

Crown Dependencies' Corporate Tax Reviews

27 August 2010

1. Executive summary

- 1.1. The United Kingdom Crown Dependencies are self-financing. Longstanding constitutional arrangements with the United Kingdom have established their sovereignty in determining the tax policies necessary to maintain viable economies and finance their domestic expenditure requirements.
- 1.2. Generally applicable low (or no) corporate taxes are not impugned under the EU Code of Business Conduct (the “Code”). The general principles underpinning 0/10 were agreed by the Code Group to be compliant (at the time of adoption of 0/10 by the Isle of Man).
- 1.3. There are no agreed or generally applicable international standards pertaining to minimum corporate tax rates.
- 1.4. The adoption of regimes providing for tax neutrality limited to particular business streams (through express and detailed exemptions from a tax regime of broad application) would lead to the decline of a financial services industry. New and innovative products would be established in other jurisdictions which accommodate innovation without any required amendment to their laws.
- 1.5. Broad based tax neutrality is accordingly essential to maintaining a viable (finance-based) economy for the Crown Dependencies.
- 1.6. In the event of imposing generally applicable corporate taxation, it is highly unlikely that the Crown Dependencies would be able to secure a broad double taxation agreement network in a time frame that preserves the financial services sector.
- 1.7. Continuation of the current 0/10 tax system is the preferred option.

2. Background

- 2.1. Jersey, Guernsey and the Isle of Man have announced corporate tax reviews, issuing consultation papers seeking input from interested parties.¹ The International

¹ Guernsey Fiscal and Economic Policy Group, *Corporate Tax Review Public Consultation*, 21 June 2010; Isle of Man Treasury Income Tax Division, *Reviewing the Isle of Man's Business Taxation System: A Consultation Document*, 25 February 2010 (consultation closed on 28 May 2010); and States of Jersey Green Paper, *Business Tax Review: A public consultation on corporate taxation*, June 2010.

Financial Centres Forum (the “Forum”)² welcomes the invitation to provide comment on this important issue.

- 2.2. We note that the Crown Dependencies’ corporate tax reviews are conducted in the context of EU suggestions that the current 0/10 tax regimes no longer comply with the “spirit” of the Code which is being revisited in light of the recent global financial crisis and resulting fiscal deficits in EU member countries. We also note that a formal review of the regimes in Jersey and the Isle of Man by the EU is pending. The Guernsey regime will not be formally reviewed by the EU following a Guernsey suggestion that the review of their corporate tax regime will proceed on the basis of the presumption of a 10% minimum tax rate.
- 2.3. The international context in which the Crown Dependencies are determining domestic policy is changing rapidly. The Crown Dependencies will need to accelerate current efforts to become more dextrous with EU tax policy and national tax systems generally. Their strategy should include the provision of data and analytical support to EU Member States on the benefits to their economies and employment resulting from the Crown Dependencies’ facilitation of global investment flows into EU Member States.
- 2.4. We also encourage Crown Dependency policy makers to reflect on the endgame. There are no soft options that permit long term accommodation of all parties.

3. EU Code of Business Conduct

- 3.1. We understand that the Code Group will clarify whether and why the 0/10 regime is perceived to be in conflict with the “spirit” of the Code. Although there is no obligation to align with EU tax policy objectives, the Crown Dependencies may wish to articulate proactively why 0/10 is within the policy of the Code. In particular, we note that the general principles underpinning 0/10 tax systems were accepted by ECOFIN as being Code compliant (as respects the Isle of Man) in March 2003.
- 3.2. The policy concern in the Code pertains to provision of favourable treatment to non-residents not also available to residents. Generally applicable low or no corporate taxes are not impugned under the Code.
- 3.3. While the presumption must therefore be that 0/10 is Code compliant, there may be elements in individual Crown Dependencies’ implementation of 0/10 that may not have been examined by the Code Group, such as anti-avoidance measures including attribution or deemed dividend arrangements. These elements should be separated out and examined discretely so as not to inappropriately undermine the principle of 0/10 generally.
- 3.4. The Forum reserves the right to comment again after the Code Group has reported to ECOFIN.

² The International Financial Centres Forum is a non-profit organisation committed to informing the public debate on the role of IFCs. The IFC Forum has an initial membership comprised of six major professional firms operating across international financial centres: Appleby, Conyers Dill & Pearman, Mourant Ozannes, Ogier, Rawlinson & Hunter and Walkers. For further information visit our website at www.ifcforum.org.

4. Crown Dependencies self-finance and so require domestic control of tax policy

- 4.1. Sovereign states establish fiscal policies necessary to meet governmental needs for expenditure and accordingly have an exclusively domestic right to set their tax systems and rates. To be effective tax system design must also permit maintenance of a viable economy with sufficient commercial activity to generate adequate tax revenue.
- 4.2. The United Kingdom does not accept responsibility for the finance of the domestic budget of the Crown Dependencies, regarding them to be self-financing. The Crown Dependencies' arrangements with the United Kingdom recognise that they enjoy sovereignty for tax purposes. The EU has no jurisdiction over the tax affairs of the Crown Dependencies. The European Court of Justice recognised this in the context of the UK Overseas Territories in March 2003 when it concluded in relation to an action by the Cayman Islands challenging EU efforts to oblige the Cayman Islands to implement a fiscal measure (the EU Savings Tax Directive), that "[t]his is a matter which falls entirely outside the competence not only of the Commission but also of the Community judicature".³
- 4.3. The right of sovereign states to control their domestic tax policies has also been recognised by the OECD which has acknowledged that "[t]ax systems in different countries also need to respond in different ways to the challenges they face... It [the OECD initiative on Harmful Tax Practices] is not about harmonisation. It is not about dictating to countries what their tax rates should be."⁴ The EU has also recognised the right of countries to exercise self-determination on tax matters from as early as 1980, acknowledging that "tax sovereignty is one of the fundamental components of national sovereignty".⁵

5. Continuation of current 0/10 tax system is the preferred option

- 5.1. Increasing corporate taxes is arguably inadvisable in policy terms given the key importance of low corporate taxation in stimulating economic growth and employment. Although the new UK government has generally raised taxes, *corporate* tax rates have been *reduced* in the 22 June 2010 emergency budget for competitive reasons in order to stimulate jobs and growth. The OECD also has recognised this positive economic effect of low corporate taxes in a 2008 report which concludes as follows:

The empirical analysis presented here provides evidence of substantial negative effects of corporate taxation on productivity and investment. These conclusions are based on a large and representative dataset of firms from OECD member countries.⁶

³ See *Government of the Cayman Islands v. Commission of the European Communities* (Case T-85/03R) 26 March 2003). Although the Crown Dependencies are not of course Overseas Territories the principles in this case would also likely apply to the Crown Dependencies.

⁴ Speech by Gabriel Makhlouf, Chair of the OECD Committee of Fiscal Affairs at the European Financial Forum, 24 July 2001.

⁵ EU Commission paper, *The Scope for Convergence of Tax Systems in the Community* (1980) and echoed in the later Commission report, *Taxation in the European Union: report on the development of tax systems* (1996).

⁶ OECD Economics Department, *Do Corporate Taxes Reduce Productivity and Investment at Firm Level?*, 2008 at paragraph 51.

- 5.2. From a process perspective, responding to external pressure to raise corporate tax rates in the absence of domestic requirements has serious and undesirable implications. Raising taxes to reflect the competitive or other concerns of other states sets a precedent with no obvious end, save effectively ceding the ability to establish tax regimes and rates to such other states. In the end, such a dynamic would confine the Crown Dependencies to a role as European satellites, no longer competitive as international financial centres. As such, the Crown Dependencies would be increasingly vulnerable to EU pressure as the international client base departs.
- 5.3. The Forum takes the view that continuation of the existing 0/10 tax system, possibly with modifications where required, is the favoured option.

6. Tax neutrality is vital to maintain and attract international financial services

- 6.1. The Crown Dependencies have developed financial services as the basis of their local economies which produce the tax revenue and other government income necessary to sustain these communities. The Crown Dependencies do not seek to impose an additional layer of tax on income and capital flows, leaving more "room" for tax elsewhere.
- 6.2. Tax neutrality is an essential requisite for preservation of the financial services business which plays the key role in the local communities in the Crown Dependencies. There is a crucial distinction between zero tax and any positive rate for international clients. Additional filing and tax compliance requirements alone would discourage many international clients even if the tax burden were seen as tolerable.
- 6.3. Preservation of tax neutrality for particular business streams (e.g. investment funds) may appeal in the short term but will discourage new types of business from establishing in the jurisdiction. If existing business streams migrate to other platforms, international financial services business in the Crown Dependencies would decline without replacement. Efforts to extend zero tax to new business lines once recognised elsewhere are unlikely to overcome "first mover" advantages.
- 6.4. Simplicity matters to clients. The loss of straightforward "fiscal clarity" will be unsettling for clients even where a planning route exists to achieve a zero rate of tax.
- 6.5. Credible threats of increased or changed taxation in the Crown Dependencies or compliance with pressure for such changes will significantly damage the confidence of international clients. It will discourage new clients and prompt some existing ones to depart. There should be no complacent assumptions that a low rate of tax would be generally absorbed by international clients.

7. No international standards on tax rates

- 7.1. We endorse compliance with international standards on transparency and information exchange as well as standards on regulation that are developed and applied on a consistent basis. However, there are no generally agreed or applied international standards as respects minimum corporate tax rates.

- 7.2. The Crown Dependencies should not agree pre-emptively to abide by purported international “standards” on tax rates, particularly those proposed by fora in which they are not represented.
- 7.3. It would be inappropriate for a grouping of EU Member States, who have agreed neither on the Common Consolidated Corporate Tax Base, nor on a minimum tax rate, to seek innovation on tax rates in the Crown Dependencies.

8. Lowering current barriers to trade

- 8.1. The Crown Dependencies are low cost conduits for investment into the EU. The EU may seek to encourage their activity as being within the interests of the EU.
- 8.2. The Forum accepts the need for the Crown Dependency governments to maintain effective international relationships in the context of a globalised economy. However, it is desirable to accompany this with an exchange of value when one government makes concessions to benefit another. Reciprocity in response to concessions by the Crown Dependencies has been limited to date.⁷
- 8.3. Double taxation agreements (“DTAs”) are often seen as a potentially useful benefit permitting international financial centres to integrate into the global economy as they assume greater international responsibilities.
- 8.4. DTAs are unlikely to be generally available to jurisdictions operating a territorial tax system. (Successes in securing DTAs by Hong Kong, Singapore and oil rich states with territorial or limited tax systems are arguably exceptions explained by the geopolitical importance of those states).
- 8.5. The Crown Dependencies are highly unlikely to secure a broad-based DTA network. Even if this were feasible, bilateral negotiations necessary to achieve this would take decades.

9. Conclusions

- 9.1. The Forum takes the view that continuation of the existing 0/10 tax system, possibly with modifications where required, is the favoured option.
- 9.2. We encourage policy makers in the Crown Dependencies to reflect on the endgame. There are no soft options that permit long term accommodation of all parties. Decisions at this stage on control of tax policy will determine whether the Crown Dependencies ultimately align with the EU or maintain their status as international financial centres.

⁷ For example, we note that Belgium has recently published a blacklist of jurisdictions which it considers “tax havens”. Jurisdictions on the OECD “white list” as well as those with which Belgium has concluded tax information exchange agreements appear on the list.