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BILLET D'ÉTAT

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BILLET D'ÉTAT

TO
THE MEMBERS OF THE STATES
OF THE ISLAND OF GUERNSEY

I hereby give notice that a Meeting of the States of Deliberation will be held at **THE ROYAL COURT HOUSE,** on **TUESDAY,** the **24th MARCH, 2015** at immediately after the conclusion of the meeting of the States of Election to be convened for **9.30 a.m. that day**, to consider the items contained in this Billet d'État which have been submitted for debate.

R. J. COLLAS
Bailiff and Presiding Officer

The Royal Court House
Guernsey

2nd February 2015

TREASURY AND RESOURCES DEPARTMENT
& SOCIAL SECURITY DEPARTMENT

PLANNING A SUSTAINABLE FUTURE –
THE PERSONAL TAX, PENSIONS AND BENEFITS REVIEW

The Chief Minister
Policy Council
Sir Charles Frossard House
La Charroterie
St Peter Port

15th January 2015

Dear Sir

The Treasury and Resources Department and the Social Security Department are pleased to lay this States report entitled "Planning a Sustainable Future" for the consideration of the States of Deliberation.

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Glossary of terms

Ageing population	a continuous increase in the median age of the population due to changes in birth rates and increases in life expectancy.
Allowances	refers to one or more income tax allowances.
Average tax rate	the combined income tax and social insurance contributions paid as a percentage of an individual's total income .
Baby boom	the period between the end of World War II and the mid to late 1960s that was characterised by a greatly increased birth rate.
Baby boomers	individuals born during the baby boom.
Budget deficit	the States' forecast expenditure exceeding expected revenue.
Consumption tax	a tax on spending on goods and/or services.
Co-payment	the portion paid by the consumer towards the cost of receiving long-term care.
Deficit	the amount that the States' expenditure exceeds its income.
Dependency ratio	the ratio of the number of people who are either above or below working age, to those who are of working age (currently 16 to 64 years).
Economic efficiency	the degree to which tax measures affect people's behaviour. The less impact a tax has on behaviour the more efficient it is deemed to be. Taxes which reduce the incentive to work or invest are considered less efficient than taxes which reduce the incentive to spend.
Employee Tax Instalments	the total amount of income tax paid to the Income Tax Office (on a quarterly basis) by employers on behalf of their employees. Similar to Pay-as-you-earn (PAYE) schemes in the UK.
Excise duties/taxes	a tax on the import or sale of specific goods.
Fairness	in the context of this report this refers to the treatment of different groups of people within the tax and benefits systems often with reference to their income. Fairness in the tax system is usually described using terms like progressive, proportional or regressive. Fairness is a subjective term; different people will have differing opinions on what is "fair"
Financial Transformation Programme	programme whose aim is to deliver recurring annual saving by transforming the way the States deliver services in order to be more efficient.
Fiscal Framework	a set of principles that the States abide by to facilitate an economic position of long run permanent balance (i.e. income is equal to expenditure over the medium-term).
General Revenue	funds received by the States, primarily through income taxation, that is not allocated for a specific purpose.
Guernsey Health Service Fund	portion of social insurance contributions allocated to the Guernsey Health Service Fund to fund health-related services such as subsidies on primary care and prescriptions and specialist medical services provided by the Medical Specialist Group
Guernsey Insurance Fund	portion of social insurance contributions allocated to the Guernsey Insurance Fund to fund the old-age pension and other contributory benefits such as unemployment and invalidity benefit.
Horizontal equity	when individuals or households with the same income pay the same amount of tax.
Independent taxation	each individual completes an annual tax return and is assessed independently of any other member of their household. Each individual

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

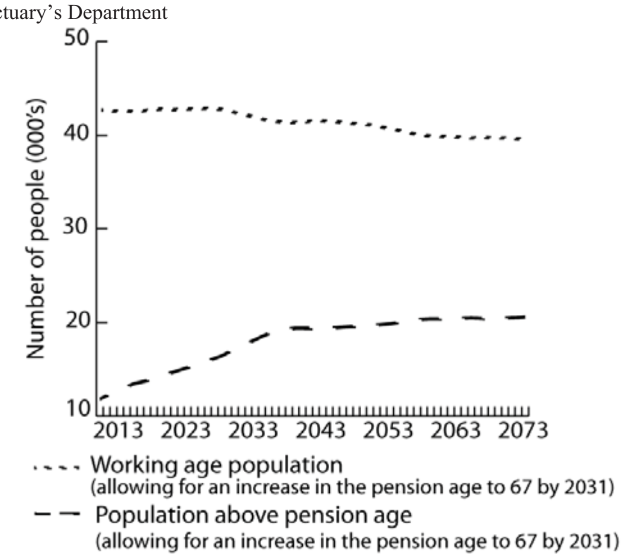
1. Executive Summary

1.1.1. The Personal Tax, Pensions and Benefits Review (the Review) was established with the objectives of examining the long-term future of Guernsey's public finances and examining the future pressures on income and expenditure. It is seeking to ensure that the income raised by the States to support public services is sustainable to 2025 and beyond, in order to continue providing the standard and range of public services that Islanders expect.

1.1.2. This report does not seek to raise further income through taxation. It considers long term pressure on expenditure and seeks to establish an appropriate limit on the amount of money taken in taxes and Social Security contributions to meet the long-term need to finance public services.

1.1.3. Over a two year period, in consultation with Islanders, businesses and the third sector, the Review has considered a wide range of subjects which affect Guernsey and Alderney's long-term financial future. While it is not the only long-term issue faced by Guernsey and Alderney, the changing demographic landscape (that is, the declining proportion of Islanders who are economically active) and the challenges that this is bringing are central to this review.

Figure 1.1: Projection of the working age and pension age population in Guernsey and Alderney
Assuming net immigration of 200 people per annum
Source: UK Government Actuary's Department



1.1.4. The Review has identified two key risks that this poses to Guernsey's long-term financial stability:

- **The population is ageing and the ratio of people above pension age to those of working age is expected to increase over the next forty years. This will mean that the demand for pensions, health and social care services will increase and the total cost of providing these services will increase proportionally.**

- **The proportion of the population which is of working age is expected to reduce over the next forty years. The reducing size of the working age population will lead to a steady erosion of public revenues, a risk magnified by Guernsey's unusually heavy reliance on taxes against personal income such as income tax and Social Security contributions.**

1.1.5. Previous States have tackled some of the challenges that this brings. This Review is the first to take a co-ordinated approach to ensuring not just that the provision of public services is ensured for the short-term, but also for the long-term – so that those at the beginning of their working lives today are not given a tax burden to carry through to their retirement, and can be assured that their public service needs are met in the future. In short, the Review is how we plan for the future funding of public services and the future of our Islands.

1.1.6. These are complex and involved challenges. There is no single solution. This report presents a package of strategic recommendations designed to meet these challenges by:

- **Placing an aggregate limit on government income of 28% of GDP to limit the amount of money that can be extracted from Islanders, in total, to fund public expenditure.**

- **Reducing the projected expenditure pressure on provision of pensions from the Guernsey Insurance Fund.**

- **Reducing States' expenditure on universal benefits.**

- **Reducing Guernsey's reliance on direct taxes by reducing the amount of money taken from the economy in the form of income tax and social security contributions and increasing the amount of money gained from indirect taxes, including: domestic Tax on Real Property.**

1.1.7. None of the measures presented can be, or should be, viewed in isolation. This is a package of measures and needs to be considered as such. For example, the negative effects of an increase in indirect taxation must be balanced against the opportunities this provides to reduce the income tax burden and to allow taxpayers the benefit of a greater disposable income.

1.1.8. Guernsey and Alderney are in fiscal union and the recommendations presented are intended to apply to both Islands. In areas where the Joint Board believes there is a need for more substantial change, any more detailed work or transitional arrangements will need to consider the impact on Alderney, with due regard to the different economic circumstances of the two Islands.

1.1.9. This Review should also be considered in the wider context of continuing policy initiatives. The outcome of investigations into Supported Living and Ageing Well and Social Welfare Benefits are significant parts of the jigsaw, with a bearing on the potential financial cost Guernsey faces in the long-term. In addition, population policy will have an impact on demographic issues and the implementation of the Economic Development Framework will have an impact on economic growth and tax receipts.

1.1.10. Throughout the review process there has been engagement on a variety of levels, including a formal public consultation process and dialogue with a number of different interest groups, such as business bodies and third sector groups. Throughout this process discussion has inevitably focused on the concerns surrounding consumption taxes. While the Joint Board acknowledges that there are valid concerns relating to consumption taxes if introduced in isolation, given the need to rebalance the overall tax base, the recommendation of this Review is that the option of introducing a consumption tax is a valid one but one that needs to be considered in more detail.

1.1.11. Furthermore, while the mandate of this Review is to look at personal taxes, feedback from a variety of industry groups in particular has highlighted that consideration of the wider context must include the tax contribution of the corporate sector, while always remembering that maintaining a tax environment which is both acceptable to the international community and competitive in a global market is crucial to Guernsey's economic success.

1.1.12. Guernsey's current corporate tax regime was reviewed very recently, the last review having closed in 2012. Clarity and surety about the amount of tax companies will be liable to pay is a key consideration for international businesses looking to remain in, or locate to, the Islands and uncertainty can be damaging to the economy. The zero-10 tax system is comparatively simple and it has also been reviewed and deemed compliant with the European Code of Conduct on Business Taxation. The advantages of this should not be underestimated.

1.1.13. However, consultation with external groups has raised the issue of further review of the corporate tax system, and consideration of territorial taxation in particular. Moving to a territorial system was considered as part of the corporate tax review but was not recommended. Following the successful outcome of reviews of the zero-10 schemes in Jersey and the Isle of Man by the European Commission, it was considered preferable to continue zero-10 (with the removal of tax on deemed distributions) rather than risk further uncertainty by pursuing an alternative, and, as yet, unproven system.

1.1.14. Internationally the developments of corporate taxation are on-going. The Joint Board believes that development of an internationally acceptable and sustainable system of territorial tax which might be suitable for Guernsey is still some years away. Nonetheless, it is recommended that the Treasury and Resources Department continue to monitor international developments in corporate taxation to ensure Guernsey's on-going competitiveness and that the Island is providing the most appropriate tax environment to both the international business community and locally resident businesses.

1.1.15. Growing the economy is not within the mandate of this review; however it is clearly a vital part of a sustainable future. The Review assumes a modest level of economic growth: lower than pre-crisis averages but higher than has been experienced in the last five years. If this level of growth is not achieved this could have significant consequences for the States' fiscal future. Supporting policies such as the Economic Development Framework and removing, where possible, barriers to economic growth are critical if our economy is to stay vibrant and strong. The States must not lose sight of the need to support and facilitate economic and business growth.

1.1.16. However, particularly given the recent economic experience, for the purposes of fiscal planning it would be imprudent to assume that the Islands can consistently achieve high levels of growth.

1.1.17. Population size and make up are also key variables in projecting Guernsey's future economic well-being. Again this review has used an assumption of a modest level of net immigration consistent with historical averages to underpin its modelling[1]. It is recognised that this is inconsistent with the official policy of no population growth but it is, in the view of the Joint Board, a more realistic basis on which to plan for the future. It should be noted, however, that if net immigration levels are significantly lower than those assumed there could be both fiscal and economic consequences. Projections show that lower levels of net immigration could result in higher dependency ratios, a smaller working age population and a more pronounced shrinking of the tax base.

[1] It should be noted that the population fell over the year ending March 2013. Data for 2014 is not yet available and it is too early to make any judgement about whether this represents an isolated event or a change in population trends.

2. Introduction

2.1. About this report

2.1.1. In the summer of 2014, the Treasury and Resources and Social Security Departments (the Joint Board) published a Principles and Issues Document, to seek to provide more information and facilitate informed public debate on the issues covered in the Personal Tax, Pensions and Benefits Review (the Review).

2.1.2. The primary objectives and guiding principles of the Review are detailed in this report but, to avoid excessive repetition this report does not re-examine all the issues which were established in the Principles and Issues Document published in July 2014. That document is included as Appendix 1.

2.1.3. This report contains a package of strategic level recommendations arising from the Review and sets parameters for various measures within which a revised taxation structure can be developed. Given the scope of the project, it is not feasible to put forward full details of each recommendation and the necessary legislative changes in a single report. It is therefore proposed that, if accepted, the recommendations of this report are taken forward through a series of further projects, to be administered by the responsible Departments, which would lead to more detailed proposals and recommendations for any necessary legislative changes.

2.1.4. Accordingly, it is not envisaged that all these changes would be implemented immediately. The Review proposes a ten-year transition period during which time the fiscal and social implications of the changes will be carefully investigated and managed to ensure that the impact on the annual States' budget is clearly understood in any given year, and that households who may be unfairly disadvantaged by the changes are protected throughout the transition.

2.1.5. For ease of review, the recommendations are structured in a series of four modules which summarise the key points in the following areas:

- **Module 1: Long-term control of government income and expenditure**
- **Module 2: Management of long-term expenditure pressures**
- **Module 3: Targeting benefits expenditure**
- **Module 4: Establishing a sustainable tax base**

2.1.6. The modules are designed to facilitate reference within this report and divide topics up into natural groupings. Whilst it is hoped that this will make the information easier to access and the purpose of the resolutions within the package of measures clearer, this does not mean that the modules are to be viewed as completely independent. For example, a decision that will result in the expenditure of more money in modules 2 or 3 may mean that it will be necessary to raise additional funds from the recommendations for taxation in module 4.

2.1.7. Further analytical detail of the recommendations is presented in the Appendices. The Appendices also contain analysis of options that the Joint Board considered during the review process but which have not been recommended.

2.1.8. The issues presented and the recommendations made affect both Guernsey and Alderney and therefore, unless otherwise stated, references made to Guernsey refer to both Islands. However, it is acknowledged that in some areas the situation in Alderney may be different from that in Guernsey and reference to this is made where necessary.

2.2. The Challenges

2.2.1. One of the primary considerations of this review is the changing balance of our population and the financial implications of this for government income and expenditure. Between 1945 and the mid to late 1960s, there was an extended period of high birth rates. Combined with the increases in life expectancy, which have resulted from improvements in social standards and health care over the last 50 years, this means that over the next 40 years the percentage of our population over pensionable age will increase and the percentage of people below pensionable age will decrease. This is referred to as an 'ageing population'.

2.2.2. Guernsey has one of the highest dependency ratios in the world. In March 2013, the dependency ratio for Guernsey and Alderney combined was 0.52[2]. That is, for every 100 people of working age in Guernsey and Alderney there were 52 people who were either of compulsory school age or younger, or at or above the current pension age (65). Even allowing for a moderate level of population growth, this ratio is projected to continue to increase well beyond the middle of this century, to increase to as much as 0.83 by the 2060s. This increase is driven by an increase in the population of pension age, the population of compulsory school age being projected to decrease over this period.

2.2.3. The Review has identified two key risks that this poses to Guernsey's future financial stability.

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[2] Note that the dependency ratio in Alderney is significantly higher than the combined average for both Islands. According to data provided by the Social Security Department the dependency ratio in Quarter 1 2013 was 0.51 in Guernsey and 0.68 in Alderney.

2.2.4. The first, and more widely recognised of these, is that as our population ages and dependency ratios become more extreme, the demand for pensions, health and social care services will increase and the total cost of providing these services will increase proportionally. Statistically, this is inevitable. As people age they become eligible to draw an old-age pension, and the number and complexity of their medical needs tend to increase, as does their need for social care to support their everyday lives. **While improvements in the general level of health among older people may well mitigate this to some extent, providing these services to an increasing number of older people will cost more.**

2.2.5. If the States are to continue to provide the next generation of older people with the level of services they may need, the ongoing provision of these services will require careful planning. To provide an acceptable level of services to those who have contributed to our tax system throughout their lives, without placing an unsustainable tax burden on the generation which follows them, is a difficult problem.

2.2.6. The second risk is that the reducing size of the working age population will lead to a steady erosion of public revenues. The working age population typically pays the majority of direct taxes, with almost 90% of income tax and social security contributions in Guernsey paid by working age people and their employers. As the proportion of people of working age decreases, so will the amount of revenue raised in direct taxes relative to the total size of the population unless specific measures, aimed at maintaining the amount raised, are implemented.

2.2.7. This problem is of particular concern in Guernsey. As a result of the decision to move to the zero-10 tax regime in 2008, and the accompanying decision to recoup a part of this revenue by increasing receipts from Social Security contributions, Guernsey is unusually heavily reliant on direct taxes. **In 2013, Guernsey sourced 74% of its total public revenues from tax on personal income and Social Security contributions. This is more than 10 percentage points higher than any OECD member state or island jurisdiction for which data are available.**

2.2.8. This heavy reliance on direct taxation makes Guernsey particularly vulnerable to any factor that may reduce the total taxable income of the population. This includes the potential reduction in the working age population over the next thirty to forty years.

2.2.9. As well as a possible reduction in total employment income, it is likely that there will be an increase in the percentage of people supporting themselves on capital wealth or the sale of assets. Much of this wealth, for example that gained through the appreciation of property assets, is not taxable. Taxing this wealth with capital gains or inheritance taxes is not a viable option for Guernsey and was excluded as an option at the outset of the review process. Both capital gains and inheritance taxes would undermine Guernsey's "tax neutral" offer for international finance business in general, and fund and pensions activities in particular. They are also liable to avoidance issues and therefore expensive to administer and offer relatively little revenue for the administrative burden.

2.2.10. A heavy reliance on direct taxes also makes Guernsey more vulnerable to economic conditions, with increases in unemployment and any reduction in average earnings likely to have a direct impact on government income.

2.2.11. **This means that not only is Guernsey's dependency ratio more challenging than those of most jurisdictions and getting more so, but also its tax base is structured in such a way as to make it particularly vulnerable to the implications this has for its public revenues.**

2.2.12. Guernsey cannot sustain this position in the long-term. At some point a change in the tax system will become unavoidable if Guernsey is to continue providing the services the community requires. The sooner these decisions are made the more scope there will be to manage and phase their introduction to minimise their impact on our community and our economy.

2.2.13. While an increase in the income tax rate may seem the simplest way to tackle the need to meet the increased expenditure and the potential erosion of the tax base resulting from the changing demographic structure, in reality this would be a short sighted solution.

2.2.14. An increase in the headline tax rate, or even higher rates for higher earners could damage Guernsey's competitive position, particularly when compared to the other Crown Dependencies, making it more difficult to recruit and retain staff in Guernsey. With recruitment and retention of staff already cited as a significant issue for local businesses the repercussions for Guernsey's economy could be significant. Furthermore, with revenues derived from direct taxes being particularly susceptible to any changes in workforce numbers, the additional revenues themselves would be at risk of erosion requiring further compensatory measures to be adopted.

2.2.15. The Joint Board is of the view that there is no single solution to the long-term challenges Guernsey faces. However, it would seem to be reasonable to conclude that the degree of reliance on taxes and social insurance contributions charged against personal income must be reduced over time.

2.2.16. This report presents a package of measures to transform both income and expenditure in order to create a financial system resilient and flexible enough to meet the challenges Guernsey faces in the future.

3. Background

3.1. Review history and process

3.1.1. The Review commenced in January 2013, taking a long-term approach to the way in which the States of Guernsey raise money from the local population and to assessing how much money the States should spend on the provision of public services such as the old-age pension, universal and means-tested benefits and health and social care.

3.1.2. The Review has been undertaken as a joint initiative between the Treasury and Resources and Social Security Departments. All political members of both boards have been involved in the process, forming a single "Joint Board".

3.1.3. The principal aim of the Review is to present, for debate, a vision of how the Joint Board feels the personal tax, pensions and benefit systems should be transformed over the next ten years, in order to make it sustainable, fair and efficient in the long term.

3.1.4. The Review commenced with a formal public consultation (see **Appendix 2**), which was subsequently followed by more informal consultation with a wide range of third sector representatives, corporate bodies and industry groups regarding the issues and potential options identified by the Review. In recognition of the breadth and significance of the Review, the Joint Board has also sought to engage other political members in order to build into the proposals a broader range of political viewpoints.

3.1.5. The Principles and Issues Report, published in July 2014, outlined many of the key issues identified during the review process and some of the options available for mitigating them. A detailed account of the background of this Review and the challenges it seeks to overcome are provided in this document (see **Appendix 1, section 2**).

3.2. Consultation and engagement

3.2.1. When the initial consultation document was published, a series of public meetings were held in Guernsey and Alderney. The report on the consultation was published in August 2013.

3.2.2. The second phase of consultation and engagement was with business groups and third sector groups. Meetings were held with, among others, the Guernsey Chamber of Commerce, the Confederation of Guernsey Industry, the Guernsey International Business Association, the Construction Industry Forum, the Guernsey Society of Chartered and Certified Accountants, the Institute of Directors and a selection of representatives from third sector organisations including Guernsey Disability Alliance, the Citizen's Advice Bureau and Age Concern.

3.2.3. In the summer of 2014 the Joint Board published a Principles and Issues Document publically outlining the aims of the Review and the areas which it was considering. Reader-friendly short versions were sent to every household in Guernsey and Alderney and a longer summary document was distributed through States' offices, Douzaines, libraries, on the internet and social media.

3.2.4. Meetings were also held with Deputies, primarily through briefings to Departmental Boards. A meeting was also held with Alderney States' members.

3.2.5. Throughout the process there has been extensive engagement with the media, including appearances by the Ministers of the two departments on Island FM and BBC Radio Guernsey, and an online question and answer session with the Guernsey Press. This type of engagement will have reached large numbers of the Islands population; the objective was to explain to Islanders what the Review was looking at and to ask them to make their views clear.

3.2.6. The proposals have also been reviewed by the Fiscal Affairs Department (FAD) and the Expenditure Policy Division of the International Monetary Fund (IMF) who are supportive of the principles underlying the review and provided bi-lateral advice on the recommendations.

3.3. Corporate taxes

3.3.1. The personal tax regime cannot be viewed in isolation. Instead it needs to be considered in the wider context of Guernsey's entire tax system.

3.3.2. During the review process, there have been repeated calls for the States to consider whether a territorial corporate tax regime could be introduced.

3.3.3. A territorial system was considered as part of the 2010 corporate tax review, which was closed in December 2012. Given that, while this review was ongoing, zero-10 tax regimes in Jersey and the Isle of Man were deemed to be compliant with the European Code of Conduct (subject to the removal of the tax on deemed distributions), a move to a territorial tax system was not considered a viable option at that time. More detail on the background of that review and the review's findings are summarised in **Appendix 3**.

3.3.4. The Joint Board does not believe that the introduction of a territorial corporate tax regime is a viable option at the current time. It would lose the simplicity of zero-10 and the competitive advantage of a headline 0% rate of corporate tax. Key technical issues to be resolved with a territorial regime would be defining "Guernsey source" and "permanent establishment" to ensure that only the provider, not the product, is taxed, and addressing the potential effects on those parts of the Guernsey economy whose competitiveness may be sensitive to the possibility of increased taxation which a territorial system may bring.

3.3.5. Whilst internationally there has been a trend towards *elements* of territorial tax, neither of the other two Crown Dependencies has publicly announced any intention to move away from zero-10. Both Jersey and the Isle of Man apply a broad based consumption tax system and therefore do not have the same issues with over-dependence on direct taxes. Therefore Guernsey would need to be contemplating a unilateral move.

3.3.6. The States have resolved to reform zero-10 on two occasions: in the 2013 and 2015 budgets. This has extended the company intermediate rate of taxation (the 10% rate) to fund administration, fiduciary and insurance management activities. Combined these extensions raise around £10m per annum in additional revenue.

3.3.7. The Joint Board believes it is essential to ensure that the economy is not undermined by placing Guernsey at a competitive disadvantage. It also strongly believes that the States have a responsibility, and it is in the Islands' best long term economic interests, to sustain business confidence by providing a stable platform for businesses to operate from.

3.3.8. However, being mindful of the concern that has been expressed regarding the possible introduction of additional taxes, the Joint Board recommends the States:

> To direct that 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 report back to the States should it consider any changes are necessary.

3.4. The limitations on predicting the future

3.4.1. Predicting the future is not easy. It can only be achieved by taking our current position and incorporating assumptions of what may happen based on what has happened in the past and what seems most likely to happen in the future.

3.4.2. The further from the present time projections extend, the less accurate they are likely to be. This is because even small differences between the assumptions made and real experience accumulate over time. It also becomes increasingly likely that an event will occur during the projected period which will significantly impact either the level or trends of the variables projected.

3.4.3. That is not to say such predictions are not useful. They can provide very informative illustration of what may happen. They can also indicate the relative impact of changing one or more of the assumptions used in isolation or in combination. For example the impact of an increasing population compared to constant population. However, these should be considered as the best estimates of what could happen, rather than a concrete projection of what will happen.

3.4.4. As part of the review process, two separate pieces of work were commissioned to examine the impact of various proposals. The first of these was an update of the actuarial projections of the Guernsey Insurance Fund produced by the UK

Government Actuary's Department in 2011 to incorporate revised assumptions of projected earnings growth and more recent population data. More detail on these is provided in **Appendix 5b**. The Actuarial reports produced are provided in **Appendices 5c** and **5d**.

3.4.5. The second piece of work was the construction of a flexible model of the tax system by Frontier Economics. This has enabled the examination of the relative impact of various tax and benefit measures on States' finances and their impact on households. More detail on this analysis is provided in **Appendix 8k**.

3.4.6. The majority of the modelling provided by Frontier Economics is based on a micro-economic approach, utilising a snap shot data set extracted from the Income Tax, Social Security and Housing administration systems. It calculates the impact of measures on a household by household basis and aggregates this to provide overall impact and distributional analysis as presented in this report.

3.4.7. This data set, although significantly more detailed than the information available to most jurisdictions conducting similar exercises, has its weaknesses. The majority of the data date from 2009 (although some is more recent) and, while the model adjusts for changes in price level, there is an inherent assumption that the basic make-up of the population and the distribution of earnings has not changed significantly over this period. There is also a small proportion of the population for whom none of the systems from which data have been drawn hold enough detail to be able to include them in the modelling exercise.

3.4.8. However, Policy Council staff, who have overseen the development and validation of the model have, where possible, cross-checked estimates against estimates produced by macro-economic approaches (which derive estimates based on high level aggregated data) and are confident that the estimates are valid within a reasonable level of accuracy based on the information currently available.

3.4.9. The modelling work has been constructed in such a way as to enable the modelling to be updated with more recent data as they becomes available. It is hoped that the completion of the Rolling Electronic Census (REC) project, which is due to be completed in the first half of 2015, will give access to more recent and more sophisticated data. It will also largely automate much of the manual cleaning of the data, enabling much more regular updates of this information.

3.4.10. This REC information should be available for use in the implementation and transition stages of the project. However, as highlighted previously, it is impossible to predict the future with complete accuracy. Revision of these estimates as better and more recent data become available is inevitable.

3.5. Population and economic assumptions

3.5.1. As explained in the Principles and Issues document (**Appendix 1, section 9**), although this Review is not mandated to review population policy or economic growth, both these factors will have a significant bearing on Guernsey's fiscal future. Both factors form critical assumptions in the projections made in this report.

3.5.2. For the purpose of this report, the modelling has assumed immigration levels consistent with recent experience (net immigration of 200 people per year). This is counter to the official States policy to maintain the population in Guernsey at the level it was in 2007. If the States were to achieve this, or even if it were as to maintain the population at its current level (which is about 2,000 people higher than in 2007), the Island would need to achieve net **emigration** for a period of at least ten years. The Joint Board is of the opinion that, while the Population Management regime may offer the States more control of immigration, the States do not and cannot control the population to this extent. In reality, it is highly unlikely that the States can achieve this policy objective.

3.5.3. Changing population assumptions have a considerable impact on the projections contained in this report. The impact of these were examined in more detail in the 2012 Policy Council report on the long-term impact of demographic change on public expenditure[3]. Although the assumptions made in this report have been subsequently revised to reflect more recent experience, it does illustrate the potential scale of the impact on States' finances of changing population assumptions.

3.5.4. This report does not seek to discuss States' population policy in any detail. However given the impact migration assumptions have on the projections of both government finances and the economy in future, and the concerns raised during the engagement process regarding the impact on businesses of States policies in this area, the Joint Board recommends the States:

To direct the Policy Council to review the impact of population policy on current and future economic growth in Guernsey and report back to the States of Deliberation with its findings no later than July 2018.

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

To direct the Treasury and Resources Department and Social Security Departments when making recommendations for changes in tax and benefits during the transitional period as detailed in paragraphs 6.1.1 to 6.1.7 of this Report, to have regard to the numbers of people resident in Guernsey and Alderney, their demographic make-up and their level of economic activity.

3.5.5. Unless otherwise stated, the modelling used in this report is based on an assumption of earnings growth of 1.5% in real terms; lower than Guernsey's long-term average earnings growth rates, but a higher rate than has been experienced since the beginning of the financial crisis in 2009.

3.5.6. Earnings growth assumptions can be combined with projections of the working age population (which are themselves based on the migration assumptions discussed above) to project Guernsey's finances relative to the size of the economy. Under this model, earnings growth and the size of the working age population are the determining factors in economic growth. Changing the rate of earnings growth has a significant impact on the projections of States' finances. Lower rates of growth result in higher levels of expenditure relative to GDP and larger projected deficits.

3.5.7. Again, while growing the economy is not within the mandate of this review, it is clearly a vital part of a sustainable future. The States must not lose sight of the need to support and facilitate economic and business growth. However, for the purposes of fiscal planning, it would be imprudent to assume that the Islands can consistently achieve high levels of growth.

3.5.8. During the engagement process, numerous groups cited that not enough is being done to facilitate business activity in Guernsey and that there are obstacles to doing business in Guernsey, which are damaging to its competitive standing. The Joint Board notes that a significant element of the Economic Development Framework is aimed at overcoming barriers to private sector business and economic growth in Guernsey.

3.5.9. This is a key area of work and includes a number of work streams to facilitate business activity in Guernsey and support economic growth. These include:

- Measures to attract high net worth individuals to Guernsey;
- A "red-tape" audit;
- Work to improve connectivity and business communication.

3.5.10. The Joint Board fully supports this work and the formation of the Economic Development Fund to facilitate projects in this area. A greater public awareness of the work that is underway could reassure businesses that their interests are considered and improve confidence in Guernsey's economic prospects.

3.6. Resolutions and references

3.6.1. The Personal Tax, Pensions and Benefits Review has been referenced at numerous points since its commencement and there are a number of resolutions giving direction to the review to examine particular issues. These are detailed in the table below and references provided to where the relevant information is contained in this report.

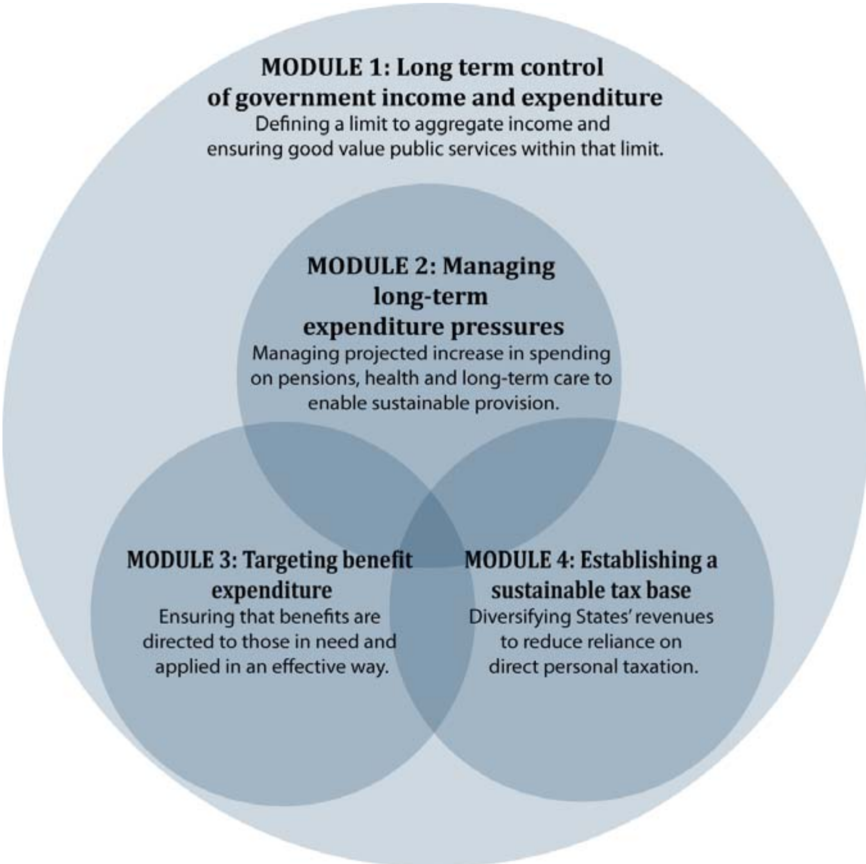
Publication	Resolution	Reference
113th Medical Officer of Health Annual Report 2012/2013 (Billet d'État VIII, May 2013)	"To direct that in recognition of the aim of Recommendation 5 of the Medical Officer of Health's 113th Annual Report any Propositions laid before the States of Deliberation by States Departments in connection with the comprehensive review of personal taxes, pensions and benefits will, subject to existing resources available to the States, take into account the potential impact on health, wellbeing and health equity among the population."	Section 9
2013 Budget (Billet d'État XXVI, December 2012)	"To direct that: a) the Treasury and Resources Department shall consider the case for making changes to mortgage interest tax relief as part of the comprehensive review of personal taxes, duties and contributions referred to in paragraphs 3.1 to 3.4 of that Report;	Paragraphs 5.4.31 to 5.4.33
	b) in advance of that comprehensive review no changes shall be proposed by the Treasury and Resources Department in respect of the cap of £400,000 which at the present time applies to mortgage interest tax relief;	Appendix 8d
	c) any proposals to make changes to mortgage interest tax relief which are put before the States of Deliberation by the Treasury and Resources Department as part of, or further to, that comprehensive review shall be accompanied by an assessment of the likely financial impact of those changes upon taxpayers who are at that time eligible to claim mortgage interest tax relief."	
	"To direct that as part of their comprehensive review of personal taxation referred to in paragraphs 3.1 to 3.4 of that Report the Treasury and Resources Department shall consider the rôle of taxation in deterring property speculation (having regard inter alia to the suspension in 2009 of the Dwellings Profits Tax (Guernsey) Law, 1975 and the effects thereof), and shall include in their 2014 Budget Report their conclusions together with any recommendations considered necessary."	Appendix 8d

2015 Budget (Billet d'État XXII, October 2014)	No formal resolution was agreed but verbal reassurance was offered by the Treasury and Resources Minister that the review would incorporate an examination of higher tax rates for higher earners and a withdrawal of allowances for higher earners (otherwise referred to as "20 means 20").	Appendix 8b and c
Modernisation of supplementary Benefit (Billet d'État XX, October 2013)	"That the [Social Security] Department be directed to report to the States of Deliberation after the conclusion of the Personal Tax, Pensions and Benefits Review with proposals to achieve long-term sustainability of the Guernsey Insurance Fund. That the Social Welfare Benefits Investigation Committee shall have regard to the findings and emerging recommendations of the Personal Tax, Pension and Benefit Review." While it was not approved the original recommendations of this report also included the following: "that the Treasury and Resources Department and the Social Security Department be directed to examine the options for funding recommendations (xxviii) to (xxx) as part of the Personal Tax, Pensions and Benefits Review and report back to the States by no later than October 2014"	Module 2 Sections 4.2 and 5.2 Module 3 Sections 4.3 and 5.3
Maternity and paternity provisions and the UN convention on the elimination of all forms of discrimination against women (Billet d'État IV, February 2012)	"To direct the Social Security Department to report back to the States, at the same time it reports on the funding of other benefits, with proposals for funding and requesting the preparation of the necessary legislation to provide for: a) Changes to the maternity grant to make it available to all new mothers. b) Changes to maternity allowance to split it into a maternal health allowance and a new born care allowance with the rate of both being £180 per week (2011 rate) and the conditions as set out in paragraphs 7.10 to 7.25. c) A new adoption grant at same rate as a maternity grant in the case of adoption for a child under 18. d) a new benefit of parental allowance of £180 per week (2011 rate) which can be claimed by either parent immediately following the adoption of a child under 18 years of age. "To direct the Treasury and Resources Department to report back to the States, at the same time as the Social Security Department reports back on proposition 10 above, with proposals to fund any consequential expenditure incurred by the States as an employer or in the grant from General Revenue."	Section 5.2

4. Module overview

4.1.1. As explained earlier in the report, the modular structure is designed to separate the recommendations of the review into broad areas, but the modules are interconnected.

4.1.2. The recommendations in each module, outlined in more detail in the sections which follow, serve different objectives within the package and an overview of each module is presented in this section. A more detailed overview of the recommendations within each module is provided within section 5 and further technical analysis (including options which have not been recommended) is presented in the appendices.



4.1. Module 1: Long-term control of total government income and expenditure

4.1.3. We need to establish how big the government in Guernsey should be by asking the question: What is the maximum amount of money the people of Guernsey are willing to pay to provide public services?

4.1.4. The Fiscal Framework (Billet d'État XI, April 2009) provides a structure within which the General Revenue Budget should operate and applies limits to taxation, but these limits do not apply to Social Security contributions income or to expenditure on pensions and other insurance type benefits, which fall outside the General Revenue Budget.

4.1.5. The Joint Board recommends the extension of the Framework to capture income from Social Security contributions as a mechanism for establishing a greater degree of co-ordination and control over the total amount of money the States take from households and businesses to support public services (see sections 4.2 and 5.1). This establishes an overall financial envelope within which the States can provide public services.

4.1.6. The Fiscal Framework criterion to achieve "long-run permanent balance" requires that the States should not, in the long-term, spend more than they receive, but allows for periods of high demand for expenditure or negative pressure on income (during an economic downturn for example) where it might be necessary to run a deficit. In effect, this criterion requires the States to manage their expenditure so that it can be achieved within their income.

4.1.7. To enable the States to achieve this, the Joint Board supports every effort to maintain and enhance the culture of scrutiny of expenditure and improved efficiency that has developed in recent years. **A tight rein on expenditure will be necessary if the States are to deliver an appropriate level of quality public services within those set limitations.**

4.1.8. This principle of long-term balance is as applicable to Social Security expenditure as to General Revenue, albeit that because of the insurance type nature of the expenditure it needs to be applied over a much longer time period than would be appropriate for General Revenue. Within Module 2, proposals are presented which aim to achieve this.

4.2. Module 2: Management of long-term expenditure pressures

4.2.1. Clear and effective long-term planning to meet known demands is a key part of ensuring a sustainable future for Guernsey's public services. The recommendations presented within this module seek to mitigate some of the expenditure pressures Guernsey faces, while others are being reviewed in other work streams.

4.2.2. While it is not the only long-term pressure faced by the States, the most significant expenditure demands expected over the next forty years are a result of the ageing population. The next generation of older people (those currently aged between their mid-40s and mid-60s) is expected to be significantly larger than the current one. In addition, a steady increase in life expectancy over the last fifty years means that, on average, people are living longer and potentially entitled to an old-age pension and requiring services such as care and support services for a greater proportion of their lives.

4.2.3. This has significant implications for government expenditure, particularly in the funding of pensions and health and social care. Careful management of these pressures is needed if the States are to provide subsequent generations of older people with the level of support they may require in a sustainable manner.

4.2.4. The review has looked specifically at the provision of old-age pensions in Guernsey and recommends measures to relieve the expenditure pressure on the Guernsey Insurance Fund (GIF) to improve its sustainability. These include setting a formal guideline for the uprating of pensions to aid long-term planning. In the short- to medium-term, the intention is to set this just above the rate of price inflation (relative to the increase in earnings) to allow sufficient time to develop and establish policies, which will support greater personal responsibility and personal pension provision. It is intended that this guideline will be reduced to RPIX (or prices) only in the long-term (see section 5.2).

4.2.5. In addition, having reflected on the improvements in life expectancy since the current old-age pension was introduced in the 1960s, the Joint Board feels that the measures agreed in 2009 to increase the pension age to 67 do not go far enough.

4.2.6. The majority of the benefit of increased life expectancy is felt by the individual with an increasing proportion of the average person's life being spent in retirement. Meanwhile the cost of providing people with pensions for an increasing length of time has been borne by the GIF. Redressing this balance by further increasing the pension age improves the income projections and reduces the potential expenditure from the fund in the long-term. This makes a significant contribution to improving the GIF's stability.

4.2.7. This has the added benefit of extending the potential size of the available workforce and retains the skills and experience of these individuals in the workforce for longer. This will mitigate some of the issues presented by the projected decline in the working age population, and has both economic and fiscal benefits in the long term.

4.2.8. However, it is recognised that this must be supported by a different approach to older people in the workplace, who may require more support and flexibility in their employment.

4.2.9. Pressure on health and social care services is a more complex problem, both in estimating its potential scale and in finding a sustainable solution.

4.2.10. It is estimated that the Guernsey Long-Term Care Fund, which subsidises private sector nursing and residential care, will be exhausted in the next decade if action is not taken to increase funding or restructure services. **It is estimated that this Fund would require the equivalent of an increase in Social Security contribution rates of between 0.6% and 1.9% (in monetary terms equivalent to £9m and £27m) to make it sustainable under the current structure.**

4.2.11. Beyond this, there are care and support services offered by other departments, including Health and Social Services and Housing, all of which face a significant increase in costs as the population ages.

4.2.12. Whilst it is expected that the increasing cost pressure will be significant, it is important to remember that the next generation of older people are very likely to be fitter, healthier and more independent than their parents were at the same age. Their need for, and expectations of, the support and care services may be very different from traditional models and this needs to be reflected in long-term, strategic planning.

4.2.13. The Supported Living and Ageing Well Strategy (SLAWS) Working Party is currently conducting a review of the provision of the services in this area, but it is clear that as currently structured the projected cost is unsustainable. While it is not the intention of this Review to pre-empt the outcome of SLAWS, the Joint Board has discussed some areas in which the financial viability of this provision might be improved, which it would wish the SLAWS Working Party to consider.

4.2.14. There are similar implications for the wider provision of health services, with an increase in the number of older people likely to result in an increase in the number of patients with multiple and complex medical needs, which can be costly. Although, once again, the extent of the cost pressure needs to be tempered by the general anticipated improvement in health among older people. Internal projections of how large an increase in expenditure this may require over the next 30 years range anywhere from 0% to 6% of GDP, depending on what assumptions are made about increases in medical costs and the progression of the economy. **Relative to today's economy this is equivalent to an increase of up to £130m at the extreme end of the projections; this could double spending on health and social care in Guernsey.**

4.2.15. It is clear that careful planning and management of health services in Guernsey is critical if it is to provide a sustainable system of health care in the long-term within an acceptable level of taxation.

4.3. Module 3: Targeting benefits expenditure

4.3.1. Effective targeting of expenditure to the areas it is most needed is key to long-term expenditure control. Within this report the focus is on the redirection of expenditure away from the provision of universal benefits within the Social Security system, such as Family Allowance, towards other priorities within social policy.

4.3.2. The selection of universal benefits in particular relates to the 2013 Modernisation of Supplementary Benefit report (Billet d'État XX, October 2013), which directed this review to identify funding for the integration of the Supplementary Benefit and Rent Rebate Schemes. Although work on modernising the welfare system is still on-going, and the Social Welfare Benefits Investigation Committee (SWBIC) is expected to report back on this during 2015, as part of this review universal benefits have been investigated as an area where expenditure could be more effectively targeted.

4.3.3. Family Allowance is the most commonly referenced of these universal benefits and there is some public support for reducing expenditure in this area, and the Joint Board recommend the withdrawal of a universal Family Allowance over a period of up to 10 years.

4.3.4. This benefit currently costs approximately £10m per annum and, allowing for the compensatory increase in Supplementary Benefit expenditure, it is estimated that a complete withdrawal of the benefit would release approximately £8m of annual expenditure for reallocation, once transitional phases are complete. **This report does not make any assumptions about how this expenditure might be redirected**.

4.3.5. However, this would have a larger impact on lower income households relative to the size of their income, with the most significant impact being felt by those households who claim Supplementary Benefit but are subject to the benefit limitation[4]. The redirection of a portion of the expenditure released by the withdrawal of Family Allowance could be used to mitigate this either by diverting expenditure to the existing means-tested benefit system or some other mechanism. A further mitigating measure could include increasing the benefit limitation.

4.3.6. Other universal benefits which have been considered include a general reshaping of the prescription system. This would remove the automatic exemption from charges for over the age of 64, a practice which reflects neither a patient's ability to pay nor the true cost of drugs and medicines; and to require a nominal £1 contribution from those whose prescriptions are exempt.

[4] Under the normal assessment process, receipt of Family Allowance is included in the assessment of a household's income when calculating a household's benefit entitlement. The loss of this income would therefore result in an increase in the benefit receipts for most households in receipt of supplementary benefit. However, for those subject to the benefit limitation there are discretionary arrangements in place, which allow all or part of a household's Family Allowance to be excluded from their income for the purpose of calculating their benefit entitlement. As the system currently operates, these households may not receive an increase in benefits to compensate for the loss of Family Allowance

4.3.7. The primary care grant paid towards GP and nurse appointments (which costs the States approximately £3m per year) is also an area where the Joint Board feels the expenditure could more effectively be used elsewhere. In this instance, there is little evidence that the grant has been effective in controlling the cost of primary care appointments. The Joint Board recommends a move to withdraw this grant over the next ten years and to seek more effective ways of managing primary care costs.

4.4. Module 4: Establishing a sustainable tax base

4.4.1. In order to provide public services such as health care and education, the States must collect money from the economy to support the necessary expenditure. It is important for Guernsey's long-term stability to ensure that this money is collected in a way which is sustainable, efficient and fair. Recommendations within this module seek to achieve this.

4.4.2. It is not the intention of the recommendations in this section to raise more revenue but to create a sustainable tax base from which to support public services. In Module 1 the Joint Board has recommended what it feels to be an appropriate limit on the amount of revenue the States raise each year. If it should prove necessary to increase income to support public services in the long-term this will need to be considered by the States as the need arises, and when the extent of any necessary increases becomes clearer.

4.4.3. As outlined previously, Guernsey sources an exceptionally large proportion of its public income from taxes and contributions charged directly against personal income sources. This includes both income tax and Social Security contributions which, for the majority of people are charged against the same income and have a similar impact on a household's disposable income.

4.4.4. In the view of the Joint Board, the current over-dependence on direct taxes represents an unacceptable risk to public finances. It exacerbates the risk of the erosion of public income as a result of demographic change and makes Guernsey's public revenues particularly vulnerable to economic pressures, which might reduce employment, earnings or both in the future, as they have over the past five years.

4.4.5. The conclusion of the Joint Board is that, in order to improve the sustainability of Guernsey's tax system, the way in which Guernsey sources its public revenues needs substantial restructuring to reduce the dependence on direct personal taxation.

4.4.6. The Joint Board recommends that this is achieved by reducing revenues from personal income tax and social security contributions and collecting this money from indirect taxes instead. This would include an increase in revenues from existing indirect taxes, such as domestic Tax on Real Property. However, having reviewed the available information, the Joint Board does not feel that there is sufficient scope within the existing indirect taxes to achieve a significant reduction in the reliance on direct personal taxes. The most effective options for diversifying the tax base are outside the current tax base.

4.4.7. This includes the introduction of a broad-based consumption tax, which could provide a significant source of revenue into the system at a relatively low rate, providing the States with the flexibility to remodel the personal income tax and Social Security systems to make them fairer and more competitive.

4.4.8. Measures to reduce the direct personal tax burden include increasing the tax allowance to assist lower and middle income households, applying the lower earnings threshold on Social Security contributions for employed and self-employed people as an allowance to make this more consistent with the treatment of income for non-employed contributors, and redressing the issues caused by the exceptionally high upper earnings limit applied to Social Security contributions.

4.4.9. The available analysis (presented in appendix 8j) suggests that a broad based consumption tax, along similar lines to that applied in Jersey, could be less regressive than it is perceived to be, even when viewed in isolation. Combined with a significant increase in personal tax allowances and measures to compensate those in receipt of benefits and old-age pensions by anticipating the inflationary impact of the tax, a broad-based consumption tax could provide Guernsey with the opportunity to reduce the overall tax burden for many lower and middle income households.

4.4.10. There is a cost implication for businesses in administering a consumption tax, but again the Joint Board is of the opinion that this has been over-stated by the critics of consumption taxes. There are options for minimising the administrative burden for companies, including a high compulsory registration threshold. This would mean that small to medium-sized companies would not have to register (although they may choose to) with the collection agency and would not have to administer the consumption tax. In Jersey the exemption threshold, which is set at a turnover of £300,000 means that more than 70% of businesses are not required to register with the tax office for GST and are not required to charge GST to their customers.

4.4.11. Avoiding the temptation to apply an extensive list of exceptions, like that in the UK VAT system, would also reduce the administration burden for both businesses and government. **Adopting an international services entity (ISE) scheme, similar to that applied in Jersey, could also significantly reduce the burden of a consumption tax for the financial services sector, for which the administration may otherwise be relatively complex. Based on receipts in Jersey it is estimated that an ISE scheme could contribute £4m to a consumption tax system in Guernsey.**

4.4.12. Nevertheless, given the strength of public feeling against consumption taxes, the Joint Board recommends a more detailed and thorough investigation be carried out before detailed recommendations regarding the introduction of a consumption tax are presented to the States, and that this should include measures for the compensation of vulnerable households and mechanisms by which the impact on businesses can be minimised.

4.4.13. Beyond issues of diversification, the Joint Board recommends that the income tax system be streamlined (see section 5.4 and appendices 8d and e). This streamlining would:

- remove elements of the current system which could be considered inequitable, such as mortgage interest relief or the ability of married couples to transfer unused tax allowances between spouses (a facility not available to unmarried couples unless they have children);
- simplify the system making it easier to understand and to administer.

4.4.14. The Joint Board also recognises the inequities in the current system of Social Security contributions particularly for those subject to non-employed and self-employed contributions. The contributions liability for self-employed and non-employed individuals can be exceptionally large, particularly when considered relative to the contributions of those classified as employed.

4.4.15. This is partly as a result of the increase in the upper earnings limit on Social Security contributions phased in between 2006 and 2014 and partly a result of the definition of income used in assessing contributions for those classed as non-employed

4.4.16. The Joint Board recommends further investigation of the upper limit applied to contributions and the income on which it is assessed, in order to redress these issues.

5. Overview of recommendations

5.1.1. This section provides an overview of the specific recommendations contained in the report. More detail of the reasoning and an analysis of the impact of recommendations and other options considered in isolation is contained in the appendices.

5.1.2. The recommendations provide a framework within which the Treasury and Resources and Social Security Departments can work over the next ten-years to achieve the desired objectives. In acknowledgement that there are many unknowns and that circumstances and demands on expenditure may change over a ten year period, the recommendations are designed to be flexible enough to allow the States to adapt to changing conditions.

5.1.3. An overview of the possible impact of recommendations as a package once *all transition measures have been completed* is included in section 7. The package presented assumes that the States will raise approximately the same amount of revenue as they do now. In addition, measures to reduce universal benefit expenditure outlined in Module 3 could save up to £12m. Some of this money will be required to rebalance the benefit systems.

5.1.4. While the package presented is broadly revenue neutral, the recommendations are structured in such a way that it would be possible to raise additional revenues from within this structure should the States agree it to be necessary as more detailed information of potential cost pressures becomes available. **Any decision to increase revenues would need to be debated and agreed as part of the annual budgeting process and should reflect both progress in controlling total expenditure levels and the cost implications of the ageing population.**

5.1.5. This report does not propose that all these changes should take full effect immediately. A significant amount of further work will be required to progress many of these recommendations to implement real changes, while others require careful and phased transition. Given the interconnected nature of these work streams the Joint Board recommends the States:

To agree that in order to ensure that public services can continue to be delivered economically and sustainably in the long term, ongoing changes in the demographic make-up of the populations of Guernsey and Alderney require the adoption of a package of measures in relation to the tax and benefits systems, as put forward in this Report.

To agree that any changes made to the personal tax system as a result of the approval of the recommendations 4 to 41 in this Report, including any transitional arrangements should be completed no later than January 2025 unless otherwise agreed.

To direct the Treasury and Resources Department and Social Security Department to co-ordinate their actions and report annually to the States on the transitional measures required as a result of the approval of the recommendations 4 to 41, to ensure that any groups of people disadvantaged by the measures agreed are adequately protected throughout the transition period detailed in paragraphs 6.1.1 to 6.1.7. of this Report.

5.1. Module 1: Long term control of total Government income and expenditure

Defining a limit to total government income[5]

5.1.6. The Joint Board believes that, to find a solution to the issue of supporting States' expenditure in the long-term, the States need to establish the size of government that is appropriate for Guernsey: **i.e. What is the maximum amount of money the people of Guernsey are willing to pay to provide public services?**

5.1.7. The Fiscal Framework sets a limit on taxation within General Revenue of 21%[6] of GDP, limiting the amount by which taxes within the General Revenue Budget can be increased without breaching the agreed framework.

5.1.8. At present the level of States' revenues covered by the Framework is well within that figure (an estimated 17.9% in 2014)[7]. However, this does not capture revenues from Social Security contributions (estimated at 7% of GDP in 2014) or Departmental Operating Income (which includes fees and charges levied for government services).

5.1.9. The Joint Board recommends the States:

> To amend the Fiscal Framework to place an upper limit on aggregate government income, incorporating General Revenue, Social Security contributions and fees and charges, such that total government income should not exceed 28% of Gross Domestic Product (see Figure 5.2.1.).

5.1.10. In support of this, the Joint Board feels that extending the Framework to capture Social Security contributions income will:

- Extend the limitations already in place to cap taxation through the General Revenue Budget to the collection of Social Security contributions and operating income;

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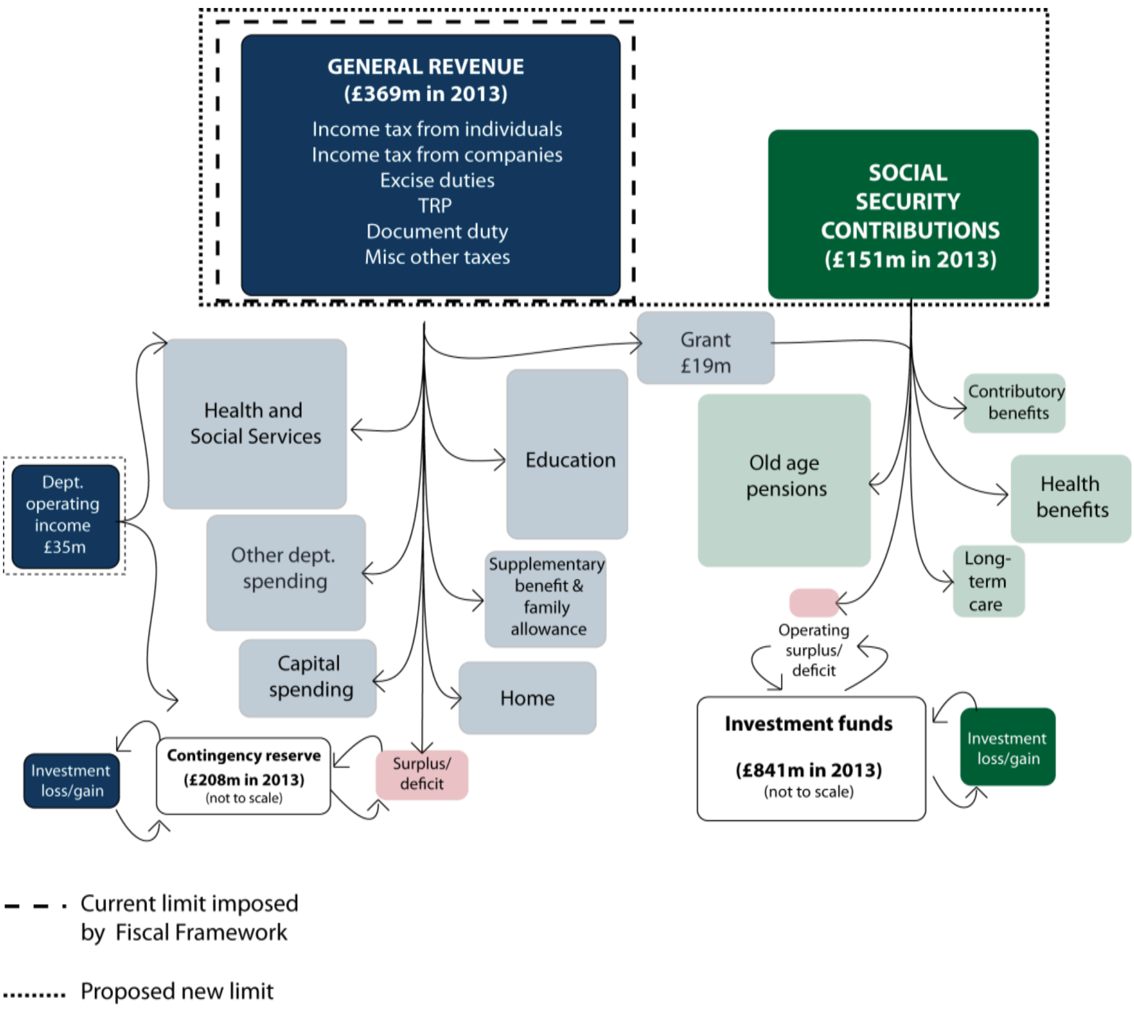
[5] For more detail please see appendix 4.
[6] This level was set with reference to long-term average levels of revenue income and expenditure in Guernsey.
[7] This is partly because the revenue grant paid to social security was reduced in 2007 and 2008 and revenue from contributions increased to compensate.

- Provide clear guidance on acceptable levels of taxation to aid future fiscal policy making;
- Provide a clear incentive to control expenditure growth on an on-going basis, which will be needed to provide public services in a way that is sustainable within the imposed limit in the long-term;
- Provide surety to both the population and the business community regarding the level of tax they are required to pay; and
- Require on-going co-operation and consultation between the Treasury and Resources and Social Security Departments in the setting of tax and contribution rates.

Figure 5.2.1: Illustration of cash flow and proposed limitations



5.1.11. The Joint Board does not recommend a limit to total government **expenditure**. The current projections for pensions expenditure in particular mean that for an extended period of time the increasing total cost of paying old-age pensions in particular make it almost impossible to establish a limit to aggregate expenditure which will be meaningful in the long-term.

5.1.12. However, the reserves held by Social Security (in excess of £800m) can be used to support the projected operating deficit on the Guernsey Insurance Fund and this need not necessarily be unsustainable in the long-term, provided measures are taken to avoid exhausting the reserves held and to replenish the reserves once the peak demand for pension payments has passed.

5.1.13. The Joint Board feels that, establishing a minimum level of reserves (see section 5.3) and requiring that this be maintained within the limitations on aggregate income, is a more appropriate way of ensuring control of expenditure from Social Insurance funds.

5.1.14. It is recommended that the limit on aggregate income be set at 28% of GDP. This level is:

- broadly equivalent to the average level of aggregate income received by the States of Guernsey in the years immediately prior to the introduction of zero-10 in 2008;
- 1.7% of GDP (approximately £38m at current levels) higher than the current level of aggregate income projected for 2015;
- 1.1% of GDP (£25m) higher than the current level of aggregate expenditure projected for 2015; and
- An estimated 1% of GDP less than the total projected funding requirements of the known and estimable pressures on States long-term spending, if nothing is done to mitigate the projected cost (see appendix 4).

5.1.15. The spare capacity, beyond current expenditure levels, is intended to enable the States to meet *long-term* demand for services, not to fulfil short-term objectives. To make a significant increase in income levels to meet short-term demands could undermine the ability of the States to meet long-term pressures on spending (such as the provision of health and social care for older people) within the limitations set.

5.1.16. To fund all known and estimable short- and long-term pressures on expenditure (detailed in Appendix 4) using current service models would require an increase in income to an estimated 29% of GDP. Beyond this there is a known but inestimable increase in healthcare, which will add further pressure.

5.1.17. A limit of 28% of GDP will therefore require the States to manage and restrain expenditure pressures if it is to provide public services in a sustainable way within this level.

5.1.18. The Joint Board is therefore not recommending a significant increase to aggregate income at this time but acknowledges that some increase may be necessary in the long-term.

Beyond the Financial Transformation Programme

5.1.19. The States have successfully restrained expenditure from General Revenue in recent years but it is clear from the public response to this review that there is still a perception that the provision of public services by the States is inefficient. This is despite the expectation that the Financial Transformation Programme (FTP) will have achieved recurring annual savings of £29m by the scheduled close of the programme in December 2014. The projects identified within the programme which have not yet been completed will continue beyond December 2014 and it is anticipated that the £31m financial target for the FTP will have been met or exceeded by 2017.

5.1.20. In real terms (i.e. adjusted for inflation) General Revenue Expenditure, excluding the appropriation to the Capital Reserve, is expected to be £17m lower in 2014 than in 2009.

5.1.21. This is not to say that there are not further savings to be made after the closure of the FTP. The Treasury and Resources Department is committed to continuing the drive towards a more streamlined government and intends to continue to pursue work streams which will deliver internal efficiency and reduce costs. Continuing this process has an important role to play in the future management of government expenditure. Given the potential scale of the increase in costs, particularly in health and social care, tight financial management and scrutiny of costs will be essential if expenditure is to be kept within tolerable limits.

5.1.22. It is important to understand that achieving savings on a large scale requires investment. For example, initiatives such as the Strategic Asset Management Programme, the Contributions and Tax Services project and e-Government could each present opportunities to reduce administration costs and improve the standard of services offered to the public but these initiatives cannot be achieved without investment.

5.1.23. In the 2015 Budget, the Treasury and Resources Department recommended that a Transformation and Transition Fund be established to support projects like those mentioned above, which offer a significant long-term transformation in the delivery of public services and which can demonstrate measurable benefits and a return on investment.

5.1.24. Members are asked to note the intention of the Treasury and Resources Department to continue work to achieve cost savings beyond the lifespan of the Financial Transformation Programme.

5.2. **Module 2: Management of long-term expenditure pressures**

Old-age pensions[8]

5.2.1. The projected increase in the proportion of people above the state pension age in Guernsey has a considerable impact on Guernsey's old-age pension scheme. The combination of the expected increase in the number of people claiming a pension, the increase in the length of time they are expected to claim for, and the decrease in the number of working age people paying full contributions, means that the current operating deficit of the GIF is expected to increase significantly over time.

5.2.2. Being supported by a relatively large fund (equivalent to more than 5 years of expenditure in 2014), the old-age pension system in Guernsey is in many respects more sustainable than many in Europe (including the UK, which is funded directly from the contributions received in any given year). **Nevertheless, under the assumptions used in the previous actuarial review, it is not sustainable in its current form. Without mitigating action, the money held in the GIF, which supports this expenditure, will be exhausted by the middle of the century.**

5.2.3. This issue has been on the States agenda for some time. In 2009, the Social Security Department presented a report containing proposals to improve the sustainability of the GIF (Billet d'État XXI, July 2009). The States agreed to increase the pension age from 65 to 67 between 2020 and 2031.

5.2.4. The recommendations presented at that time also included a recommendation to increase the employers' contribution by 0.5%. Combined, these measures, according to the actuarial projections available at the time, could have maintained the reserves of at least two years of expenditure beyond 2060, at a rate of annual uprating of halfway between prices and earnings; but this proposal was not approved.

5.2.5. The Social Security Department again recommended a 0.5% increase in employers' contributions in 2013 (Billet d'État XX, October 2013) but again this was not approved. As a result, although the decision taken to increase the pension

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[8] Please refer to Appendix 5 for further details

age to 67 has made some improvement in the projected position of the fund, the issue remains unresolved.

5.2.6. Further action is required to ensure the long term stability of the fund. Options available for achieving this include:

- An increase in the annual income of the GIF, either through increased contributions or an increase in the grant provided from General Revenue (which itself would need to be funded from either expenditure cuts or increased revenues).
- A reduction in the rate of assumed annual increases in pensions, currently halfway between prices and earnings.
- A further increase in the pension age.
- A combination of two or more of the above.

5.2.7. In view of the recommendation to limit total government income and responses to the public consultation, the Joint Board feels that measures to reduce the projected expenditure would be more appropriate than an increase in the GIF's income.

5.2.8. Accordingly, the Joint Board recommends a package of measures to improve the sustainability of the GIF, which are discussed further in **Appendix 5**. **As a package, these recommendations could eliminate the need to increase the contribution rate for the purpose of funding the payment of pensions during the period of high demand.**

Private and workplace pension provision:

5.2.9. With respect to pension provision the Joint Board recommends the States:

To direct the Social Security Department, in consultation with the Treasury and Resources Department, to present to the States of Deliberation for approval, a report or reports outlining policies to ensure adequate personal or workplace pension provision in Guernsey and Alderney covering the following parameters:

- the enhanced take up of private pension schemes;
- the creation of a pension scheme designed to capture those not currently making personal provision (outside of the existing statutory old-age pension scheme);
- the enhancement of incentives for contribution to a private pension scheme through the tax system;
- the feasibility of devising a scheme whereby pensioners may, if they so wish, invest their pensions in a fund tracking the performance of the capital funds managed on behalf of the States of Guernsey.

To agree that any additional pension scheme adopted as a result of recommendation 7, be made available to contributors no later than January 2020.

5.2.10. In respect of these recommendations, a survey conducted in 2012 (see **Appendix 5b**) demonstrated that, outside the public sector, less than half of those surveyed had private or workplace pension schemes. This lack of personal provision, combined with the general move away from defined benefit pension schemes, suggests that many of those currently in the workforce may struggle to meet their financial needs in retirement.

5.2.11. Following a successful amendment placed to the States Strategic Plan by Deputy Gillson in 2009, stating that States objectives should *'include a duty of individuals to take personal responsibility to the fullest extent possible for the welfare and actions of themselves and their children',* independence and personal responsibility are identified in the States Strategic Plan as a way of promoting positive social outcomes. Given the public recognition of the need for personal responsibility during the consultation process, the Joint Board feels that it is necessary to promote a greater level of saving for retirement, particularly among younger and lower income individuals.

5.2.12. Increasing personal provision should reduce the percentage of people who depend very heavily on the old-age pension for their income in retirement (See Appendix 1 section 6.3.2). It would also reduce the proportion of pensioners who need Supplementary Benefit to top up their income in retirement and enable the States to reduce welfare spending in the long-term.

5.2.13. The advisors from the expenditure division of the IMF were in agreement that fiscally prudent ways of promoting greater participation in supplementary personal and company pension schemes should be explored.

Pension Reserves:

To agree that long-term planning for statutory old-age pension provision be designed to maintain a buffer of at least two years of expenditure within the Guernsey Insurance Fund.

5.2.14. Previous reports on maintaining the stability of the Social Security funds have assumed that long-term planning should retain the equivalent of two years of annual expenditure in reserve in order to provide sufficient margin for error. The option of reducing the level of reserves retained as a buffer has been raised in past debates.

5.2.15. Internal analysis performed by the Policy Council demonstrates that if this were to be reduced to a single year of expenditure this would make a fairly minimal reduction in the amount of additional revenue required to "stabilise" the fund. With respect to the GIF, reducing the minimum funding ratio from two years to one year reduces the estimated increase in contributions required by only 0.1%.

5.2.16. The increased risk entailed in reducing the assumed minimum level of reserves heavily outweighs the benefit gained in terms of annual income requirements. Given the inherent difficulties of projecting this far into the future outlined in section 3.4, it would be imprudent to reduce the margin of error.

Annual uprating of pensions:

To agree to establish a guideline for the annual uprating of statutory old-age pensions be established, set initially at 1/3rd of the real increase in median earnings, with the intention to reduce this to RPIX subject to suitable policies to enhance personal provision being in place..

To direct the Social Security Department to take the above guideline in recommendation 10 into account in its recommendations for the annual uprating of statutory old-age pensions, and to provide the States of Deliberation with detailed reasoning for any recommendation to deviate from it in its annual uprating report.

To direct the Social Security Department to review the guideline for the annual uprating of statutory old-age pensions no later than 2020, having regard to progress made in establishing supporting policies to enhance personal pension provision and the actuarial projections for the Guernsey Insurance Fund at that time.

5.2.17. The percentage increase in the old-age pension made each year, relative to the level of inflation and the increase in earnings has a very significant impact on the projected sustainability of the GIF (see **Appendix 5**). The Joint Board therefore feels that it is important to establish a guideline to be used in the annual uprating of pensions to aid in long term planning.

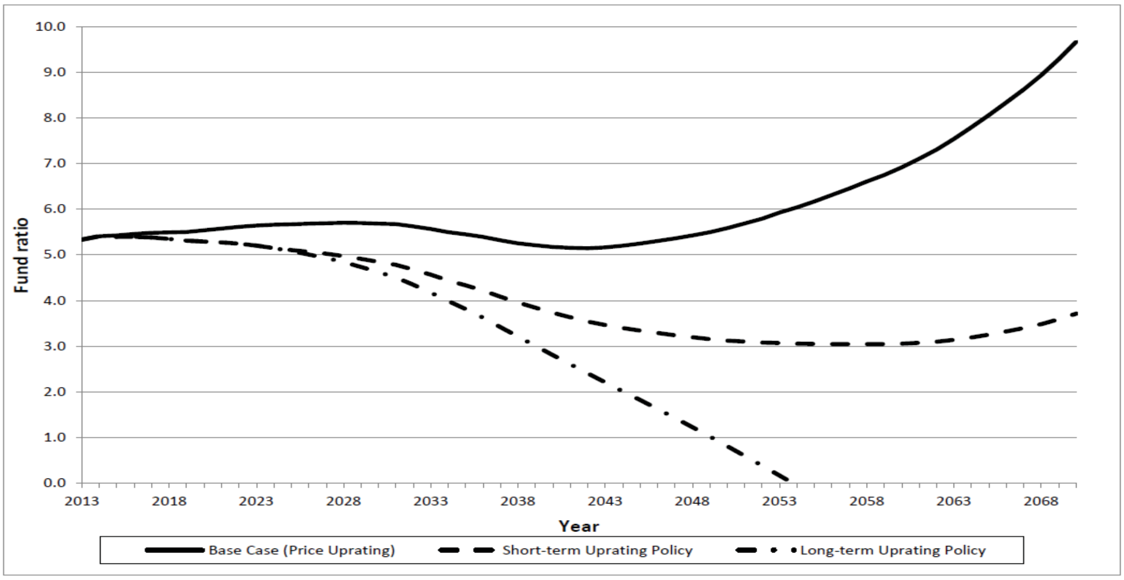
5.2.18. In previous years, there has been an informal policy of uprating pensions by halfway between prices (RPIX) and earnings in line with the previous projections presented by the UK Government Actuary's Department. However, the last two annual uprating reports recommended increasing pensions by RPIX only, reflecting the weak economic conditions and the growing expenditure pressure on the GIF.

5.2.19. If this guideline were to be established at prices (RPIX) only, assuming the current weak economic conditions improve from those experienced in the last five years, the GIF could be made sustainable with no further action (see figure 5.3.1). However, doing so would result in a more rapid deterioration in the replacement rate (the value of the old-age pension relative to earnings), thus increasing the risk that pensioners will be subject to relative poverty (see appendix 5c and d).

Figure 5.3.1: Projection Funding ratios for proposed uprating scenarios based on 100% modelled contributions (upside economic case, for downside case see appendix 5b)

Source: UK Government Actuary's Department

Base case = uprating by RPIX only; Short term Uprating Policy = Uprating by RPIX +0.5% for ten years and RPIX only thereafter; Long term uprating Policy = uprating by RPIX +0.5%



5.2.20. Given the current weakness in private pension provision referred to previously, the Joint Board recommends that the guideline level be set slightly higher than the increase in RPIX, at 1/3rd of the real increase in earnings in the short- to medium-term. Projections suggest that this level of increase (combined with an increase in the pension age outlined below) could be sustained for up to ten years without requiring any further action to stabilise the fund. However, if economic conditions do not recover sufficiently to meet the projections above additional action may be required (see **Appendix 5c**).

5.2.21. The Joint Board further recommends that this guideline be reviewed periodically with a view to reducing the guideline for uprating of the old-age pension to prices only in the long-term. This review should take account of both the revised projections of the fund stability and the progress made towards promoting a greater level of private provision.

5.2.22. Advisors from the IMF described this proposal as “fiscally reasonable”. They also suggested that consideration might be given to maintaining the higher level of indexation for current retirees and those within 5 or 10 years of retirement while establishing a lower level of indexation for everyone more than 5 or 10 years from retirement. This would add a level of complexity to the current system that would be undesirable but this may be something which could be considered in future reviews.

5.2.23. The IMF also suggests indexation could be liked to a price index based on the consumption of older people, something which is not currently available in Guernsey. Again, this may be option which could be considered in any future review.

Pension Age:

To agree that the age at which an individual is entitled to claim their statutory old-age pension should be increased from 65 to 70 years, such increase to commence in 2020 at a rate of 2 months per year to reach age 70 in 2049.

To rescind the States Resolution dated 31st July 2009 (Billet d’État XXI, July 2009) stating “That pension age shall gradually be increased to 67 through increases of 2 months per year, starting in 2020.”

5.2.24. In 2009, the Social Security Department presented a report containing proposals to improve the sustainability of the GIF (Billet d’État XXI, July 2009). The States agreed to increase the pension age from 65 to 67 between 2020 and 2031. This is the first increase in the state pension age since the current pensions law was first enacted in 1965.

5.2.25. If this is compared with average life expectancy projections; the average number of years an individual can be expected to live beyond the age of 65 is projected to have increased by 10 or 11 years between 1965 and 2031. As a result people are spending, on average, a greater proportion of their life in retirement and a smaller proportion of their life contributing towards their old-age pension.

5.2.26. Further increasing the state pension age could more evenly share the benefit of increased life expectancy between the individual and the economy by increasing the number of years over which a person is economically active. It would also increase the income to the GIF by increasing the length of time over which people are paying contributions, and reduce expenditure projections by decreasing the average length of time people will be in receipt of an old-age pension.

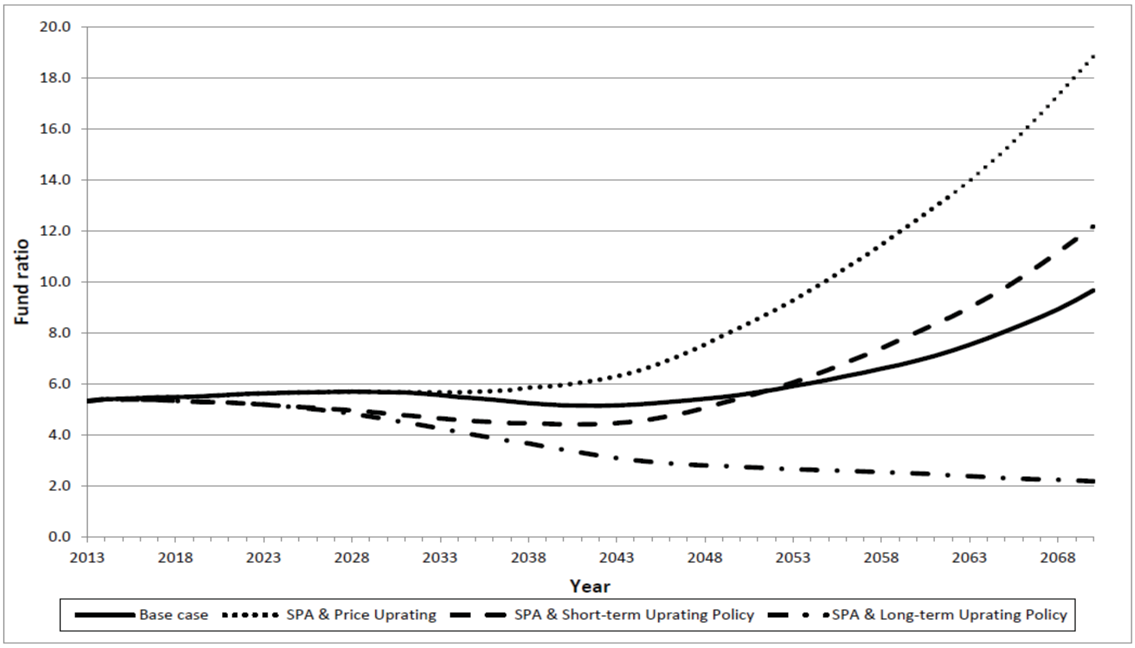
5.2.27. Increasing the state pension age will also offer a partial solution to the problem of a declining working age population (albeit that it is to be expected that many people will choose not to work to an increased pension age).

5.2.28. Combined with the recommendation above to establish a modest guideline for uprating pensions each year, increasing the state pension age to 70 by 2049 significantly improves the sustainability of the GIF. This could enable a more sustained period of uprating at a rate moderately above RPIX (see figure 5.3.2). Again, if economic conditions remain as stagnant as they have in the last four years, further action may be necessary in subsequent reviews (See Appendix 5c).

Figure 5.3.2 Projecting Funding ratios for proposed increases in State pension age based on 100% modelled contributions (upside economic case, for downside case see Appendix 5b)

Source: UK Government Actuary's Department

Base case = uprating by RPIX only; Short term uprating policy = Uprating by RPIX +0.5% for ten years and RPIX only thereafter; Long term uprating policy = uprating by RPIX +0.5%; SPA = increase in State Pension age to 70 by 2049



Note: *The recommendation to maintain a buffer of at least two years of expenditure within the Guernsey Insurance Fund means the projected funding ratio presented in figures 5.3.1 and 5.3.2 and similar graphs should stay above 2.0 throughout the projected period.*

The series labelled "SPA & Short term uprating Policy" best reflects the recommendations of this review.

5.2.29. The IMF described the proposed increases in pension age as "rather cautious", and suggested that the States may wish to consider commencing the increase earlier and increasing the pension age more rapidly in the early stages, possibly reaching 67 by in the 2020s, and proceeding at a slower pace thereafter. The Joint Board considered this option, but felt that it would be inappropriate to change the start date or rate of increase already agreed in 2009.

Support for an older workforce:

To direct the Social Security Department, in consultation with all other relevant departments, to investigate measures aimed at supporting longer working lives and assisting older people who wish to work to remain in the workforce, and to report to the States of Deliberation with its findings no later than December 2017.

5.2.30. Those approaching retirement age today and in the future are in general much fitter, healthier and more active than their parents would have been at the same age. That said, as people age their level of health and fitness tends to decline. Some people may find it difficult to continue their current profession to a greater age. This is particularly true for those with physically or mentally demanding jobs. It will therefore be necessary to increase the level of support offered to older people in the work place.

5.2.31. If Guernsey is to make the most of the skills and expertise of those approaching retirement, it is necessary to foster a more flexible and inclusive working environment for older people, particularly if the state pension age is to be increased.

5.2.32. The States should work with industry groups to offer more support to those who may struggle to continue their current role in the run up to retirement. In particular, as the largest single employer in the Guernsey, the States will need to undertake a thorough assessment of its own practices with regard to employees approaching pension age and establish good practices that can be mirrored in the private sector.

Parental benefits

5.2.33. In accordance with the UN Convention on the Elimination of All Forms of Discrimination Against Women, in 2012, the States approved recommendations to enhance the provision of maternity and paternity benefits in Guernsey (Billet d'État IV, February 2012). At the same time, the States directed the Personal Tax, Pensions and Benefits Review to find a source of funding for this benefit. This benefit is expected to be provided from the GIF, for which provisional estimates are that this would cost approximately £1.9m per year.

5.2.34. Under the recommendations presented for pensions, assuming the guideline level of pension uprating is reduced to RPIX only in the medium term (within ten years), and economic conditions improve beyond very recent experience, this benefit could be provided from the GIF without the need to increase contributions. If economic growth is not forthcoming, additional funds could be required to support this benefit.

5.2.35. The Joint Board notes that the Parental Benefits project has not yet reached the implementation stage and final proposals are not expected to be brought to the States until 2017. By this time it may be possible to get a clearer idea of Guernsey's economic and fiscal position.

5.2.36. The Joint Board recommends the States:

To direct the Social Security Department to review the funding of parental benefits with reference to recommendations 9 to 14, where agreed, as part of the Personal Tax, Pensions and Benefits Review, before any proposals for change to such benefits resulting from its review entitled 'Changes to Parental Care Provisions' are laid before the States of Deliberation.

Long-term health and social care services

5.2.37. One of the largest expenditure pressures Guernsey faces is providing health and social care and support services for an increasing number of older people. It is well understood that as people get older, their health and fitness levels decline and as a result they often need a greater level of medical support and care in their day to day lives.

Supported living and long-term care[9]

5.2.38. Currently services are provided by a combination of means including:

- The provision of social care services by the Health and Social Services Department.
- The subsidy of respite and long-term nursing and residential care placements supported by the Long-Term Care Fund and Social Security contributions.
- The extra care housing provided in the form of public private partnerships between the Housing and Health and Social Services Departments, and third sector organisations.
- A range of social, day care and residential care services offered by charitable and third sector organisations.
- The provision of invalidity benefit, attendance allowance and other financial benefits by the Social Security Department.

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[9] Please refer to Appendix 1 section 6.5 and Appendix 6

5.2.39. The provision of these services is complex and faces some big challenges, not only in providing the necessary funding to provide adequate support for an increasing number of older people, but also in ensuring that such services are appropriate for the changing needs and expectations of those receiving care and support.

5.2.40. As previously highlighted, what it means to be “old” is changing and people tend to be fitter and more independent for longer. The future model of care provision will need to ensure that people are supported in maintaining their independence.

5.2.41. A review of how supported living services are provided and funded will form an integral part of the forthcoming Supported Living and Ageing Well Strategy (SLAWS).

Funding of long-term health and social care services

To acknowledge that the present model of provision of long-term residential and nursing care for older people is financially unsustainable and to direct that the Policy Council give consideration to the suggestions outlined in paragraphs 5.2.42 to 5.2.48 of this Report, when reporting to the States of Deliberation on a Supported Living and Ageing Well Strategy.

5.2.42. From a purely financial point of view, under the current system, the Long-Term Care Fund (LTCF) receives only just enough revenue from Social Security contributions to cover the Fund’s current expenditure each year, and the Fund is expected to fall into an operating deficit in the near future. The reserves available are limited and it is expected that, unless changes are made, these could be exhausted in 10 years.

5.2.43. To make this fund sustainable in the long term could require the equivalent of an increase in Social Security contributions of anywhere between 0.7% and 1.9%. At the level of contributions received today this is equivalent to approximately £8m to £21m per year of additional funding.

5.2.44. This does not cover the potential increase in cost which could be faced by the Health and Social Services, Housing and Social Security Departments for the provision of other services to support older people under the current model. There are currently no projections available but it is possible that these costs (most of which are met year by year from General Revenue) could become considerable.

5.2.45. What is apparent is that without significant additional funding in the form of increased tax or social security contributions, the provision of health and social care services for older people is not sustainable under the current model. To do nothing about restructuring these services would be a very expensive choice for the tax payer.

5.2.46. This report does not seek to comment on what might be appropriate in terms of care services. but financially there are options which could be explored. The Long-Term Care Fund was established on the premise that those eligible for the subsidy would not need to sell their homes in order to pay for residential or nursing care, allowing their property to be passed on to their heirs.

5.2.47. While this may be a desirable outcome for those who claim the benefit, the practice is expensive. The subsidy paid on a single long-term residential care placement is in excess of £20,000 a year; each nursing care placement costs £40,000 a year.

5.2.48. Increasing the co-payment[10] for those who can afford to pay more and including in the assessment some form of equity release (although it may be limited, as it is in Jersey) could reduce the mounting cost pressure.

SLAWS and the Fiscal Framework

To direct the Policy Council to ensure that the outputs of the Supported Living and Ageing Well Strategy can be achieved within the financial limitation set out by the Fiscal Framework and any extension of those limitations to incorporate income from Social Security contributions agreed by the States of Deliberation's approval of recommendation 6 .

5.2.49. The Joint Board acknowledges that it is likely that the SLAWS project will, by necessity, recommend an increase in the funding of the services captured within its scope, although the magnitude of this increase is not clear at the present time. However, it is the view of the Joint Board that this project and others like it should be mindful of the need to control government spending and the overall financial limits imposed by the Fiscal Framework, including any which may arise from the recommendations of this review.

Health Care[11]

5.2.50. Health care and social care costs are among the most difficult to predict, particularly in a jurisdiction as small as Guernsey, where a single complex case can increase the total expenditure by as much as 0.5%. While Policy Council staff have attempted illustrative projections of health and social care costs in the past, the

[10] Under the current system the States meet the majority of the cost of nursing and residential care placements with a weekly grant, but residents are required to make a contribution (or co-payment) towards the cost. Those unable to meet this cost can apply to Supplementary Benefit for assistance.
[11] Please refer to Appendix 1 section 6.4

range of possible outcomes is huge; with estimates of additional expenditure demand ranging anywhere from 0% to 6% of GDP over thirty years. **At the most extreme, these projections suggest that expenditure on health and social care could more than double over the next thirty years.**

5.2.51. As people age, they tend to suffer from a greater number of, and more complex, medical conditions. An increase in the number of people likely to need more complex medical care will almost certainly result in an increase in the annual expenditure required to support medical services in Guernsey.

5.2.52. However, the expectation is that the next generation of older people will live longer, healthier lives than their current counterparts; and while it would be easy to assume that the medical care needed by a 75 year old today will be the same as the needs of a 75 year old in twenty years' time this may not be the case. Statistics from the UK NHS show that, while medical costs do increase with age, the most significant increase occurs in the last year of a person's life, regardless of how old they may be. A combination of an increase in the number of older people and greater complexity of conditions means that associated costs are likely to increase significantly, even allowing for more 'healthy' years of life.

5.2.53. Medical inflation (the annual increase in the cost of providing services per treatment) and the ever growing expectation the public has about what services they should have access to, also have an important role to play. History shows that medical costs typically increase faster than prices in the rest of the economy. While pharmaceutical and technological developments can bring costs downwards this is generally not the case. New and more effective drugs and treatments are typically more expensive than those they replace.

5.2.54. The general public, understandably, would like access to all the latest and most advanced medical treatments and the amount of money the States *could* spend on healthcare is almost unlimited. **Tight financial control will be required to prevent healthcare spending increasing to unsustainable levels. Restraining medical expenditure may require some difficult decisions, and in the long-term it is likely that an increase in spending will be required.**

5.2.55. This spending pressure will affect both General Revenue and Social Security budgets and the Joint Board would like to highlight the necessity of the on-going work to review the provision of health and social services in Guernsey and supports the on-going efforts to improve financial control of health service costs.

5.3. Module 3: Targeting benefits expenditure

Introduction to benefits

5.3.1. Benefits can be broadly divided into two classes: universal benefits[12], available to anyone who meets the claim criteria regardless of their income (such as Family Allowance); and means tested benefits, which require claimants to demonstrate a financial need to be able to claim (such as Supplementary Benefit). There are advantages and disadvantages of each and the concept of "fairness" often comes into play in the consideration of benefits.

5.3.2. Universal benefits tend to be more expensive in monetary terms. Payments are routinely made to households who have no demonstrable need for them. However, they are simpler and cheaper to administer since, unlike means tested benefits, they do not require extensive assessment to establish an individual or a household's right to claim.

5.3.3. Means tested benefits can also entail a degree of social stigma, which can discourage households from claiming a benefit for which they may have real need. They can also create poverty traps, a situation by which a claimant is discouraged from earning more money for themselves if it might threaten their eligibility to claim, which in some instances can leave them worse off than before.

5.3.4. The States offer two principal means tested schemes: Supplementary Benefit, which provides monetary support for low income households; and the Rent Rebate scheme, which provides reductions in rents for tenants in social housing. The two schemes work on different assessment processes and there is a significant overlap between the two.

5.3.5. The report on Benefit and Contribution rates for 2014 and Modernisation of Supplementary Benefit Scheme (Billet d'État XX, October 2013) presented proposals to integrate the Supplementary Benefit and Rent Rebate schemes into a single system. The proposals for integration of the two schemes had a significant cost implication and the October 2013 report directed this review to investigate

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[12] Technically the provision of all States' health, social and education services which are not means tested are universal benefits; however, only those monetary benefits administered by Social Security, provided in the form of payments or subsidies, are under review in this context.

possible sources of funding for the increase with particular reference to the current cost of universal benefits.

5.3.6. However, the proposals were not accepted and, instead, major changes to the welfare system were deferred to allow the formation of the Social Welfare Benefits Investigation Committee (SWBIC) to carry out a more thorough examination of the issues.

5.3.7. The mandate of SWBIC is:

- To examine all aspects of the Supplementary Benefit (Guernsey) Law, 1971, as amended, and relevant aspects of the States' Housing (Tenancies, Rent and Rebate Scheme) (Guernsey) Law, 2004 in order to assess the appropriateness or otherwise of the legislation and associated policies in view of the economic and social changes since their inception;

- To develop a single, comprehensive social welfare benefits model to replace the Supplementary Benefit (Guernsey) Law, 1971, as amended, and relevant aspects of the States' Housing (Tenancies, Rent and Rebate Scheme) (Guernsey) Law, 2004, which single, comprehensive model shall be capable of fulfilling and balancing the social and fiscal objectives of the States;

- To ensure that during the formulation of a single, comprehensive social welfare benefits model, and in order to develop an objective rationale for the determination of assistance that is both socially just and financially sustainable, detailed consideration is afforded to the circumstances of, inter alia, the aged, the sick, the disabled, families on low incomes, families with three or more dependent children and persons with no further reasonable expectation of employment due to age or ill health;

- To ensure that during the formulation of a single, comprehensive social welfare benefits model consideration is afforded to the policy letters of the Social Security Department laid before the States in Billet d'État V of 2012 and Billet d'État XX of 2013 and the letters of comment attached to those policy letters by other committees of the States.

5.3.8. While this work is still on-going, this review has examined methods by which funding may be diverted within the current system of benefits to finance additional welfare benefit costs.

5.3.9. The Social Security Department provides a number of so-called "universal" benefits. These benefits can be claimed by anyone living on the Islands who is registered with the Social Security Department and fits the other claim criteria. There is no requirement to have paid any Social Security contributions and they are not restricted to those on low incomes. These include: Family Allowance, the subsidy on prescriptions, the automatic exemption of those over 64 from the need to pay prescription charges, the subsidy on primary medical care appointments and the provision of free TV licences to those aged 75 or more.

5.3.10. However valid the reasons for universal benefits at the time of their introduction, it seems unlikely, if the States were considering introducing such benefits today, that they would choose to introduce them in their current form in the present financial climate.

5.3.11. In general, the Joint Board is of the view that the continued provision of non-contributory universal benefits to all, such as Family Allowance and the subsidy on primary care, is not sustainable in the long term. The responses from the public consultation also showed that only 20% of respondents would favour the States continuing to pay universal benefits, while 65% would favour some form of reduction in expenditure on universal benefits.

5.3.12. The Joint Board is of the view that such expenditure could be better targeted to help those with the most need and that savings made by reducing expenditure in these areas could be more effectively used elsewhere.

Family Allowance[13]

5.3.13. Family Allowance is currently paid at a rate of £15.90 a week per child to the parents or primary carers of all children who are:

- resident in Guernsey or Alderney
- below compulsory school age
- 19 or under and in full time education and who are resident in Guernsey or Alderney.

5.3.14. These payments are provided from General Revenue and at the end of 2013 there were 6,929 claimants at an annual cost of £10m. The system costs an estimated £20,000-£30,000 a year to administer (approximately 0.5 full time employee).

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[13] Please refer to Appendix 7a

5.3.15. The responses from the public consultation indicated that many people feel that the continued provision of Family Allowance to households regardless of their circumstances is undesirable.

5.3.16. Several options have been considered which would reduce expenditure on Family Allowance and these are detailed in Appendix 7a. These include:

- Restricting the number of Family Allowance claims which could be made per household;
- Means testing the payment;
- Reducing the universal payment;
- Complete withdrawal of Family Allowance.

The Joint Board recommends the States:

To agree to phase out the payment of a universal Family Allowance under the Family Allowances (Guernsey) Law, 1950 between 2016 and 2025, through gradual reductions in the amount paid having regard to the increases in personal tax allowances as outlined in recommendation 27 below, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.

5.3.17. The public consultation demonstrated that there is a desire to reduce expenditure on universal benefits and Family Allowance in particular.

5.3.18. While means testing this benefit would better target these funds, the administration required in doing so would make the provision of this benefit inefficient and a complete withdrawal of the benefit is therefore preferred.

5.3.19. Acknowledging the desire to better target this expenditure and the current on-going review of welfare benefits by the SWBIC, the Joint Board feel that the redirection of a portion of these funds to the social welfare system could effectively mitigate the impact of the proposals in this report in respect of those households currently on the margin of the benefit system.

5.3.20. Compensating those currently within the welfare benefit system (either as Supplementary Benefit claimants or social housing tenants) would cost an estimated £2m. **Allowing for this increase in Supplementary Benefit costs, withdrawing Family Allowance would result in a net reduction in expenditure of an estimated £8m.**

5.3.21. Within the wider context of this review the impact of those most heavily impacted by the above recommendation, that is working families with an income just beyond the threshold for welfare benefits, could be benefited by an increase in the personal allowance or the application of an allowance to Social Security contributions.

5.3.22. Advice received from the FAD noted that, while this may be motivated by the need to reduce expenditure levels, it is often argued that cash benefits may be more easily designed to target the need of particular recipients than general tax measures such as an increase in the tax allowance.

Prescription subsidies

5.3.23. Drugs, medicines and appliances provided in the community are heavily subsidised[14]. At the present time any individual covered by the Guernsey Health Benefit scheme is liable to pay only a flat charge of £3.40 per prescribed item unless the individual is exempt. The remaining costs of the drugs, medicine, medical appliances and dispensing fee are paid for by the Social Security Department from the Guernsey Health Service Fund.

5.3.24. Exceptions from prescription charges apply to:

- low income households, limited primarily to those on Supplementary Benefit although there are a limited number of households who do not qualify for Supplementary Benefit who are awarded an exemption on the basis of low income;
- those with severe disablement claiming an attendance allowance;
- all insured individuals over the age of 64.

5.3.25. Unlike the English system, exemptions are not offered on the basis of a defined list of medical conditions[15].

5.3.26. In 2013, the Guernsey Health Service Fund spent £15m on drugs and medicines. Whilst this Fund is currently healthy, the pressures resulting from the ageing population are likely to increase the expenditure from this Fund in the future. This

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[14] Drugs medicines and medical appliances in hospital are provided free at the point of delivery without applying a prescription charge. These, together with the costs of employing pharmacy staff, are provided under the Health and Social Services Department's general revenue budget.

[15] However, the Kings Fund published a report in 2014 recommending that English prescription charges be significantly reduced (by as much as 70%) and the medical exemption system removed.

will likely include an increase in the total number of prescriptions issued, as more of the population are of an age at which they are likely to need multiple regular prescriptions and without review, an increase in the number of people exempt from prescription charges on the basis of age.

5.3.27. With this in mind the Joint Board recommend the States:

> To agree to phase out the universal exemption from prescription charges for those over the age of 64 by 2020, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.

5.3.28. In support of this recommendation, age is not necessarily an indicator of wealth and, particularly given the improvements in fitness levels among older people; neither is reaching pension age necessarily an indication of poor health. There are many people provided with an exemption from prescription charges through this route who could afford to pay. The Joint Board therefore feels that the provision of exemption from prescription charges solely on the basis of age is inappropriate.

5.3.29. Those over the age of 64 would still be eligible to claim exemption though the other available routes.

> To agree to introduce in 2016 a nominal fee for prescriptions of up to £1 per item for all those currently exempt from prescription charges, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating report.

5.3.30. Providing prescriptions free of charge may mean that those receiving exempt prescriptions may not fully appreciate the cost associated with provision of this service. The application of a nominal charge would help ensure that people value the drugs, medicines and medical appliances provided. It may also encourage patients to be more discerning in accepting prescriptions where they may already have a supply.

5.3.31. Given that many of those exempt from prescription charges are low income households, the charge would need to be set at a level which would not discourage patients in difficult financial circumstances from accepting prescriptions, which may be to the detriment of their health.

> To agree to increase prescription charges to £4.40 per item in 2016 and thereafter to review them as part of its annual uprating report, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.

5.3.32. The Joint Board is of the view that there is some limited scope for people to make a larger contribution to the cost of their prescriptions and is therefore recommending a step change from £3.40 to £4.40 per item from 2016. However, the Joint Board would wish to avoid the need to develop and administer a defined list of medical exemptions and would therefore not recommend that prescription charges be increased to a level comparable with that currently charged in England (£8.05).

Consideration of the health impact and possible mitigations of changes to prescription charges

5.3.33. There is a risk that an increase in the cost of prescriptions may have a detrimental impact on the health of those who are on low incomes but who would not qualify for additional financial assistance, or those who require a large number of prescriptions.

5.3.34. While the Joint Board would wish to avoid the administrative burden of creating a defined list of exempt conditions, it has considered the possibility of other mechanisms by which the cost of prescription charges to the individual might be mitigated. Within the context of this review it has not been possible to investigate these to any great extent, but they could include:

- Reviewing the legislation which limits a GP's prescription to no more than 28 days' supply.
- Investigating schemes such as the "season ticket" scheme in the UK[16] or the prescription limitation applied in Ireland, which applies a limit to the amount an individual or households are required to pay in prescription charges over a defined period.

5.3.35. The Social Security Department will consider these further in the implementation of the above recommendations.

[16] http://www.nhs.uk/Planners/Yourhealth/Pages/Prescriptioncosts.aspx

Primary medical care consultation grants[17]

5.3.36. Financial support for the costs of primary care consultations is provided to everyone through the health benefits scheme as a £12 grant for a consultation with a doctor and £6 for a consultation with a nurse. As with prescription charges, those eligible for means tested Supplementary Benefit or medical assistance schemes get their primary medical costs paid in full.

5.3.37. Subsidies on primary medical care cost the States £3.5m in 2013.

5.3.38. The Joint Board recommends the States:

> To agree to phase out the Health Benefit grant for primary care appointments by 2025 and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.

5.3.39. This grant was designed as the first phase in a broader suite of changes to the way primary and specialist healthcare were to be provided in Guernsey.

5.3.40. Significantly, the grant was intended to reduce the cost of primary medical care to consumers. However, consistent with concerns raised at the time of its introduction, there is little evidence to suggest that it has reduced the cost of primary medical care in Guernsey. Furthermore, because it has not been possible to reach an agreement with local practitioners to develop a mechanism by which control of the total cost of a consultation can be achieved, the grant has not been increased for several years and the relative value of the grant has been eroded by price rises.

5.3.41. While on the surface removing this grant would risk a one-off or phased increase in GP consultation fees of £12, to continue paying the grant when the evidence suggests that it is not achieving its intended purpose would seem illogical.

5.3.42. Nevertheless, there would be disadvantages in removing the grant; not least that accessing primary medical care in Guernsey is already expensive and a further

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[17] This grant has a chequered history and a number of issues which are detailed in Appendix 5

increase in costs may further discourage people from seeking medical attention they may be in need of. **However, releasing the £3.5m of expenditure currently tied up in the provision of this benefit could provide an opportunity to find a more effective way of supporting primary health care in Guernsey.**

5.3.43. The mechanism for withdrawal of this benefit will need careful consideration and consultation with healthcare providers.

TV licences for over 75s

5.3.44. Under the present system, the Social Security Department provides TV licences to over 75s at an annual cost of £600,000, a cost which will increase as the population ages, potentially doubling in real terms by 2032 and continuing to increase well beyond this point.

5.3.45. The Joint Board recommends the States:

> To agree to phase out the provision of free TV licences for those over the age of 74 and those over the age of 64 claiming Supplementary Benefit by closing the scheme to new members in 2016 and closing the scheme to all by 2020 and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.

5.3.46. The current TV licence costs £145 per year. As previously stated, age is not necessarily an indicator of low income and this service is provided to many who could better afford a TV licence than some of those who do not receive one.

5.3.47. It is the view of the Joint Board that this benefit could be withdrawn with minimal impact on the individuals concerned.

Means tested benefits

5.3.48. As highlighted in the introduction to this Module, the States operate two principal parallel systems of means tested benefits: Supplementary Benefit and Rent Rebate.

5.3.49. There is a clear administrative inefficiency in operating two separate schemes, particularly given a significant proportion of claimants are in receipt of both benefits. There is also a level of inequity in that generally social housing tenants are better off under the Rent Rebate scheme than private sector tenants in receipt of Supplementary Benefit.

5.3.50. The Social Security Department has brought two reports before the States with recommendations to achieve the integration of the two schemes (Billet d'État V, March 2012 and Billet d'État XX, October 2013). An amendment to the most recent of these led to the formation of SWBIC, which is currently working on this issue and it is due to report to the States in 2015.

5.3.51. Controlling welfare spending is difficult in any jurisdiction. This is always a balancing act between the desire to provide a suitable financial safety net for those on moderate or low incomes and what the Government can afford to provide, while encouraging claimants to become responsible for their own self support. What is evident from the two previous reports is that it is highly unlikely that a satisfactory unified system can be developed without an increase in its overall cost, and as is the case with the on-going project on Supported Living and Ageing Well, it is unclear at this stage what that cost will be.

5.3.52. As noted previously, the 2013 report directed this review to investigate ways in which funding for this increased cost could be met from universal benefits. While, as outlined above, the Joint Board does believe that a substantial sum could be found from the reduction or removal of various benefits, the preference of the Joint Board is to phase these changes over a period of time. It is therefore likely to be some years before sufficient savings have been made from the universal benefits system to cover the cost of reconciling the two means tested benefits systems.

5.3.53. In the interim it may be necessary to make a temporary increase in the Social Security budget to cover the transition period. However, as outlined in relation to the SLAWS work stream, it is the view of the Joint Board that this project should be mindful of the need to control government spending and the overall financial limits imposed by the Fiscal Framework, including any which may arise from the recommendations of this Review.

5.3.54. As such the Joint Board recommends the States:

To direct that the Social Welfare Benefit Investigation Committee ensures that the outputs of its review of social welfare benefits complies with the Fiscal Framework and any extension of those limitations agreed by the States of Deliberation's approval of recommendation 6.

5.4. Module 4: Establishing a sustainable tax base

Current income sources and distribution[18]

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

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

5.4.3. The tax base in Guernsey has undergone, in relative terms, a sizable shift in the last eight years. The introduction of zero-10 in 2008 reduced the revenue from corporate taxation by approximately 60% placing the States Revenue budget in a deficit position.

[18] For more detail please refer to Appendix 1 Section 7

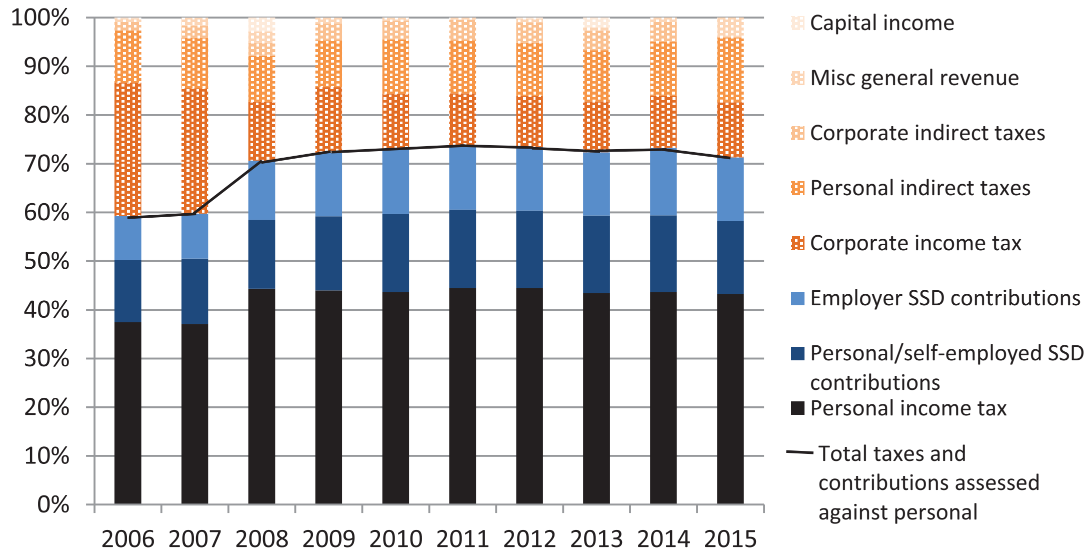
5.4.4. Several measures were employed to reduce the deficit:

- increasing tax on immovable property (TRP), particularly for commercial properties, and other indirect taxes;
- reducing the revenue subsidy paid to Social Security, compensated by an increase in the Social Security contributions paid by employers and mid- to high-earning individuals; and
- reducing States expenditure through the FTP, which aimed to introduce annual savings by transforming the delivery of services so they were more efficient.

5.4.5. The result of all these changes has been to shift the distribution of government revenues away from direct corporate taxes to indirect corporate taxes, and taxes and contribution charges directly against personal income (see figure 5.5.1).

5.4.6. Prior to 2008, the States received less than 60% of their total income (excluding operating income) from personal income tax and Social Security contributions. In 2008 this increased to more than 70% and has continued at a level of between 72% and 74% in all subsequent years.

Figure 5.5.1: Distribution of public revenues in Guernsey, 2006-2015



5.4.7. Jersey also adopted a zero-10 tax regime in 2009 but, unlike Guernsey, opted to introduce a GST to compensate for the resulting loss in revenue. As a result neither Jersey nor the Isle of Man, which also adopted zero-10 in 2006 but operates a VAT system comparable to the UK's, has as heavy a reliance on direct taxes as Guernsey. Their tax bases are therefore much more comparable to those of other jurisdictions.

5.4.8. As part of the review process, the Joint Board has reviewed the distribution of the States' income sources and identified an unacceptable level of risk in the current distribution of income. These risks are outlined in more detail in **Appendix 1, Section 7** and **Appendix 8a**.

5.4.9. This is not the first time the distribution of revenues has been raised as a concern. In the 1988 and 1989 Budget Reports, the Advisory and Finance Committee expressed concerns about the proportion of revenue generated by income tax (incorporating tax on both personal and corporate income) and the vulnerability this represented to States' finances.

5.4.10. The Joint Board is of the view that the States should diversify the tax base; reducing reliance on direct taxes in favour of indirect taxes. While it is accepted that the States will still gain the majority of its income from direct taxation on personal income, the Joint Board recommends that the States bring the tax base closer into alignment with practices in other jurisdictions where significantly less reliance is placed on direct personal taxation.

5.4.11. Advice received from the FAD was supportive of this position, agreeing that rebalancing of the tax base away from the heavy reliance on direct taxes is a sensible move in the face of a strongly aging population and the shrinking of the income earning workforce. Furthermore the FAD highlight that indirect taxes (including property taxes) are more conductive to growth than personal and corporate income taxes.

5.4.12. The Joint Board recommends the States:

To agree in principle that, to bring Guernsey's tax base more into line with those in other advanced economies, by 2025 the reliance on direct personal taxes and Social Security contributions should be both reduced significantly from its current level of 74% of total government income and diversified, so that a greater proportion of taxation revenue is derived from other forms of taxation.

Options available for changing the tax base

5.4.13. The Joint Board has considered a number of elements within the direct and indirect tax systems in Guernsey, which may form part of a solution. These elements are considered in isolation in Appendices 8a-k. They include:

- Income tax rates (Appendix 8b);
- Personal income tax allowances (Appendix 8c);
- Specific income tax allowances (Appendix 8d);
- Independent taxation (Appendix 8e);
- Social Security contributions (Appendix 8f);
- Property taxes (Appendix 8g);
- Other indirect taxes (Appendix 8h);
- Broad based consumption taxes (Appendix 8i).

5.4.14. Much of the analysis utilises a model built by Frontier Economics, an overview of which is provided in Appendix 8k.

5.4.15. In reality, there are only a limited number of levers available for changing the structure of public income and the majority of the burden of the two largest sources of total income – Income Tax and Social Security contributions – is borne by the same demographic group: economically active working age people.

5.4.16. Increasing taxes on income and Social Security contributions would only increase the burden on those already paying the most. Proposals such as "higher rates for higher earners" or "withdrawal of tax allowances for higher earners" may redistribute the tax burden within this group but are likely to increase the number of people (typically those with a larger income) who plan their affairs in such a way as to minimise their tax liability.

5.4.17. Outside the Income Tax and Social Security systems there are few options within our current tax system from which significant revenue could be raised to diversify the tax base.

5.4.18. Within the existing personal tax system, domestic TRP is the only really feasible option that may be able to raise enough revenues to make a significant contribution to redressing the balance between direct and indirect taxation. To achieve a significant amount of redistribution would require an increase in domestic TRP rates by as much as ten times its current rate, off set, at least in part, by a reduction in the direct tax take. If such an increase in property tax is not acceptable the only option is to look outside the current tax system for the solution.

5.4.19. The Joint Board recommends a number of measures within both the General Revenue and Social Security systems outlined in the following pages.

5.4.20. This review is not about corporate taxation but corporate tax may play a role in this in the long-term. The proposals laid out in the 2015 Budget will contribute an estimated £3m to General Revenue, but it is unlikely to change the distribution of the tax base by more than 1% of total income.

5.4.21. During this on-going dialogue, there have been repeated calls for the States to review whether a territorial corporate tax regime should be introduced, in particular, instead of a consumption tax, notwithstanding the uncertainty that an announcement of a further assessment of the corporate tax regime may bring.

5.4.22. A territorial system was considered as part of the 2010 corporate tax review, which was closed in December 2012 but was not considered a viable option at that time. More detail on the background of that review and the review's findings are summarised in **Appendix 3**.

5.4.23. The Joint Board does not believe that the introduction of a territorial corporate tax regime is a viable solution within the time frame of this Review. It would lose the simplicity of zero-10 and the competitive advantage of a headline 0% rate of corporate tax. Key technical issues to be resolved with a territorial regime would be defining "Guernsey source" and "permanent establishment" to ensure that only the provider, not the product, is taxed, and addressing the potential effects on those parts of the Guernsey economy that may be sensitive to the possibility of increased taxation which a territorial system may bring.

5.4.24. While internationally there has been a trend towards elements of territorial tax, this has typically been utilised as a mechanism for reducing corporate taxes in other jurisdictions. Neither of the other two Crown Dependencies has publicly announced any intention to move away from zero-10. Both Jersey and the Isle of Man apply a broad based consumption tax system and therefore do not have the same issues with over-dependence on direct taxes. Thus, Guernsey would be contemplating a unilateral move.

5.4.25. The Joint Board recommends the States:

> To direct that 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.

Income tax

Personal Allowances

> To agree that between 2015 and 2025, and subject to approval and implementation of the measures set out in recommendations 28 to 39 below, to phase in increases in personal tax allowances to no more than £17,500 (at 2015 prices), the level of phasing having regard to the effect of the other measures introduced as a result of the States of Deliberation's approval of these recommendations, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.

5.4.26. Since April 2014, the personal tax allowance available in Guernsey is less than that available to taxpayers in the UK[19] - albeit that the UK no longer provides some reliefs, such as mortgage interest, which are provided in Guernsey. It is also less than the tax allowance available to low and middle income households in Jersey (i.e. those subject to the marginal tax system).

5.4.27. This means that some lower and middle income households may pay more income tax in Guernsey than in Jersey or the UK making the income tax system uncompetitive for attracting and retaining staff such as teachers and nurses.

5.4.28. The Joint Board recommends that the personal allowance be increased over a period of time in order to redress this issue and to compensate lower and middle income households for the increase in tax in other areas resulting from adoption of other recommendations to follow later in this report (for example the withdrawal of relief on mortgage interest or the possible introduction, in due course, of a consumption tax).

5.4.29. However, the Joint Board recognises that increasing the tax allowance could remove a significant number of low income households from the need to pay income tax. It is recognised that it would be undesirable for too high a proportion of residents to be outside the income tax threshold. The Joint Board therefore

[19] The Coalition Government (and other political parties) have stated their intention to continue increasing the personal allowance to at least £12,500 (Appendix 8).

recommends that the personal allowance be increased to no more than £17,500 at 2015 prices with the intention of keeping at least 75% of households within the income tax system.

5.4.30. Advice from the FAD would support this as a simple, transparent and potentially fair way of scaling back the income tax burden, albeit costly in terms of lost revenue.

Mortgage Interest Relief

> To agree to phase out the relief provided on mortgage interest in respect of principal private residences by 2025, with the phased withdrawal of Mortgage Interest Relief to be achieved by reducing the cap on interest deductible and that the withdrawal should broadly follow the schedule provided in Appendix 8d, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.

5.4.31. There are a number of issues with mortgage interest relief that make it undesirable to continue its provision in the long-term:

- Because the amount of relief granted increases with interest rates, provision of this allowance passes a portion of the risk of increases in interest rates from borrowers to income tax revenues (and therefore to the tax payer in general)
- Because the relief is incorporated into the calculations used by lenders to assess how much a household can borrow, over time it has resulted in an upward pressure on house prices.
- It offers a subsidy on housing costs which is not available to those who do not have a mortgage and is therefore inequitable.

5.4.32. Providing mortgage interest relief is irrational and asymmetric in the absence of taxation on the corresponding income (i.e. imputed rent – the market rental value of a property) on owner occupied property.

5.4.33. Analysis suggests that withdrawal of mortgage interest relief, when combined with an increase in personal allowances may have a strong progressive impact. As reflected in analysis provided by Oxford Economics, and advice received from the FAD suggests that the immediate withdrawal of mortgage interest relief could reverse the upward pressure it has exerted, effectively supressing house price increases for a period of time. However, both the shock to the housing market from this downward pressure and the impact on individual householders can be softened by withdrawing this allowance over a period of time (for more details see **Appendix 8d).**

5.4.34. As part of the 2015 Budget, a recommendation to reduce the maximum level of relief an individual can claim was approved and the Joint Board recommends the continuation of this process.

Personal Allowances for those over the age of 64

> To agree to freeze the personal tax allowance provided to those over the age of 64 until such time as the personal tax allowance for those under the age of 65 reaches the same level and thereafter that the personal tax allowance for all tax payers should be the same, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.

5.4.35. In Guernsey those over the age of 64 receive a larger personal allowance than those under 65 (Appendix 8f). As previously highlighted, age is not necessarily an indicator of either income level or costs. Neither has this practice been reviewed in the light of existing resolutions to begin increasing the pension age from 2020.

5.4.36. The Joint Board considers that the provision of a larger tax allowance solely on the basis of age is inequitable and that this practice should be phased out.

5.4.37. This has the added advantage of more evenly balancing taxation between those of working age and those of retirement age, making a small reduction in our dependence on the working age population. Advisers from the FAD deem this measure sensible, particularly with reference to improving horizontal equity.

Independent taxation

> To agree to move towards a system of independent taxation in which all tax payers are treated as individuals, by removing the ability to transfer tax allowances between married couples or couples with children, with each tax payer being assessed on an individual basis, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.

5.4.38. As outlined in Appendix 8e, the current tax system is structured in such a way that married couples and unmarried couples with children are able to transfer any unused tax allowance between spouses, enabling these couples to reduce their tax liability. This facility is not available to unmarried couples without children or to same sex couples. In today's society this could be seen as discriminatory.

5.4.39. To extend this facility to all cohabitating couples would be administratively complex and could potentially significantly reduce tax revenues, particularly if the above recommendation to extend the personal tax allowance is accepted.

5.4.40. Given the changing nature of family units in modern society, and the proposal above to significantly extend the personal tax allowance, the Joint Board recommends a move towards independent taxation, which would require all adults to be assessed as individuals for tax purposes. This would remove the facility for married couples and couples with children to transfer their tax allowances.

5.4.41. This would result in an increase in the number of tax returns submitted each year but should reduce the proportion of returns that require manual assessment. In the long term this should reduce the administrative burden experienced by Income Tax staff.

5.4.42. The cost in lost income tax revenues of providing the facility to transfer unused tax allowances between spouses is dependent on the value of the personal allowance. It is estimated that at the current allowance rates a move to independent taxation could increase income tax revenues by between £5m and £7m. If personal allowances are increased in line with the recommendations included in this review, the financial benefit of a move to independent taxation would increase.

5.4.43. This move would be consistent with the trend in most developed counties but, for some couples this could have significant financial implications and its introduction will require either careful phasing or to be combined with a significant increase in the personal allowance to minimise the impact on those couples who utilise this facility. Particular consideration is needed for pensioner couples who tend to make greater use of this facility and who may not have the flexibility to adapt their finances to the change in the tax structure.

5.4.44. This is discussed in more detail in **Appendix 8e** including intermediate options which the Treasury and Resources Department may wish to consider as part of the transition in order to mitigate the impact of this on households which might be unduly impacted.

Charge of Child Allowance

To agree that, subject to approval of a move towards independent taxation, the allowances available for 'Charge of Child' (as described in paragraph 5.4.45) should be phased out by 2025, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.

To agree that the phased withdrawal of 'Charge of Child' allowances (as described in paragraph 5.4.45) should be achieved by reducing the available allowance to reflect the annual increase in the personal allowance each year.

5.4.45. The Charge of Child allowance is offered primarily to single parents. To be entitled to this allowance an individual must be receiving Family Allowance for one or more children and not cohabiting with another person. Couples (married or otherwise) are only entitled to claim this allowance if one spouse is totally incapacitated and has to maintain or employ someone to have care of the child.

5.4.46. This allowance is currently claimed by an estimated 700 households and costs approximately £1m in lost revenues each year.

5.4.47. This needs to be closely co-ordinated with any decision on whether Guernsey should move towards independent taxation. This allowance is provided in lieu of the ability to transfer unused allowances from a spouse. If a move to independent taxation is made and the charge of child provision is retained, this allowance would discriminate in favour of single parents, who would be able to claim an additional allowance not available to couples. If the charge of child allowance is withdrawn but the ability to transfer allowances between married and co-habiting couples with children is retained, the system will discriminate against single parents who will not be able to access the potentially unused allowance of a spouse.

5.4.48. It is therefore proposed that, if a move to independent taxation is made, the States should phase this allowance out. Like other measures, and as highlighted in consultation with the FAD, the impact of the withdrawal of this allowance could be significant for the households currently claiming it and could potentially have a regressive impact. Transition arrangements will need to co-ordinate the withdrawal with the implementation of other recommendation to avoid unfairly disadvantaging these households.

5.4.49. It should be noted that, at present, claims for Charge of Child allowances and any application for cohabiting couples with children to transfer any unused allowances between partners are dependent on the receipt of Family Allowance. If the recommendation to withdraw Family Allowance is accepted and either or both of these are retained beyond the point at which this withdrawal is completed, it will be necessary to change the criteria on which eligibility for these is assessed and amend the legislation accordingly.

Social Security Contributions

5.4.50. Contributions for Social Security are assessed against earned income for the majority of contributors. For employees, contributions are deducted at source (i.e. they are deducted from their wages by their employer); an additional contribution is made by their employer.

5.4.51. The structure of the Social Security system has changed fairly significantly since its inception in response to various pressures and, in some cases these changes are no longer consistent with the original principles of the Social Security system or have, unintentionally, introduced inconsistencies and inequities in the way contributions are collected in Guernsey.

5.4.52. As part of the package of measures proposed by this Review the Joint Board would seek to redress some of these issues. It must be noted that resolving these issues will in some cases require an alternative source of revenues and a renegotiation of the grant paid from General Revenue as a subsidy on the income of two of the three funds administered by the Social Security Department, known as the Revenue Grant.

Inequities in the Social Security system

5.4.53. The Joint Board recommends the States:

> 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 will 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.

5.4.54. The upper earnings limit on Social Security contributions in Guernsey, which defines the maximum amount a contributor can be required to pay in contributions, is exceptionally high when compared to other members of the Sterling area (see **Appendix 8f**). This limit stands at £135,252 in Guernsey in 2015 compared to £48,240 in Jersey and £41,860 in the UK[20]. At this level the limit in Guernsey is applied to fewer than 5% of the highest earning individuals in Guernsey.

5.4.55. This came about as part of one of the measures to reduce the deficit resulting from the introduction of Zero-10. The grant paid from General Revenue to the Social Security funds was reduced between 2006 and 2008 and the upper earnings limits for employers and (by amendment) employees were increased as part of a package of measures to replace the lost income to the funds.

5.4.56. For higher earners, this means that the link between the amounts they pay in contributions and the average value of benefits being received by current beneficiaries (known as the 'insurance principle') has been broken. Rather than the contributions of lower income individuals being subsidised from General Revenue by way of the revenue grant (as was the original intention of the insurance based scheme), they are now more substantially subsidised by Social Security contributions from higher earners.

5.4.57. This is not necessarily a bad thing. Within a principle of 'social solidarity', it is quite reasonable for higher earners to pay towards the Social Security benefits of other contributors in addition to themselves.

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[20] In both Jersey and the UK a 2% rate is applied to earnings above this threshold. In Jersey this is limited by a second threshold.

5.4.58. While this income is collected through the contribution system, it could be considered that it introduced an element of taxation into the Social Security system. The increase in the upper earning limit collected more money from individuals earning (or in some cases with income) above the previous threshold (approximately £47,000 at 2015 prices). This affects those with earnings in the top 25%.

5.4.59. Part of the issue with this is that within the Social Security system people in different employment categories pay contributions at different rates (see Appendix 8f).

5.4.60. Up to a point, this reflects the different entitlement to benefits of those in the various contribution classes and the payment of a contribution from employers on behalf of their employees. However, the upper limit goes beyond the level at which there is a link between contributions paid and benefits received. This means that higher earners in different contribution classes are subsidising the contributions of those earning less money at different rates. Contributions paid by high earning or income individuals who are classified as self-employed or non-employed and under 65 are disproportionately large when compared to those paid by people who are classified as employed or those over the age of 64.

5.4.61. This is further compounded because income on which a contributor is assessed is also dependent on their classification under the Social Insurance Law. Those classified as employed or self-employed and under 65 are assessed only on their employed or self-employed income up to the upper earnings limit. Other forms of income are not taken into account for the purpose of contribution liability.

5.4.62. An individual classified as non-employed or anyone over the age of 64 is liable for contributions on their entire income (although in the case of those over the age of 64 this is at a much reduced rate).

5.4.63. This means that two individuals with the same non-employed income source (for example rental income) could have different liabilities on that income, even if their total income is the same. If one contributor were under 65 and classified as employed (or self-employed), they would not be liable for contributions on this income. If a second individual were over the age of 64 or non-employed (i.e. they do not have enough employed or self-employed income to qualify for these contribution types) they would be liable for contributions on this income at a rate of 2.9% if they are over the age of 64 or 9.9% if they are under 65. Once again, this means that contributions for those classified as non-employed can be disproportionately large relative to those who are employed.

5.4.64. It is believed to be fairly common practice for those under 65 who might otherwise choose to be non-employed (for example those retiring early) to undertake a nominal amount of employment to qualify for an employed contribution. This protects their non-earned income and minimises their liability for contributions, while still maintaining their contribution record and pension entitlement. This practice is made more attractive by the high rate (9.9%) and high upper limit on non-employed contributions and by participating in a nominal amount of employment, individuals with a large non-employed income can reduce their annual contributions liability by more than £10,000.

5.4.65. At an earlier stage in the process the Joint Board consulted with the FAD regarding the possibility of reducing the upper limit on Social Security contributions and replacing a portion of the lost income by withdrawing income tax from the revised limit. Having reflected on the advice given the Joint Board felt that further work was needed before such a complex solution could be recommended.

5.4.66. The Joint Board believes that the issues outline above need further investigation to seek to redress the inequity within the system. Options available for achieving this may include:

- A reduction in the upper earnings limit for all contributors:
    - This could be replaced by a flat rate of contributions for all contribution classes above an insurance based limit similar to the systems in the UK and Jersey;
    - While, as outlined in **Appendix 8c**, the Joint Board does not believe the withdrawal of tax allowances for higher earners is a viable option while the upper earnings limit is as high as it is at present, this may be a more viable solution if the limit is reduced.
- A restructuring of how contributions for non-employed people are assessed;
- A reduction in the rates charged for non-employed or self-employed people.

Allowances for employed and self-employed

> To direct that, subject to the implementation of suitable administrative systems and suitable alternative sources of revenue, the Social Security Department further investigates a restructuring of Social Security contributions to apply an allowance for employed and self-employed individuals.
>
> To direct the Treasury and Resources Department to revise the grant paid to the Social Insurance Fund to compensate for the revenue lost to the Social Security funds if an allowance is introduced for employed and self-employed individuals.

5.4.67. For those who are classified as employed or self-employed the lower earnings limit is applied as a threshold not as an allowance. This means that as soon as a contributor's earnings exceed this level they are liable for contributions on *all* their employed or self-employed income.

5.4.68. In 2010, as part of the restructuring of non-employed contributions, an allowance, similar to that applied on income tax, was applied to contributions for non-employed people (including those over the age of 64). This means that non-employed contributors are not liable for contributions on the first £7,223 of their income.

5.4.69. To apply the lower earnings limit for employed and self-employed people as an allowance would reduce the contributions paid by all contributors in these classes. For most employed contributors this would reduce their liability by £408 a year; for most self-employed contributors this would reduce their liability by £715 a year. Relative to income this would have the most benefit for low income working households, particularly if there are two adults employed in the household or if one or more of the earners in the household are self-employed.

5.4.70. At the current lower earnings limit, application of the limit as an allowance would cost in the region of £10m. It is therefore apparent that in order to achieve this it would be necessary to identify an alternative source of income. Within the package of measures outlined, it is proposed that part of the revenue from the widening of the tax base could be diverted through the revenue grant to the social insurance funds to enable this to be achieved.

5.4.71. It should also be noted that the current computer systems used for the collection of contributions would be very difficult to modify to achieve this and that the programming hours required to make the necessary modifications are prohibitive. However, given on-going work to modernise computer systems at both Social Security and Income Tax, the Joint Board does recommend that this be pursued further, subject to the implementation of new systems.

5.4.72. Advice from the FAD was supportive of the above, both from a distributional point of view (the proposal introducing a more progressive element to social insurance contributions) and in order to eliminate the distortions created by the current system (described in more detail in Appendix 8f).

Indirect taxes

Tax on Real Property

To direct that, as part of the annual Budget Report, the Treasury and Resources Department to increases the rates of domestic Tax on Real Property by no more than 7.5% per annum in real terms between 2016 and 2025.

5.4.73. Although the average amount of tax applied to domestic properties was increased when the system was modernised in 2008 (see **Appendix 8g**) and a further increase agreed in the 2015 budget, the tax charged is still relatively low. The average domestic TRP bill in Guernsey in 2015 will be approximately £173 a year.

5.4.74. Property taxes are very efficient and very stable. They are easy to collect, they are very difficult to avoid, revenues are easy to predict year on year and they have a limited impact on an individual's behaviour. For example, an increase in TRP would need to be substantial in order to influence people's decisions about which properties they choose to live in.

5.4.75. For all the reasons outlined above, an increase in domestic TRP is an attractive option for diversifying the tax base and strongly supported by advice from the FAD. However, in 2014, domestic TRP raised approximately £4m and it is anticipated that it will raise just less than £5m in 2015. A 100% increase would therefore only raise £10m. In order to have a significant impact on the distribution of revenues in Guernsey, the increase in TRP rates would need to be of the order of 1000%, bringing average TRP rates in Guernsey to a level on a par with Council Tax rates in the UK.

5.4.76. TRP as it is applied in Guernsey is regressive[21], particularly if it is assumed the increased cost to landlords is passed to tenants in the form of an upward pressure on rental prices. While some increase may be absorbed by landlords, the likelihood is that very significant increases in domestic TRP cost would be passed on, at least in part, to tenants.

5.4.77. Unlike income tax and consumption taxes, households' TRP liability does not easily adapt to changes in circumstances - for a household to reduce their liability they would need to move house.

5.4.78. Therefore, while the Joint Board would recommend a relatively large increase in domestic TRP rates over a period of ten years, their preference would not be to use TRP as the sole or primary mechanism for diversifying the tax base (although modelling of such scenarios is included in Appendix 8g). A real annual increase in TRP rates of no more than 7.5% per annum would result in a maximum increase across a ten-year period of just over 100%.

[21] It should be noted that property taxes in most countries are considered progressive, particularly if applied on a banded basis or on property value. However both banding and, more particularly, assessment by property value, would make Guernsey very simple and administratively efficient system, more complex.

Document Duty

To direct the Treasury and Resources Department to review the structure of Document Duty as part of the ongoing budgetary process.

5.4.79. Document duty, the tax paid on the purchase of a property in Guernsey, is one of the most volatile revenue streams in the current budget being dependent on both the number and value of property sales made (see **Appendix 8g**).

5.4.80. As currently structured, for low value sales, document duty is high relative to equivalent charges in the UK and Jersey, and this may represent a barrier to entering the housing market for some people. At higher values, document duty charge in Guernsey is lower than that charge in either the UK or Jersey and there may be some scope for a limited increase in document duty on high value transactions.

5.4.81. Furthermore the systems in both the UK and Jersey each apply a more sophisticated, graduated system of charges (see **Appendix 8g**). Moving to a similar system in Guernsey could have two benefits: it would avoid step changes in the cost of purchasing a property as the property value increases; and it could also ease any distortion to the housing market these step changes may be causing[22].

5.4.82. If such a change is considered, due regard will need to be given to any possible increase in administration required either by the States or conveyance agents. However the Joint Board believes that the idea of such a change is worthy of further consideration and the Treasury and Resources Department should be directed to do so as part of the normal budgetary process.

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[22] For example, a property advertised at a value just above the band threshold may be subject to a greater downward pressure on its eventual sale price to bring it in to a lower band than a property advertised at a value just below the band threshold.

Annual vehicle taxes

5.4.83. Prior to 2008, the States charged an annual tax on vehicle registration which raised approximately £6m per annum. This tax was withdrawn in 2008 to reduce administration costs and the excise duty on fuels increased to replace the lost income. At numerous points during the consultations on this Review there have been suggestions that an annual tax on motor vehicles should be reintroduced.

5.4.84. The introduction of an annual fee at an average of £200 per vehicle could raise an estimated £9m which would make a significant contribution to the objective of redirecting taxation from direct to indirect taxes. However, this is likely to be regressive, and in relative terms, have a larger impact on lower income households. It will also have a cost implication for businesses, particularly those which operate multiple vehicles.

5.4.85. Advice from the FAD highlights that the strengthening of vehicle taxes to address environmental concerns is consistent with trends in other developed countries. Commentary provided by the FAD also suggests that regressive element of vehicle taxation could be overcome by incorporating elements such as engine size in the calculation of the tax base.

5.4.86. In light of the on-going consideration of vehicle taxes as part of the Environment Department's, Integrated Transport Strategy the Joint Board is not making any recommendations in this area. However, any subsequent States decision on vehicle taxes will need to be considered as part of the transition arrangements so that their introduction can be coordinated effectively with other changes to the overall tax system.

Environmental Taxes

5.4.87. Among the stated aims in the States Strategic Plan 2013-2017 was the integration of fiscal and economic, social and environmental policies, and for them to be afforded equal status. However, notwithstanding the reference to environmental taxes in the original consultation report, the already large scope of this project and the limited resources devoted to it has meant that this review has not given detailed consideration to the use of any new such taxes (e.g. a carbon tax).

5.4.88. While there is no intention to introduce any such taxes as part of this current Review process, this may be an area that the Policy Council will wish to revisit at an appropriate time in the future. However, any such taxes will need careful integration with other fiscal and social policy developments to ensure that any significant regressive measures can be compensated for.

5.4.89. For example, carbon taxes such as those outlined in the consultation report would apply a tax to all fuel and energy purchases including electricity, gas, oil, coal and motor fuels, based on the carbon emission of each fuel type. Such taxes are designed to discourage energy consumption with the aim of reducing carbon emissions. However, while this could result in environmental benefits, provisional analysis suggests that, relative to income, a carbon tax would be mildly regressive, which is of concern as the latest Household Expenditure Survey has confirmed that lower income households spend a larger proportion of their income on fuel and energy. Similarly, the impact of a carbon tax on businesses would also need further investigation as it is estimated that 60% of the burden for an environmental tax would fall on businesses rather than households.

Consumption taxes

To direct the Treasury and Resources Department to report to the States of Deliberation no later than June 2017 with detailed proposals for a broad-based consumption tax, and agree that such should include:

- the rate at which a consumption tax should be levied, which should be no more than 5%;
- the viability of sharing resources for the administration of any such tax with Jersey;
- the one-off and annual costs for the States of Guernsey of introducing and administering any such tax;
- the one-off and annual costs (if any) to island businesses in introducing and administering any such tax, together with any proposals for measures to mitigate such costs;
- a mechanism to prevent increases in the rate of any such tax without, for example, a 2/3rds parliamentary majority;
- the measures required to off-set the introduction of any such tax with a reduction in direct taxation through increased personal tax allowances;
- the measures required in the pensions and benefits system to mitigate the impact on groups of people that may be disadvantaged by its introduction, particularly those on low or fixed incomes, including those in retirement; and
- a review of necessary impôt and excise duties to avoid double taxation..

5.4.90. Despite the acknowledged unpopularity of a broad based consumption tax, the Joint Board considers its introduction to be the most effective mechanism for diversifying the tax base and reducing the reliance on direct taxes. At a comparatively low rate of 5% (which would be among the lowest in the world) a consumption tax could raise an estimated £50m, which would provide the States with a significant amount of flexibility to rebalance the tax base.

5.4.91. The Joint Board proposes that the revenue from a consumption tax could be used to reduce the direct tax burden and redress some of the underlying issues identified within the current Social Security system. These include:

- A significant increase in personal tax allowances available for income tax to make the Guernsey income tax system more competitive with those in Jersey and the UK, particularly for lower to middle income households.
    - Modelling indicates that, alone, a consumption tax at a rate of 5% could enable the increase in the personal tax allowance to more than £16,000. Other measures, such as increases in TRP and withdrawal of mortgage interest relief would allow this to be increased further;
- An opportunity to improve the equity of the Social Security contributions system;
- The application of the lower earnings limit of social insurance as an allowance for employed and self-employed individuals to make the system more equitable between insurance classes and reduce the burden of social insurance contributions for lower to middle income working households.

5.4.92. Consumption taxes, applied on a broad basis are considered more economically efficient than income tax (although less so than TRP) and, as highlighted in **Appendix 8a**, are more evenly distributed across the population than income tax or Social Security contributions.

5.4.93. The FAD typically supports the introduction of broad based consumption taxes, including as a measure to reduce the very high reliance on direct taxation and to rebalance the tax structure in favour of growth. In reference to Guernsey situation in particular, the FAD highlight in their advice the need to consider the administrative cost of this tax in a small jurisdiction, how best to manage the taxation of financial services under within any proposed scheme (see paragraph 5.4.107 and the overall distributional consequences of the package of measures (see Section 7),

5.4.94. Throughout the consultation process a number of objections have been raised regarding consumption taxes. The Joint Board considers that many of these concerns, although valid, are a result of a misunderstanding or misinterpretation of consumption taxes and their impacts relative to other forms of taxation. Some of these are addressed below.

Consumption taxes are inflationary…

5.4.95. This is true. The introduction of a consumption tax would result in a one off-increase in prices and therefore increase the standard measures of inflation. It is estimated that a 5% consumption tax applied on a broad basis would result in a one off increase in RPIX by 3% to 4%, which would be apparent in the headline annual percentage changes for a period of 12 months. After this time a consumption tax applied at a constant rate would not impact inflation to any significant degree.

5.4.96. However, *all* other direct or indirect personal tax measures would reduce the amount a household can afford to buy, although they are not all incorporated in the calculation of standard inflation measures. For example increasing either income tax or social security contributions would decrease the amount of money a household has available to buy goods and services but, because neither are included in the calculation of RPI or RPIX, neither would increase the reported measures of inflation. The fact that the effect of direct personal tax rises is not captured by the measurement of inflation does not mean that the impact on a household's purchasing power does not exist.

5.4.97. The reverse is also true by reducing a household's direct tax liability (either through reducing their income tax or Social Security payments), households would have more money available to spend and increase their purchasing power. This could offset the increase in costs resulting from a consumption tax for many households.

The increased cost of buying goods on-island will mean people will buy more online…

5.4.98. The challenges presented by the online marketplace are not unique to Guernsey. The ability for customers to buy at low cost, directly from wholesalers who have a wide selection of goods and have it delivered quickly, means that the traditional retail outlet is under pressure everywhere, regardless of the presence or otherwise of a consumption tax. However, an additional tax could increase this pressure in some areas, most notably, the sale of non-perishable low to medium value items which can be easily shipped from around the world.

5.4.99. In most consumption tax systems, imported goods over a threshold value are subject to consumption tax and this should discourage any increase in online shopping and importation. There is a balance required in the setting of this threshold. The lower this is set, the less incentive there may be to import goods to avoid the tax. However, at low levels the administrative cost of collecting the tax may be greater than the tax received. Setting this threshold at an appropriate level is a detail that will require careful consideration.

Consumption taxes are regressive…

5.4.100. The analysis conducted by Frontier Economics (see **Appendix 8i**) suggests that the regressive nature of a broad based consumption tax has been overstated. Based on data extracted from household expenditure surveys in both Guernsey and Jersey, with the exemption of domestic housing costs (which is a standard part of almost all consumption tax systems) and factoring in increases in pensions and benefits to reflect the impact on inflation, a Guernsey consumption tax could be broadly proportional relative to household income.

5.4.101. It is estimated that the increase in pensions and benefits and other measures to compensate low income households for the introduction of a 5% consumption tax (which would raise an estimated £50m) could cost up to £6m. An allowance for this expenditure has been factored in to the calculation within this report.

5.4.102. More detail of what measures would be needed to mitigate the impact of a consumption tax on low income households will be included in the next stage but an adjustment to pension and benefit rates to reflect the impact a consumption tax will have on prices should minimise the impact on many low income households. They may have to pay more for goods and services but they will have more money to spend.

5.4.103. It is proposed that a consumption tax could be combined with a significant increase in the personal tax allowances, which would be of particular benefit to low to middle income working households. Combined, a consumption tax offset by an increase in personal allowances may mean that many households could pay less tax overall.

5.4.104. The analysis suggests that to achieve a similar level of diversification by a significant increase in domestic TRP, and assuming that this increase in costs is transferred to tenants in rental accommodation, could be more regressive than a broad-based consumption tax. The same is likely to be true of an annual vehicle tax, although reliable data are unavailable.

Consumption taxes are complicated and cost a lot for businesses to administer…

5.4.105. While there will be some administrative cost to businesses, if government and businesses can work together on the design of a system, there are ways to minimise this. It need not be nearly as onerous as that experienced by businesses in the UK when VAT was introduced. A simpler system, with a minimum number of exceptions (such as that used in New Zealand), clear guidance and reporting structures could be much simpler for business to administer than a more complex system such as UK VAT.

5.4.106. The advance in computerised tills and accounting systems means that, for larger businesses, it should be possible to automate much of the process once the initial system changes have been made. For those businesses too small to operate advanced administration systems, a high compulsory registration threshold can protect small businesses from the administrative burden. **In Jersey, the registration threshold is set at an annual turnover of £300,000, which means that well over 70% of businesses are not required to register with the tax office for GST and are not required to charge GST to their customers (see Appendix 8i).**

5.4.107. Management of financial services within a consumption tax environment will need to be carefully managed in order to ensure the tax neutrality of the financial products offered by Guernsey businesses is maintained. To use the Jersey model as an example, international services are zero-rated and other financial services are exempt.

5.4.108. Because of the breadth and complexity of services offered by international financial service providers, the administration of a consumption tax can become involved and to mitigate this Jersey operates a system of registration for International Services Entities (ISEs), which enables financial institutions to pay a flat rate annual fee rather than accounting for GST in the normal way. ISEs cannot charge or be charged GST and this effectively eliminates most of the administration burden for these businesses; this would be an option to help support the international services sector in Guernsey. **Based on the revenues raised from the ISE scheme in Jersey, it is believed that this would raise an estimated £4m.**

5.4.109. Jersey's ISE scheme does not extend to insurance companies and, given the large volume of international captive insurance business undertaken in Guernsey, the extension of an ISE scheme to capture such businesses would need to be explored in the next phase. There are other industries in Guernsey which supply electronic services to an international market, including eGaming which is particularly active in Alderney. Measures to ensure such industries remain competitive in an international market will also need to be explored.

5.4.110. All external advice the Joint Board has received, including that from Frontier Economics and Professor Geoffrey Wood has recommended that, if a decision to introduce a consumption tax were made, the system should be kept as simple and broad as possible. As tempting as it may be to introduce multiple exemptions for the apparent benefit of some household groups, these would increase the administrative burden for businesses and the impact of a consumption tax on the economy in general.

A consumption tax will require a lot more bureaucracy to administer…

5.4.111. Provided the system is kept relatively simple, the administrative cost to government need not be high. In Jersey, it is estimated that collecting GST costs about 1p for every £1 collected. Depending on the design of the system it is estimated that it would require the appointment of between 5 and 10 additional members of staff divided between the administering department (probably Income Tax) and the Guernsey Border Agency. As part of the upgrade of its systems, the Guernsey Border Agency has already begun implementation of software which would be capable of handling charges on imports.

5.4.112. The total annual cost is estimated at £500,000 with the possibility of reducing this if administrative savings could be made by sharing resources with Jersey.

Consumption taxes are too easy for the government to increase…

5.4.113. The proposed limit on total government income is, in part, intended to address this concern in relation to all forms of taxation - not just consumption taxes.

5.4.114. It may also be possible to apply other measures which may either make it more difficult for the States to increase the tax. For example, a requirement to display the tax paid on all receipts and invoices would maintain awareness of the amount of tax consumers are paying in the form of consumption taxes and maintain public pressure to keep consumption tax levels low.

5.4.115. It may also be possible to develop a requirement for a two-thirds majority of States members to approve a proposition to increase the rate. It is proposed that such mechanisms be investigated as part of a more detailed report on consumption taxes.

6. Transition

6.1.1. It is not intended that all these changes will take place immediately. The Joint Board envisages these changes being phased over a ten-year period (or longer if that proves necessary).

6.1.2. Given the range and potential impact of the measures outlined, the transition will inevitably require very careful and co-ordinated implementation. A number of the measures recommended require significantly more work to develop transitional arrangements and ensure that suitable mechanisms are in place to protect those on low incomes.

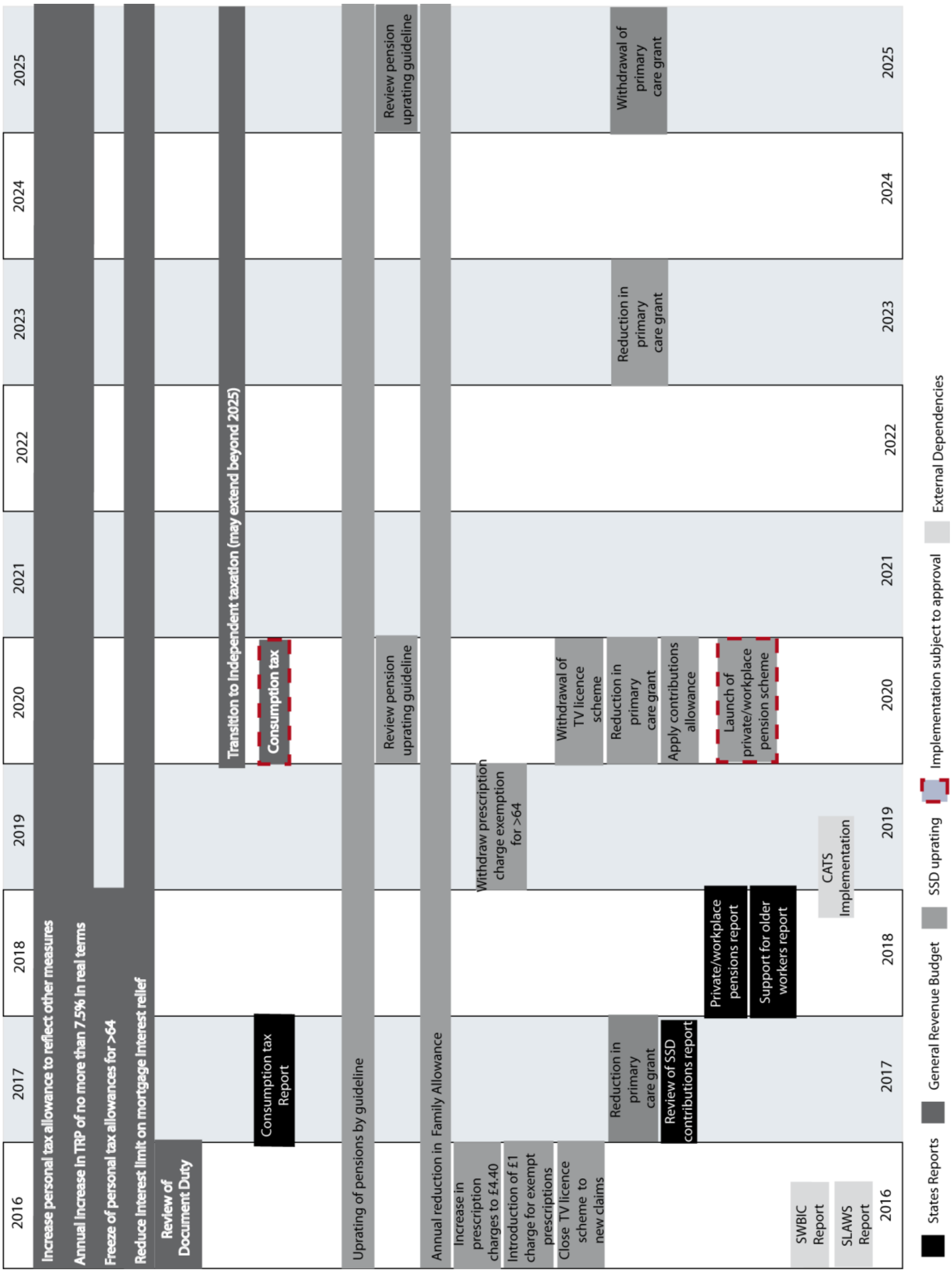
6.1.3. It is for this reason that the Joint Board recommends ongoing co-ordination between the Treasury and Resources and Social Security Departments throughout the transition period and that each Department, whether separately or jointly, reports back to the States with more detailed information as the various work streams progress.

6.1.4. It is the intention that the ongoing work be managed as a programme to ensure continuous co-ordination and to enable the sharing of staff and resources between work streams. An outline of how this programme might look is provided overleaf.

6.1.5. Given the complex nature of the proposals, it is essential that the Departments be able to adapt the transition phase to circumstances through the annual budget process. For example, any future introduction of a broad-based consumption tax would need to be timed to coincide with a significant increase in personal allowances, in order to balance the impact on both the taxpayer and General Revenue. If a consumption tax is not introduced, the increase in tax allowances would need to be adjusted to compensate for this.

6.1.6. The figure presented overleaf illustrates how the transition from the current system to the tax base modelled in the analysis above might be achieved.

6.1.7. The transition should be managed to minimise the year on year impact on the General Revenue and Social Security Budgets. It is highly unlikely that the transition will follow this exact path as it will be necessary to adapt the transition measures to the progress of implementation of the various work streams and other fiscal pressures.


2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
Increase personal tax allowance to reflect other measures
Annual increase in TRP of no more than 7.5% in real terms
Freeze of personal tax allowances for >64
Reduce interest limit on mortgage interest relief
Review of Document Duty
Consumption tax Report
Transition to independent taxation (may extend beyond 2025)
Consumption tax
Uprating of pensions by guideline
Review pension uprating guideline
Review pension uprating guideline
Annual reduction in Family Allowance
Increase in prescription charges to £4.40
Introduction of £1 charge for exempt prescriptions
Close TV licence scheme to new claims
Withdraw prescription charge exemption for >64
Withdrawal of TV licence scheme
Reduction in primary care grant
Reduction in primary care grant
Reduction in primary care grant
Withdrawal of primary care grant
Review of SSD contributions report
Apply contributions allowance
Private/workplace pensions report
Support for older workers report
Launch of private/workplace pension scheme
CATS Implementation
SWBIC Report
SLAWS Report
States Reports
General Revenue Budget
SSD uprating
Implementation subject to approval
External Dependencies

7. Demonstration of possible outcomes

7.1.1. The recommendations of this Review have been drafted to allow sufficient flexibility to adapt to circumstances, which may change over the transition period. The transition and setting of more specific rates is to be managed through the usual budgetary processes (i.e. though the annual General Revenue Budget and Social Security uprating reports) and it is recommended that the Treasury and Resources and the Social Security Departments continue to work together throughout the transition.

7.1.2. This section examines how the tax base *might* look in 2025 if all the elements were accepted and what impact this could have on households relative to the current tax base. As previously mentioned, there would be a ten-year transition period to reach this stage. As outlined, this scenario would reduce the dependence on direct personal taxes from 74% to an estimated 66%. This could reduce income from direct personal taxes and social insurance contributions from an estimated £402m in 2015 to an estimated £355m once transition is complete, reducing direct tax receipts by more than 10%.

7.1.3. The analysis presented includes an overview of the impact by both income level and household type. **The actual impact on any one household is very much dependent on an individual household's circumstances: how much income it has, where its income comes from, who lives in the household and how they choose to spend their money. There can be considerable variation of impact within the categories outlined in the analysis below.**

7.1.4. It should be noted that the analysis compares households, and the tax and benefit systems as a whole, on a like for like basis. In reality, over a ten-year period many households are likely to see a significant change in their circumstances. In some households children will be born, in others children will grow up and may move out; people will get married or divorced or retire; some households may increase their income, other households may see their income decrease.

7.1.5. The parameters overleaf have been used to create the scenario modelled. They includes both income and expenditure measures and, where possible, the impact of mitigation measures such as the increase in Supplementary Benefit and old-age pension payments.

7.1.6. While income measures are modelled to be broadly revenue neutral (within about 1% of current total income), the scenario as modelled includes the net reduction annual expenditure of £12m from the withdrawal of, or reduction in, universal benefits over a ten-year period.

7.1.7. Given the proposed phasing of the withdrawal, this money will not be available immediately, but it could be redistributed to other new or existing service areas. However, it is not possible to model the impact of this redistribution of expenditure until it is clear how the States will choose to reallocate this money, and it would be presumptive to make any assumptions or recommendations in this report.

7.1. Scenario Parameters

Income Measures

7.1.8. The parameters outlined below represent a possible outcome achievable within the recommendations contained in this report.

7.1.9. The income measures outlined below are designed to be broadly revenue neutral (i.e. they would raise a similar amount of revenue as is currently raised) after inclusion of any impact of pensions and benefits to offset the inflationary impact of these measures. The effect of increases in the Guernsey old-age pension and Supplementary Benefit to compensate for the inflationary impact of a consumption tax are included in the modelling where possible.

Income tax

- Income tax rate remains at 20%
- Move to full independent taxation (i.e. the ability to transfer unused allowances is phased out)
- Personal allowances increased to £17,500
- Removal of Mortgage Interest Relief
- Equalise tax allowances for those under and over pension age
- Withdraw the allowance for Charge of Child

Social Security Contributions

- Apply lower earnings limit for employed and self-employed contributors as an allowance at the same level as that available to non-employed contributors

Indirect taxes

- Domestic TRP increased by +100% in real terms
- Broad-based consumption tax at 5%
    - Offset by increases in pensions and benefits to compensate for the inflationary impact. Application of this will cost an estimated £6m: £3m to apply this to old-age pensions; £3m to apply this to current Supplementary Benefit claimants and others currently outside the Supplementary Benefit system
    - Includes an International Services Entities Scheme (raising an estimated £4m)

Expenditure measures

7.1.10. Net of the impact that the withdrawal of universal benefits may have on the payment of supplementary and other benefits, it is estimated that, over a ten year period, expenditure measures will release an estimated £12m of expenditure which can be redirected to other service areas.

7.1.11. Please note that the reallocation of this expenditure has not been incorporated into the analysis, since at this time it is not known how the States would choose to redistribute this expenditure.

7.1.12. The redistribution of this money through other projects may well have a beneficial impact on households. However, it is not possible to model this until it is clear how the States will choose to reallocate this money and it would be presumptive to make assumption or recommendations in this report.

Pensions (reducing long-term funding requirements not current costs)

- Establish guideline uprating of pension at 1/3rd the annual increase in earnings for up to ten years, reducing this to RPIX only beyond this
- Continuing the increase in the pension age at 2 months per year beyond 2031 (when the pension age will reach 67), to reach 70 by 2049.

Universal Benefits

- Withdrawal of Family Allowance
    - Net of increases in Supplementary Benefit to adjust to changes in the net income of claimants
- Removal of automatic exemption for prescription charges for those over the age of 64.
- Introduction of a nominal charge of £1 for exempt prescriptions
- Increase in prescription charges to £4.40
- Withdrawal of the subsidy on primary care appointments
- Withdrawal of free TV licences for over 75s

7.2. Impact on households by income

7.2.1. **Overall, including both taxation and benefit changes, households would experience a minimal impact from these changes. On average, reflecting both the changes to taxation and the withdrawal of universal benefits, households, would be worse off by an estimated 0.6% of their net income.**

7.2.2. However, if the final outcome were to reflect the parameters outlined, the distribution of tax and benefits across the community would change and some households would benefit while others would not.

7.2.3. **By income, those who receive the most benefit from the scenario outlined are lower-middle to upper-middle income households (income deciles 3 to 6). Typically these are households with at least one working adult who receive the most benefit from both the increase in personal allowances and the application of an allowance to Social Security contributions.**

7.2.4. **The majority of the negative impact in the scenario outlined would be borne by those in the highest income decile, who, on average, would be an estimated 2.2% worse off.**

7.2.5. **Those on lower incomes, many of whom are not tax payers, receive less benefit from the redistribution away from direct taxes and are more reliant on mitigations through the pensions and benefit systems.**

7.2.6. A more detailed analysis of the impact by decile is included in the following pages. Also included is a breakdown of the composition of each decile and an indication of the income ranges each decile represents.

Households in the bottom 20% (deciles 1 and 2)

7.2.7. Modelling shows that on average those in deciles 1 and 2 (the 20% of households with the lowest income) would be slightly better off in this scenario (by an estimated 0.2% of their net income).

Composition of income deciles by household type

Household type	Decile 1	Decile 2
Single adult	27%	11%
Childless couple	8%	9%
Couples with children	7%	15%
Lone parent	21%	9%
Single pensioner	15%	33%
Pensioner couple	2%	18%
Other (no children)	17%	6%
Other (children)	2%	0%
	100%	100%

Decile range **(current net household income after tax and receipt of benefits, relative to a household with two working adults with no children)**

	Decile 1	Decile 2
Min	---	£15,139
Max	£15,138	£21,722

A decile represents 10% of a data set when ranked in order.

In this case, each decile is 10% of households grouped by household income. The first decile represents the 10% of households with the smallest annual income, the tenth decile represents those with the largest annual income.

7.2.8. Low income households are expected to pay the most consumption tax relative to their income but also gain the most benefit from the increase in pensions and benefits to reflect the impact on inflation and the withdrawal of universal benefits. Approximately 70% of these households could be expected to benefit from an increase in the old-age pension, welfare benefit or both. For those in these groups in receipt of Supplementary Benefit, the withdrawal of universal benefits has only a minimal impact. Supplementary Benefit claimants are entitled to free primary care consultations, in most cases their benefit would automatically be adjusted for the loss of Family Allowance, and any increased rent resulting from increases in TRP would also be absorbed by their benefit claims.

7.2.9. If, as has been assumed, by 2025 the Rent Rebate scheme has been integrated with the Supplementary Benefit system, many of those currently receiving benefits in the form of a rent rebate would also be reached by these mechanisms. If the SWBIC project is not successful in integrating the two systems, alternative measures to reach social housing tenants and other low income households currently outside the benefit system will be necessary.

7.2.10. There are households in this group who cannot be reached through the pensions and benefit systems, primarily low income households who do not qualify for welfare benefits or choose not to claim. While some of these may benefit from the increase in tax allowances and the application of an allowance on Social Insurance contributions there may be some households who cannot be reached by either mechanism.

7.2.11. Further mitigation may be required to assist these households through the transition. These households include:

- Households with a moderate income and multiple children who are just beyond the reach of the benefit system, who choose not to claim or who are prevented from claiming by the current benefit limitation.
    - It is likely that the increase in the personal income tax allowance and the application of the Social Security lower earnings limit as an allowance may compensate these households for some of the increased cost resulting from a consumption tax. However, they may be particularly vulnerable to the withdrawal of universal benefits; in particular the withdrawal of Family Allowance and the withdrawal of subsidies on primary care (in the absence of an alternative system of supporting primary care).
    - This group is most likely to benefit from any extension of the benefit system (for example by further increase in the benefit limitation or an increase in benefit rates).
- Pensioners in receipt of a small annual income (sufficient to take them beyond the benefit threshold) but receiving no, or only very limited, old-age pension.
    - Those who own their own homes outright and have little in the way of on-going housing cost which may, in some cases, make them better off than they may appear from the available data. These people are often referred to as being asset rich and cash poor.
    - Others, who may not have capital assets to support their living expenses, may face more immediate need and any on-going work will need to consider how such households can be protected. Such households are likely to benefit from the extension of the benefit system.
- Non-householders living within the home of another household (most commonly adult children or ageing relatives).
    - Such individuals may have a limited income but may also be subject to lower housing and subsistence cost than other groups.
- Households with little annual income but too much capital wealth and savings to qualify for benefit.
    - While, based on the available data these people may appear poor, some of these households may have a considerable amount of capital wealth or other non-taxable sources of funds.

- Married couples with a single small to moderate income that transfer unused tax allowances between spouses.
  - Such households may be negatively impacted by the transition to a system of independent taxation.

Lower middle income households (income deciles 3 and 4)

7.2.12. Overall, households in deciles 3 and 4 would see an improvement in their financial circumstances in this scenario (by 0.9% and 0.6% respectively).

7.2.13. Many households in these groups benefit from both the application of the lower earnings limit on Social Security as an allowance and the increase in personal allowances. Most households (76%) in these deciles would contain at least one tax paying adult and almost all would have at least one household member contributing to the Social Security system.

Composition of income deciles by household type

Household type	Decile 3	Decile 4
Single adult	10%	12%
Childless couple	11%	15%
Couples with children	18%	25%
Lone parent	8%	6%
Single pensioner	26%	17%
Pensioner couple	22%	18%
Other (no children)	5%	7%
Other (children)	1%	1%
	100%	100%
Decile range (current net income after tax and receipt of benefits, relative to a household with two working adults with no children)		
Min	£21,723	£27,153
Max	£27,152	£32,981

7.2.14. An estimated 61% of these households would be benefited by the changes, the increase in their personal allowance and reduction in their Social Security liability more than compensating for any increase in cost resulting from GST or any loss of universal benefits.

7.2.15. Approximately 14% of households in these deciles receive some form of means-tested benefits and, as described previously, these households would be benefited by the increase in their benefits to reflect the impact of a consumption tax on inflation and the impact of the withdrawal of universal benefits on their total income.

7.2.16. While the majority of households in these deciles would be benefited by the changes, as modelled, approximately 39% could be adversely affected. Approximately 27% could be impacted by more than £10 a week. The majority of these people are those not claiming means-tested benefits but who are impacted by the withdrawal of universal benefits and specific tax allowances.

7.2.17. The high proportion of pensioners in these deciles means that the impact of the withdrawal of the subsidy on primary medical care is particularly significant to this group. This could be mitigated if a more effective way of supporting primary care costs can be found.

Middle income households (deciles 5 and 6)

7.2.18. The proportion of households with two incomes increases in these deciles and as a result the benefit of the application of the lower earnings limit on Social Security as an allowance and the increase in the personal allowance also increases. An estimated 58% of households in these deciles would see an improvement in their overall financial position in this scenario.

Composition of income deciles by household type		
Household type	Decile 5	Decile 6
Single adult	12%	9%
Childless couple	20%	25%
Couples with children	31%	35%
Lone parent	5%	3%
Single pensioner	9%	7%
Pensioner couple	15%	12%
Other (no children)	8%	7%
Other (children)	0%	1%
	100%	100%
Decile range (current net income after tax and receipt of benefits, relative to a household with two working adults with no children)		
Min	£32,982	£39,287
Max	£39,286	£45,331

7.2.19. The overall impact on these deciles is similar to deciles 3 and 4 with the average improvement in the financial position of households in these deciles of +0.5% and +0.4% respectively.

7.2.20. There are very few benefit claimants falling in these deciles so the increase in means-tested benefits has little impact on those in these deciles. The withdrawal of universal benefits again has a negative impact on households in these deciles, but relative to total income levels their impact is less than in deciles 3 and 4.

7.2.21. Both the proportion of households in these deciles with mortgages, and the average amount of interest paid on those mortgages increases from deciles 3 and 4 to deciles 5 and 6 and as a result the impact of withdrawing Mortgage Interest Relief is greater.

7.2.22. At the levels set, deciles 5 and 6 are the first where a small number of households could be affected by a significant reduction of the upper earnings limit on social security contributions.

Upper middle income households (deciles 7 and 8)

7.2.23. At this income level the withdrawal of universal benefits relative to income becomes less significant. The majority of working age households in this group have two employed or self-employed adults and approximately 53% of households would see an improvement in their circumstances.

Composition of income deciles by household type		
Household type	Decile 7	Decile 8
Single adult	10%	8%
Childless couple	33%	40%
Couples with children	32%	31%
Lone parent	2%	1%
Single pensioner	5%	5%
Pensioner couple	11%	9%
Other (no children)	7%	6%
Other (children)	0%	1%
	100%	100%
Decile range (current net income after tax and receipt of benefits, relative to a household with two working adults with no children)		
Min	£45,332	£52,681
Max	£52,680	£62,713

7.2.24. The proportion of households with one or more self-employed adults is higher in this category than in lower deciles and this group is most likely to be affected by a review of the upper earnings limit on contributions or any restructuring of the system which may result from the recommended review.

7.2.25. More than half the households in these deciles have mortgages and the impact of the withdrawal of Mortgage Interest Relief relative to income is largest in this group.

Households in the top 20% (deciles 9 and 10)

7.2.26. While relative to their income those in deciles 9 and 10 are expected to pay less consumption tax than other groups, nonetheless, in monetary terms the amount of consumption tax paid by these households would be large.

Composition of income deciles by household type		
Household type	Decile 9	Decile 10
Single adult	6%	5%
Childless couple	43%	41%
Couples with children	30%	34%
Lone parent	1%	1%
Single pensioner	3%	6%
Pensioner couple	8%	9%
Other (no children)	8%	4%
Other (children)	0%	0%
	100%	100%
Decile range (current net income after tax and receipt of benefits, relative to a household with two working adults with no children)		
Min	£62,714	£81,757
Max	£81,756	---

7.2.27. The measures to redistribute the revenue raised by indirect taxes by reducing direct taxes and Social Security contributions are aimed at benefiting lower and middle income households. As a result the benefit of these relative to their household incomes is limited for those in this group and households in the top two deciles would, in general, pay more and/or receive less in benefits in the scenario outlined.

7.2.28. In this scenario, it is expected that those in deciles 9 and 10 could be worse off by an average of 0.5% and 2.2% of their total income respectively.

7.2.29. The net change would be negative for approximately 58% of those in decile 9 and 87% of those in decile 10. A significant majority of these are working age couples, the majority of which do not have any children.

7.3. Impact by household type

7.3.1. The sections below outline the impact of the modelled scenario, outlined by household type. As with the analysis of income there can be considerable variation within the groups depending on an individual household's circumstances.

7.3.2. The pattern of impact largely reflects the current eligibility of certain groups for specific allowances and universal benefits. For example, households without children are unaffected by the withdrawal of Family Allowance but the impact of this on households with multiple children can be significant.

7.3.3. This section also suggests some further mitigation, which could be employed to reduce the impact on these households. Such actions will be considered in more detail in the subsequent stages of work to be carried out following the debate on this report.

7.3.4. The distribution of income within household type categories also has a significant impact on the average impact for each group and this information is provided in each section.

Single Adults

7.3.5. Overall the scenario outlined would be positive for single adult households, with an estimated 78% likely to see an improvement in their circumstances. Single adult households currently receive fewer universal benefits and specific tax allowances than other categories and are therefore less impacted by the withdrawal of these than other groups.

Income distribution of households		
	Income Decile	Single Adult Households
Low income	1	26%
	2	10%
Lower- middle income	3	9%
	4	11%
Middle income	5	11%
	6	8%
Upper middle income	7	9%
	8	7%
High income	9	5%
	10	4%
All deciles		100%

7.3.6. Those in this group who could be adversely affected (about 22% of single adult households) are typically in the highest or lowest income deciles.

7.3.7. There are a number of single adults in the bottom two deciles who are not in receipt of welfare benefits, but have an income of less than the revised personal tax allowance; as such they would not receive full value from the increase. The modelling suggests that the impact on these people could be lessened by a fairly modest extension to the benefit system.

7.3.8. For those in the upper deciles, the monetary benefit received from the increase in allowances for high income households would be smaller than the cost implication of a consumption tax. A significant percentage of single adult households in the upper deciles also claim Mortgage Interest Relief and therefore would be impacted by its withdrawal.

Childless couples

Income distribution of households		
	Income Decile	**Childless couples**
Low income	1	3%
	2	3%
Lower- middle income	3	4%
	4	6%
Middle income	5	8%
	6	10%
Upper middle income	7	14%
	8	16%
High income	9	18%
	10	17%
All deciles		100%

7.3.9. On average, childless couples would see an improvement in their circumstances, with an estimated 65% of households benefiting from the changes. Of those households negatively impacted by the scenario outlined, more than one-third are in the two highest income deciles.

7.3.10. In a household with two working adults, the total income tax and Social Security liability for the household could be significantly reduced. For example, a household in receipt of two full personal allowances could see their annual income tax liability reduced by more than £3,000 and their Social Security liability reduced by more than £800.

7.3.11. In households where only one spouse earns a wage higher than the proposed tax allowance, the impact of the proposed move to independent taxation could become significant. Of the 35% of households who may be negatively affected in the scenario modelled almost all could be affected by the move to independent taxation and the loss of the ability to transfer allowances between spouses.

7.3.12. While most of these households would have a higher total allowance than they currently receive (and some would not be affected by independent taxation without the increase in their personal allowance), the increase may not be enough to offset the impact of other measures.

7.3.13. Relative to the level of income, the impact of independent taxation on affected households would be more significant for lower income households. However, the number of households affected by this issue would increase significantly at higher income levels, with half falling in deciles 8 to 10

7.3.14. Of those negatively impacted, approximately 43% (or 14% of all couples without children) would be affected by the withdrawal of Mortgage Interest Relief, the impact of which would be highest in deciles 6 to 9.

Couples with children

Income distribution of households		
	Income Decile	Couples with children
Low income	1	3%
	2	5%
Lower- middle income	3	7%
	4	10%
Middle income	5	12%
	6	14%
Upper middle income	7	12%
	8	12%
High income	9	12%
	10	13%
All deciles		100%

7.3.15. For households with children the withdrawal of Family Allowance would become an important factor. Those in receipt of means-tested benefits (either through Supplementary Benefit or the Rent Rebate scheme) are assumed to be protected from the impact of this. However, it should be noted that, with the benefit limitation at its current level a small proportion of benefit claimants would not be compensated for the loss of Family Allowance unless the benefit limitation is increased or an alternative mechanism is found to compensate these households.

7.3.16. An estimated 30% of couples with children would see an improvement in their circumstances in the scenario modelled. Those negatively impacted include most of those in the top two income deciles who, in monetary terms, are expected to pay the largest amount of consumption taxes and who receive, in relative terms, less benefit from the increase in allowances.

7.3.17. The withdrawal of Mortgage Interest Relief also would have a negative impact for some households in this group, particularly those in the middle and upper income deciles.

7.3.18. As with childless couples, almost all households whose circumstances may be worse could be affected by the move to independent taxation to some degree. While again, the proportion of households affected is much higher among those with a higher income, the proportion of households affected in the lower deciles is much higher for couples with children than those couples without children in the lower and middle deciles. **The impact on this group could be lessened by extending the transition to independent taxation beyond the ten-year horizon outlined in this review.**

Lone Parents

7.3.19. On average lone parents would be the most affected household group, being affected by both the withdrawal of Family Allowance and the loss of the Charge of Child tax allowance. However, there would be significant variation in the impact within the group.

Income distribution of households

	Income Decile	Lone Parents
Low income	1	38%
	2	14%
Lower- middle income	3	14%
	4	10%
Middle income	5	9%
	6	6%
Upper middle income	7	3%
	8	2%
High income	9	3%
	10	1%
All deciles		100%

7.3.20. Within this group approximately 44% of households are in receipt of means-tested benefits and, as such, the modelling assumes that they will be protected from the majority of the changes.

7.3.21. As modelled, approximately 49% of lone parent households would be negatively impacted. The majority of these households are currently tax payers (although they may not be after the extension of the personal allowance). For these households the allowance for the Charge of Child, which is currently given to about 700 households, is worth up to £1,300 a year and its loss significantly reduces the net increase in tax allowance these households would experience as a result of the increase in the universal personal allowance.

7.3.22. Combined with the loss of Family Allowance, this means that for some households in this group the impact of the scenario as outlined could be very significant.

7.3.23. In the long term, while the Joint Board recommends that the Charge of Child allowance be withdrawn, it accepts that, given the impact of this on some households particularly in combination with the withdrawal of Family Allowance, it may be necessary to mitigate this either by deferring the commencement of the withdrawal, or extending the transition period beyond the ten year horizon outlined in this report. The consideration of how to manage this transition will need to be closely co-ordinated with the transitional arrangements for any move towards independent taxation.

7.3.24. If the withdrawal of this allowance is deferred beyond the ten year horizon shown in the analysis, the average impact on lone parent households would reduce from an estimated -2.3% of their household income to -0.8%. It would also reduce the percentage of those adversely affected from 49% to 43% but this would reduce the projected income tax revenues by an estimated £700,000.

Single Pensioner

7.3.25. While very few pensioner households continue to claim Mortgage Interest Relief into retirement, the proposals to withdraw subsidies on primary medical care appointments and the automatic exemption from prescription charges for those over the age of 64 would have a much larger impact on single pensioners and pensioner couples than on other household types.

Income distribution of households		
	Income Decile	**Single pensioner**
Low income	1	9%
	2	30%
Lower- middle income	3	20%
	4	13%
Middle income	5	7%
	6	5%
Upper- middle income	7	4%
	8	4%
High income	9	2%
	10	5%
All deciles		100%

7.3.26. The withdrawal of an extended tax allowance for those over the States pension age would be partially offset by the benefit pensioners may receive from the increase in the universal personal allowance.

7.3.27. An estimated 21% of single pensioners are in receipt of means-tested benefits. As most of these households will receive free primary medical care under the Supplementary Benefit scheme and would be compensated through the benefit systems for the inflationary impact of consumption taxes, most of these households would not be negatively impacted by the scenario as shown.

7.3.28. For those outside the welfare system, most are in receipt of at least a partial old-age pension and, as the model is outlined, will receive an increase in their pension payment reflecting the inflationary impact of a consumption tax. This increase is assumed to apply to all pension claimants regardless of their total income.

7.3.29. Approximately 41% of single pensioner households could be negatively impacted by the scenario outlined, including almost all single pensioner households falling in deciles 9 and 10. This also includes a number of single pensioners in the lowest income decile who do not claim welfare benefit. This could be because they are eligible for benefit but choose not to claim or because they are asset rich but cash poor and may not be eligible for benefit, either because their housing costs are limited or they have significant savings on which to support themselves. **Particular care will be needed to ensure that, where appropriate, this group is protected during the transition.**

Pensioner couples

7.3.30. There is significant variation within this household type. It is estimated that 59% of pensioner couples would be negatively impacted by the scenario outlined.

7.3.31. Most pensioner couples where each spouse has a significant amount of income will not be adversely affected by the scenario outlined, but for pensioner couples where all or the majority of income is assigned to one spouse, the impact of the move to independent taxation could be significant.

Income distribution of households		
	Income decile	**Pensioner couples**
Low income	1	2%
	2	11%
Lower- middle income	3	19%
	4	15%
Middle income	5	12%
	6	10%
Upper- middle income	7	9%
	8	8%
High income	9	7%
	10	8%
All deciles		100%

7.3.32. While the same is true for couples of working age, the instance of couples with a single income is higher among pensioners than among those of working age. It is also more difficult for those of pension age, particularly those in the lower and middle income deciles to adapt to changes in the tax system.

7.3.33. This impact could be mitigated by extending the transition period for the implementation of independent taxation or by applying independent taxation to working age individuals only in the first instance and enabling those over pension age to be assessed jointly. If it is assumed that at the ten year horizon independent taxation applies to working age adults only, the average impact on pensioner couples would reduce from being worse off by 0.8% of their household income to being better off by 0.4%. This would reduce the percentage of pensioner couples adversely affected from 59% to 35%. However, this would reduce the expected revenues by an estimated £2.5m.

8. Impact on health

8.1.1. As a result of an amendment to the 113th Medical Officer of Health's Annual report 2013 (Billet d'État VIII, May 2013) it was resolved as follows:

"To direct that in recognition of the aim of Recommendation 5 of the Medical Officer of Health's 113th Annual Report any Propositions laid before the States of Deliberation by States Departments in connection with the comprehensive review of personal taxes, pensions and benefits will, subject to existing resources available to the States, take into account the potential impact on health, wellbeing and health equity among the population."

8.1.2. The Joint Board recognises that there are potential health implications for some of the recommendations within this report.

8.1.3. Specifically, as highlighted in section 4.4, the withdrawal of the subsidy on primary medical consultations and the increase in charges for prescription costs would increase the personal cost of medical care in Guernsey and could mean that some people, particularly those on low incomes, may choose not to seek medical attention if they feel the cost burden is prohibitive.

8.1.4. While the Joint Board has recommended the phased withdrawal of the primary care grant, having identified that it is not effective in achieving its purpose, it recognises that the cost of primary care is an issue for many households. The withdrawal of this grant would release £3.5m of expenditure and this may provide an opportunity to find a more effective way of supporting primary care provision.

8.1.5. As suggested in section 4.4, the Joint Board also considers it would be appropriate for the Social Security Department to examine more closely the methods by which it might be possible to limit the overall cost of prescriptions to individuals who receive a large number of prescriptions per year.

8.1.6. Beyond the measures above which may have a direct impact on health outcome, the Joint Board recognises the established relationship between disposable income and health outcomes and more specifically the links between low income and poor physical and mental health.

8.1.7. The Joint Board has stated that its intention will be to protect low income households wherever possible. It should be noted that it is routine practice for the Social Security Department to increase pensions and benefits by at least the annual change in RPIX each year. In the normal course of events this inflation increase would compensate those households in receipt of those benefits for any increase in their costs should the States choose to introduce a consumption tax in the future. However, it could take up to 12 months for the increase in these costs to feed into an increase in pensions and benefit rates via the usual methods. The Joint Board recognises that an interim increase in benefit rates would be needed to protect households who may be unfairly disadvantaged in the intervening period.

8.1.8. In recognition of this, the modelling of consumption taxes includes an adjustment to Supplementary Benefit and old-age pensions which would see the income of households in receipt of these increased to compensate them for the increase in costs.

9. Resource Implications

9.1.1. This report recommends the formation of a number of work streams and projects to progress the recommendations. To ensure on-going co-ordination and cooperation between the departments it is intended that these be managed as a programme.

9.1.2. Table 9.1 below details the projects which, if approved, would be incorporated within this programme. The projects listed cover only those which could result from the outcome of this report; however, it is envisaged that other projects, most notably the Contributions and Tax System project to modernise the Social Security contributions and Income Tax collection systems, will need to be closely affiliated with this programme.

Table 9.1: Overview of projects falling within the proposed Personal Tax, Pensions and Benefits Review Programme

	Project	Lead department
	Programme management	**T&R**
Larger projects	Review of the enhancement of personal pension provision in Guernsey	**SSD**
	Supporting longer working lives	**SSD**
	Application of Lower Earnings Limit on Social Security contributions as an allowance	**SSD**
	Review of equity within Social Security contributions system	**SSD**
	Move to independent taxation	**T&R**
	Detailed investigation of consumption tax	**T&R**
	Impact of population policy on Economic Growth	**PC**
	Extension of the Fiscal Framework to incorporate Social Insurance contributions	**PC**
Smaller work streams	Phased increase in personal tax allowance	**T&R**
	Phased increase in TRP	**T&R**
	Phased withdrawal of Mortgage Interest Relief	**T&R**
	Review of document duty structure	**T&R**
	Phased changes to prescription charges	**SSD**
	Phased withdrawal of primary medical care grant	**SSD**
	Review of old-age pension uprating guideline (c2020)	**SSD**
	Phased withdrawal of free TV licenses	**SSD**

9.1.3. The number and scope of the underlying projects (listed in Table 9.1) means that the resource implication for this programme is not inconsiderable. However, when combined, these projects will review and restructure more than £500m of States revenues. It is critical that these projects be adequately resourced, and that resourcing includes the need for specialist advice which cannot be found internally and sufficient resource to communicate effectively with the general public.

9.1.4. While more detailed costing of all these projects will be required on initiation, an estimate of the overall cost of the programme is provided in Table 9.2. It is estimated that completion of the programme outlined above would cost an estimated £2.0m to £2.5m, with larger projects to be completed over a period of 3 to 5 years.

Table 9.2: Overview of resource requirements for the programme outlined

Programme & Project Management	£413,000	20%
Business and Financial Analysis	£200,000	10%
External Specialist Consultancy	£1,095,000	52%
Communications, Consultations and Engagement	£200,000	10%
Backfill	£191,000	9%
	£2,099,000	

10. Advice of Law Officers

10.1.1. The Law Officers of the Crown have been consulted about the proposals set out in this report and their comments have been taken into account during its preparation. They note the extensive legislative changes that will be necessary should all the recommendations in the report be approved by the States. In relation to these potential changes, the Law Officers advise that there should be early and regular liaison between the responsible Departments and those members of the Law Officers Chambers who will be undertaking the necessary drafting work. This will assist in ensuring that practical time-lines are established for implementation and sufficient drafting resources can be made available to complete the work within appropriate time-frames.

11. Principles of Good Governance

11.1.1. In preparing this Report, the Joint Board has been mindful of the States Resolution to adopt the six core principles of good governance defined by the UK Independent Commission on Good Governance in Public Services (Billet IV of 2011). The Joint Board believes that the proposals in this Report comply with those principles.

12. Recommendations

12.1.1. Following the PTR process the Joint Treasury and Resources and Social Security Boards recommend the States:

1. **To agree that in order to ensure that public services can continue to be delivered economically and sustainably in the long term, ongoing changes in the demographic make-up of the populations of Guernsey and Alderney require the adoption of a package of measures in relation to the tax and benefits systems, as put forward in this Report.**

2. **To agree that any changes made to the personal tax system as a result of the approval of the recommendations 4 to 41 below, including any transitional arrangements should be completed no later than January 2025 unless otherwise agreed.**

3. **To direct the Treasury and Resources Department and Social Security Department to co-ordinate their actions and report annually to the States on the transitional measures required as a result of the approval of the recommendations 4 to 41, to ensure that any groups of people disadvantaged by the measures agreed are adequately protected throughout the transition period detailed in paragraphs 6.1.1 to 6.1.7. of this Report.**

4. **To direct the Policy Council to review the impact of population policy on current and future economic growth in Guernsey and report back to the States of Deliberation with its findings no later than July 2018.**

5. **To direct the Treasury and Resources Department and Social Security Departments when making recommendations for changes in tax and benefits during the transitional period as detailed in paragraphs 6.1.1 to 6.1.7 of this Report, to have regard to the numbers of people resident in Guernsey and Alderney, their demographic make-up and their level of economic activity.**

Module 1

6. **To amend the Fiscal Framework to place an upper limit on aggregate government income, incorporating General Revenue, Social Security contributions and fees and charges, such that total government income should not exceed 28% of Gross Domestic Product.**

Module 2

7. **To direct the Social Security Department, in consultation with the Treasury and Resources Department, to present to the States of Deliberation for approval a report or reports outlining policies to ensure adequate personal or workplace pension provision in Guernsey and Alderney covering the following parameters:**

- **the enhanced take up of private pension schemes;**
- **the creation of a pension scheme designed to capture those not currently making personal provision (outside of the existing statutory old-age pension scheme);**
- **the enhancement of incentives for contribution to a private pension scheme through the tax system;**
- **the feasibility of devising a scheme whereby pensioners may, if they so wish, invest their pensions in a fund tracking the performance of the capital funds managed on behalf of the States of Guernsey.**

8. **To agree that any additional pension scheme adopted as a result of recommendation 7, be made available to contributors no later than January 2020.**

9. **To agree that long-term planning for statutory old-age pension provision be designed to maintain a buffer of at least two years of expenditure within the Guernsey Insurance Fund.**

10. **To agree to establish a guideline for the annual uprating of pensions, set initially at 1/3rd of the real increase in median earnings, with the intention to reduce this to RPIX subject to suitable policies to enhance personal provision being in place.**

11. **To direct the Social Security Department to take the guideline in recommendation 10 into account in its recommendations for the annual uprating of statutory old-age pensions, and to provide the States of Deliberation with detailed reasoning for any recommendation to deviate from it in its annual uprating report.**

12. **To direct the Social Security Department to review the guideline for the annual uprating of statutory old-age pensions no later than 2020, having regard to progress made in establishing supporting policies to enhance personal pension provision and the actuarial projections for the Guernsey Insurance Fund at that time.**

13. **To agree that the age at which an individual is entitled to claim their statutory old-age pension should be increased from 65 to 70 years, such increase to commence in 2020 at a rate of 2 months per year to reach age 70 in 2049.**

14. **To rescind the States Resolution dated 31st July 2009 (Billet d'État XXI, July 2009) stating "That pension age shall gradually be increased to 67 through increases of 2 months per year, starting in 2020".**

15. **To direct the Social Security Department, in consultation with all other relevant departments, to investigate measures aimed at supporting longer**

working lives and assisting older people who wish to work to remain in the workforce, and to report to the States of Deliberation with its findings no later than December 2017.

16. **To direct the Social Security Department to review the funding of parental benefits with reference to recommendations 9 to 14, where agreed, as part of the Personal Tax, Pensions and Benefits Review, before any proposals for change to such benefits resulting from its review entitled 'Changes to Parental Care Provisions' are laid before the States of Deliberation.**

17. **To acknowledge that the present model of provision of long-term residential and nursing care for older people is financially unsustainable and to direct that the Policy Council give consideration to the suggestions outlined in paragraphs 5.2.42 to 5.2.48 of this Report, when reporting to the States of Deliberation on a Supported Living and Ageing Well Strategy.**

18. **To direct the Policy Council to ensure that the outputs of the Supported Living and Ageing Well Strategy can be achieved within the financial limitation set out by the Fiscal Framework and any extension of those limitations to incorporate income from Social Security contributions agreed by the States of Deliberation's approval of recommendation 6.**

Module 3

19. **To agree to phase out the payment of a universal Family Allowance under the Family Allowances (Guernsey) Law, 1950 between 2016 and 2025, through gradual reductions in the amount paid having regard to the increases in personal tax allowances as outlined in recommendation 27 below, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.**

20. **To agree to phase out the universal exemption from prescription charges for those over the age of 64 by 2020, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.**

21. **To agree to introduce in 2016 a nominal fee for prescriptions of up to £1 per item for all those currently exempt from prescription charges, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating report.**

22. **To agree to increase prescription charges to £4.40 per item in 2016 and thereafter to review them as part of its annual uprating report, and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.**

23. **To agree to phase out the provision of free TV licences for those over the age of 74 and those over the age of 64 claiming Supplementary Benefit by closing the scheme to new members in 2016 and closing the scheme to all by 2020 and**

direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.

24. **To agree to phase out the Health Benefit grant for primary care appointments by 2025 and direct the Social Security Department to bring forward proposals to effect this in its annual uprating reports.**

25. **To direct that the Social Welfare Benefit Investigation Committee ensures that the outputs of its review of social welfare benefits complies with the Fiscal Framework and any extension of these limitations agreed by the States of Deliberation's approval of recommendation 6 .**

Module 4

26. **To agree in principle that, to bring Guernsey's tax base more into line with those in other advanced economies, by 2025 the reliance on direct personal taxes and Social Security contributions should be both reduced significantly from its current level of 74% of total government income and diversified, so that a greater proportion of taxation revenue is derived from other forms of taxation.**

27. **To agree that between 2015 and 2025, and subject to approval and implementation of the measures set out in recommendations 28 to 39 below, to phase in increases in personal tax allowances to no more than £17,500 (at 2015 prices), the level of phasing having regard to the effect of the other measures introduced as a result of the States of Deliberation's approval of these recommendations, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.**

28. **To agree to phase out the relief provided on mortgage interest in respect of principal private residences by 2025, with the phased withdrawal of Mortgage Interest Relief to be achieved by reducing the cap on interest deductible and that the withdrawal should broadly follow the schedule provided in Appendix 8d, and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.**

29. **To agree to freeze the personal tax allowance provided to those over the age of 64 until such time as the personal tax allowance for those under the age of 65 reaches the same level and thereafter that the personal tax allowance for all tax payers should be the same and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.**

30. **To agree to move towards a system of independent taxation in which all tax payers are treated as individuals, by removing the ability to transfer tax allowances between married couples or couples with children, with each tax payer being assessed on an individual basis and direct the Treasury and**

Resources Department to bring forward proposals to effect this in its annual Budget Reports.

31. **To agree that, subject to approval of a move towards independent taxation, the allowances available for 'Charge of Child' (as described in paragraph 5.4.45) should be phased out by 2025 and direct the Treasury and Resources Department to bring forward proposals to effect this in its annual Budget Reports.**

32. **To agree that the phased withdrawal of 'Charge of Child' allowances (as described in paragraph 5.4.45) should be achieved by reducing the available allowance to reflect the annual increase in the personal allowance each year.**

33. **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 will 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.**

34. **To direct that, subject to the implementation of suitable administrative systems and suitable alternative sources of revenue, the Social Security Department further investigates a restructuring of Social Security contributions to apply an allowance for employed and self-employed individuals.**

35. **To direct the Treasury and Resources Department to revise the grant paid to the Social Insurance Fund to compensate for the revenue lost to the Social Security funds if an allowance is introduced for employed and self-employed individuals.**

36. **To direct that, as part of the annual Budget Report, the Treasury and Resources Department increases the rates of domestic Tax on Real Property by no more than 7.5% per annum in real terms between 2016 and 2025.**

37. **To direct the Treasury and Resources Department to review the structure of Document Duty as part of the ongoing budgetary process.**

38. **To direct the Treasury and Resources Department to report to the States of Deliberation no later than June 2017 with detailed proposals for a broad-based consumption tax, and agree that such should include:**

    - the rate at which a consumption tax should be levied, which should be no more than 5%;

    - the viability of sharing resources for the administration of any such tax with Jersey;

- the one-off and annual costs for the States of Guernsey of introducing and administering any such tax;
- the one-off and annual costs (if any) to island businesses in introducing and administering any such tax, together with any proposals for measures to mitigate such costs;
- a mechanism to prevent increases in the rate of any such tax without, for example, a 2/3rds parliamentary majority;
- the measures required to off-set the introduction of any such tax with a reduction in direct taxation through increased personal tax allowances;
- the measures required in the pensions and benefits system to mitigate the impact on groups of people that may be disadvantaged by its introduction, particularly those on low or fixed incomes, including those in retirement; and
- a review of necessary impôt and excise duties to avoid double taxation.

39. **To direct that 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 report back to the States should it consider any changes are necessary.**

40. **To direct the Treasury and Resources Department to have regard to the resource implications arising from the approval of these recommendations, when recommending annual revenue allocations for the departments charged with undertaking further investigations.**

41. **To direct the preparation of such legislation that may be necessary so as to give effect to the above decisions.**

Yours faithfully

G. A. St. Pier, Minister, Treasury and Resources Department	A. H. Langlois, Minister, Social Security Department
J. Kuttelwascher	S. A. James
A. Spruce	J. A. B. Gollop
R. A. Perrot	M. K. Le Clerc
A. Hunter Adam	D. A. Inglis
J. C. Hollis, Non-voting Member	M. J. Brown, Non-voting Member

(N.B. The Policy Council commends the Treasury and Resources and Social Security Departments for producing such a comprehensive and well-researched Report on fundamental and complex issues relating to the continued financial sustainability of the Island's public services. The Policy Council is in no doubt that for the long-term good of Guernsey and Alderney it is necessary that these issues are addressed. It also agrees with the two departments that the best means of doing so is via a wide ranging package of tax and benefit measures, progressively implemented over a 10-year period.

Unsurprisingly, Policy Council members have differing views on some specific aspects of the proposed package but all welcome the opportunity that the Report presents to have these fully debated and an informed opinion reached, not just by the States but by Islanders themselves, all of whom are likely to be affected to some degree by what is recommended. In acknowledging this latter point, it is helpful that the Report is focussed on policy principles, as much further work - including further reports to the States - will be needed to implement many of the strategic decisions resulting from adoption of the package of measures put forward. These further reports – including the annual Budget and benefit uprating reports – will also provide the opportunity to fine tune the details of the package to reflect any material changes in circumstances that may affect the assumptions upon which the detailed modelling of impacts has been based.

Finally, the Policy Council concurs that, arising from the Report and in line with Proposition 4, changes in Guernsey's demographic make-up will require an assessment to be made of the effects of current population policy upon the Island's economy and upon service provision in general.)

The States are asked to decide:-

I.- Whether, after consideration of the Report dated 15th January, 2015, of the Treasury and Resources Department and the Social Security Department, they are of the opinion:-

1. To agree that in order to ensure that public services can continue to be delivered economically and sustainably in the long term, ongoing changes in the demographic make-up of the populations of Guernsey and Alderney require the adoption of a package of measures in relation to the tax and benefits systems, as put forward in that Report.

2. To agree that any changes made to the personal tax system as a result of the approval of the Propositions 4 to 41 below, including any transitional arrangements, should be completed no later than January 2025 unless otherwise agreed.

3. To direct the Treasury and Resources Department and Social Security Department to co-ordinate their actions and report annually to the States on the transitional measures required as a result of the approval of Propositions 4 to 41 to ensure that any groups of people disadvantaged by the measures agreed are adequately protected throughout the transition period detailed in paragraphs 6.1.1 to 6.1.7 of that Report.

4. To direct the Policy Council to review the impact of population policy on current and future economic growth in Guernsey and report back to the States of Deliberation with its findings no later than July 2018.

5. To direct that the Treasury and Resources Department and Social Security Department, when making recommendations for changes in tax and benefits during the transitional period as detailed in paragraph 6.1.1 to 6.1.7 of that Report, to have regard to the numbers of people resident in Guernsey and Alderney, their demographic make-up and their level of economic activity.

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   - the enhanced take up of private pension schemes;
   - the creation of a pension scheme designed to capture those not currently making personal provision (outside of the existing statutory old-age pension scheme);
   - the enhancement of incentives for contribution to a private pension scheme through the tax system;
   - the feasibility of devising a scheme whereby pensioners may, if they so wish, invest their pensions in a fund tracking the performance of the capital funds managed on behalf of the States of Guernsey.

8. To agree that any additional pension scheme adopted as a result of Proposition 7 be made available to contributors no later than January 2020.

9. To agree that long-term planning for statutory old-age pension provision be designed to maintain a buffer of at least two years of expenditure within the Guernsey Insurance Fund.

10. To agree to establish a guideline for the annual uprating of statutory old-age pensions, set initially at 1/3rd of the real increase in median earnings, with the intention to reduce this to RPIX subject to suitable policies to enhance personal provision being in place.

11. To direct the Social Security Department to take the above guideline in Proposition 10 into account in its recommendations for the annual uprating of statutory old-age pensions, and to provide the States of Deliberation with detailed reasoning for any recommendation to deviate from it in its annual uprating report.

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13. To agree that the age at which an individual is entitled to claim their statutory old-age pension should be increased from 65 to 70 years, such increase to commence in 2020 at a rate of 2 months per year to reach age 70 in 2049.

14. That the States Resolution dated 31st July 2009 (Billet d'État XXI, July 2009) stating "That pension age shall gradually be increased to 67 through increases of 2 months per year, starting in 2020" be rescinded.

15. To direct the Social Security Department, in consultation with all other relevant departments, to investigate measures aimed at supporting longer working lives and assisting older people who wish to work to remain in the workforce, and to report to the States of Deliberation with its findings no later than December 2017.

16. To direct the Social Security Department to review the funding of parental benefits with reference to propositions 9 to 14, where agreed, as part of the Personal Tax, Pensions and Benefits Review, before any proposals for change to such benefits resulting from its review entitled 'Changes to Parental Care Provisions' are laid before the States of Deliberation.

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income from Social Security contributions agreed by the States of Deliberation's approval of proposition 6.

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    - the viability of sharing resources for the administration of any such tax with Jersey;
    - the one-off and annual costs for the States of Guernsey of introducing and administering any such tax;
    - the one-off and annual costs (if any) to island businesses in introducing and administering any such tax, together with any proposals for measures to mitigate such costs;
    - a mechanism to prevent increases in the rate of any such tax without, for example, a 2/3rds parliamentary majority;
    - the measures required to off-set the introduction of any such tax with a reduction in direct taxation through increased personal tax allowances;
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40. To direct the Treasury and Resources Department to have regard to the resource implications arising from the approval of these Propositions when recommending annual revenue allocations for the departments charged with undertaking further investigations.

41. To direct the preparation of such legislation that may be necessary so as to give effect to the above decisions.