£1,893	£1,893	£1,893	£1,893
Est GST liability	£-	£-	£2,822	£1,764
Adjusted Income Support for direct tax changes	£-	£-	£-	£-
Adjusted IS for GST	£-	£-	£-	£-
Adjusted pensions for GST	£-	£-	£556	£347
Cost support	£-	£-	£-	£-
Net change in circumstances	**£-**	**£2,004**	**£1,887**	**£1,602**
		3.2%	**3.0%**	**2.5%**
		worse off	**worse off**	**worse off**

Pensioner couples

Figure A2.11

Gross income (incl benefits)	£57,573
Income support recipient	No
Equivalised income percentile	50-54
Housing	Owner occupier without mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£8,188	£9,503	£7,227	£7,971
Est TRP and excise liability	£1,913	£1,913	£1,913	£1,913
Est GST liability	£-	£-	£3,301	£2,063
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£971	£607
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	**£-**	**£1,315**	**£1,369**	**£1,239**
		2.3%	**2.4%**	**2.2%**
		worse off	**worse off**	**worse off**

Figure A2.12

Gross income (incl benefits)	£96,304
Income support recipient	no
Equivalised income percentile	80-85
Housing	Owner occupier without mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£17,310	£20,094	£16,373	£17,351
Est TRP and excise liability	£1,750	£1,750	£1,750	£1,750
Est GST liability	£-	£-	£3,704	£2,315
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£210	£131
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	**£-**	**£2,784**	**£2,767**	**£2,356**
		2.9%	**2.9%**	**2.4%**
		worse off	**worse off**	**worse off**

Figure A2.13

Comparison of low-income pensioner couple examples

Couple 1

Gross income (incl benefits)	£26,978
Income support recipient	no
Equivalised income percentile	15-19
Housing	Owner Occupier without mortgage

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£1,110	£1,198	£196	£584
Est TRP and excise liability	£913	£913	£913	£913
Est GST liability	£-	£-	£1,707	£1,067
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£644	£403
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	£-	£88	£149	£138
		0.3%	0.6%	0.5%
		worse off	worse off	worse off

Couple 2

Gross income (incl benefits)	£27,477
Income support recipient	no
Equivalised income percentile	15-19
Housing	Private renter

	Current	Option 1	Option 2	Option 3
Total income tax/social security/health tax liability	£1,282	£1,407	£270	£777
Est TRP and excise liability	£712	£712	£712	£712
Est GST liability	£-	£-	£1,668	£1,042
Adjust Income Support for direct tax changes	£-	£-	£-	£-
Adjust Income Support for GST	£-	£-	£-	£-
Adjust pensions for GST	£-	£-	£878	£549
Cost support (max modelled)	£-	£-	£-	£-
Net change in circumstances	£-	£297	-£222	-£12
		1.1%	-0.8%	0.0%
		worse off	better off	better off

Appendix 3: Contextual and supporting data

Throughout this report data is presented in equivalised gross households income percentiles. These are not adjusted for housing costs.

A percentile represents 1% of households when arranged in order from lowest income to highest income. Those in the percentiles 1 to 5 are therefore the lowest income households; those in percentiles 95 to 100 are the highest income households.

Equivalisation is a standard methodology that adjusts household income to account for the different financial resource requirements of different household types. Household size is an important factor to consider because larger households usually need a higher income than smaller households to achieve a comparable standard of living. The composition of a household also affects resource needs, for example, living costs for adults are normally higher than for children. After equivalisation has been applied, households with the same equivalised income can be said to have a comparable standard of living.

For example:

A single adult has an income of £50,000

For a couple to achieve the same standard of living they are assumed to need £50,000 *1.5 = £75,000

A single parent with on child is assumed to need £50,000*1.3 = £65,000

Figure A3.1 provides a table which translates household income percentiles into estimates of actual households' incomes for different households compositions. These are drawn specifically from the data set as analysed in this report.

Figure A3.1: Approximate value of income percentiles (£)

Equivalised income percentile	Single Adult	Couple	1 adult 1 child	2 adults 1 child	2 adults 2 children
1	7,360	11,039	9,567	13,247	15,455
2	9,300	13,950	12,090	16,740	19,530
3	10,570	15,855	13,741	19,026	22,197
4	11,538	17,307	15,000	20,769	24,230
5	11,582	17,373	15,056	20,847	24,322
10	13,574	20,361	17,646	24,433	28,505
20	18,076	27,114	23,499	32,537	37,960
30	23,292	34,938	30,280	41,926	48,913
40	28,910	43,366	37,584	52,038	60,711
50	34,777	52,165	45,210	62,599	73,032
60	40,993	61,489	53,291	73,787	86,085
70	48,110	72,165	62,543	86,598	101,031
80	57,927	86,891	75,305	104,269	121,647
90	76,319	114,478	99,214	137,374	160,270
95	102,094	153,142	132,723	183,769	214,397
96	113,801	170,701	147,941	204,842	238,982
97	130,086	195,129	169,112	234,155	273,181
98	156,942	235,414	204,025	282,496	329,578
99	218,495	327,742	284,043	393,291	458,840

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