

A Fairer Alternative

A different approach to dealing with the structural deficit

January 2023

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Executive Summary and Proposals

The purpose of this paper is to provide an alternative to the proposals that have been put forward by the Policy & Resources Committee (PRC) in their policy letter, The Tax Review Phase 2 (the Policy Letter) to address the structural deficit.

The problems with the Policy Letter's proposals that this fairer alternative seeks to address

At the core of the Policy Letter's proposals is the introduction of a broad-based Goods and Services Tax (GST) which, at a rate of 5%, is estimated will raise £68m.

Cost of living and social equity impacts

There is a real cost of living crisis in the Bailiwick, with food and housing costs in particular above the headline inflation rate, and earnings not keeping pace with prices. Notwithstanding the proposed mitigations, a broad-based consumption tax will increase the cost of living in what is already a very expensive jurisdiction.

Guernsey also has one of the highest levels of income inequality globally. 21% of children live in households that earn less than 60% of median earnings – in other words, one in every five children lives in relative poverty.

The Policy Letter proposes mitigation measures to try to ameliorate the regressive impact of GST. The cost of these measures amounts to £29m. Because this support is not targeted at those who most need it and therefore costly to implement, the need to raise additional revenue is increased.

The only way GST can contribute a substantial net revenue increase to the States is for the rate to rise above 5%. When the rate does rise, the effect of the costly proposed mitigation measures will be undermined, worsening the regressive nature of GST.

The tax burden balance

Most of the tax burden of GST will be borne by households (circa £54m). Households have already had to shoulder the majority of tax increases since the introduction of Zero-10. It is fairer, therefore, that most revenue raising measures are focused on the corporate sector rather than households – which is what is proposed in this alternative approach.

Business impacts

Although most of the revenue raised by GST will effectively come from households, the introduction of GST will also impact businesses. This is not only the case in terms of additional administration, but also the potential to reduce competitiveness. It is likely that it will be the smaller locally owned businesses which will be the most affected.

One benefit of GST that is cited in the Policy Letter is that tourists will contribute £6m. However, a plus for the islands has been their 'VAT free' status which, the industry argues, has attracted visitors. That unique selling point – as featured prominently in our marketing material – would disappear with the introduction of GST.

The non-prioritisation of expenditure control

The Policy Letter's proposals make no meaningful attempt to control expenditure to reduce the amount of additional revenue that would need to be raised.

Practical challenges

The extent of system change (including, for example, IT systems) required to implement the Policy Letter's proposals is significant and the timescale very ambitious. It is likely that the proposals would not be implemented ahead of the next general election, which introduces acute political risk of failure.

A Fairer Alternative

The alternative tax proposals can raise more revenue without the need to introduce GST, whilst also delivering other advantages.

Expenditure control

Before raising additional revenue, it is essential to control expenditure and deliver savings. This report proposes achievable real-terms reductions in States' expenditure. However, that on its own is not enough. Accordingly, it also sets out how the role and size of government needs to be determined to establish the revenues needed to fund the services that are required by the community.

The structural deficit would also be reduced by adopting a more achievable target to capital expenditure to better reflect the Bailiwick's infrastructure need and the capacity of the industry locally to deliver it.

A diversified and better-balanced tax base

In terms of the tax burden, the proposals achieve a better balance between households and corporate entities. The tax burden on households, as a proportion of total tax, has increased significantly since the introduction of Zero-10, while the reverse is true for corporate taxation: it is therefore fairer to rebalance this rather than add to the tax burden on individuals when the cost-of-living crisis is already affecting many Bailiwick residents acutely with median wages not keeping up with inflation.

A Community & Infrastructure Contribution is proposed for corporate entities which would be relatively straightforward to introduce as a scheme that worked in a similar manner to the Guernsey Registry managed annual validation charge. In addition, the report sets out further investigation that should be undertaken in relation to changes to the corporate tax system.

The restructuring of the Social Security system as proposed in the Policy Letter is supported, but with additional features:

A more progressive scheme that includes tapering of higher earners' allowances; and

An incentive to employers to retain or recruit people beyond retirement age.

Other revenue raising proposals include:

- a reduction in the income level at which tapering of the personal income tax allowance begins to £80,000;
- A visitor levy;
- TRP on non-domestic parking;
- A carbon emissions levy on visiting cruise ships; and
- Alternative sources of capital, including sustainable bonds and the investment of reserves into local projects.

Finally, other associated opportunities are also highlighted in the report that should be actioned, including closing the Public Servants' Pension Scheme to new entrants.

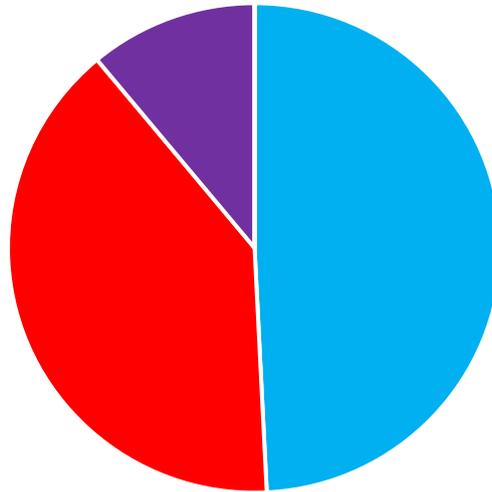
The report demonstrates how a Fairer Alternative can be achieved which reduces the structural deficit to a greater extent than the Policy Letter and at a much-reduced cost both in terms of implementation and ongoing expenditure. Whilst it may be that GST needs to be introduced at some time in the future, it is clear that it does not need to be introduced now and that government can – and must – do more before that day happens.

Table comparing the proposals in the Policy Letter with the Fairer Alternative proposals set out in this report.

		Policy Letter		Fairer Alternative	
Budget reductions		0	No real terms savings	3.6 5.7	2024 1% real terms savings excl HSC 2025 1% general revenue budget savings
Capital requirement adjustment			No change	19.0	Reduction to 1.5% of GDP
Social security contributions	Employee	(3.1)	Per section 8	(3.1) 0.4	Unchanged Tapering of allowance from £80k
	Employer	18.9	Per section 8	18.9 (0.1)	Unchanged 1% reduction for those over pension age
	Self-employed	3.0	Per section 8	3.0	Unchanged
	Non-employed/> pension age	(0.1)	Per section 8	(0.1)	Unchanged
Personal income tax	Lower rate tax band and increased allowance	(29.3)	Mitigations of GST	0	Not required as no GST
	Allowance	0		2.1	Tapering of allowance from £80k
GST		67.7		0.0	No GST
Community & Infrastructure Contribution		0		10.0	
Non-domestic, non-public parking TRP		0		0.5	Minimum
Visitor levy				2.0	To raise income from visitors.
Cruise ship green levy		0		0.5	Minimum
Ongoing costs		(2.6)		(0.2)	Excludes SIAC costs
Net Change		54.5		62.2	

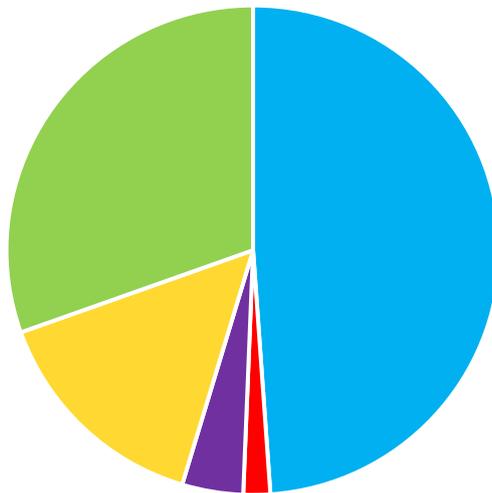
Comparison of how changes to the structural deficit are borne

Policy Letter



- Borne by businesses
- Borne by households
- Borne by non-residents
- Savings
- Policy adjustment

Fairer Alternative



- Borne by businesses
- Borne by households
- Borne by non-residents
- Savings
- Policy adjustment

Background: The Need for an Alternative

The purpose of this paper is to provide an alternative to the proposals that have been put forward by the Policy & Resources Committee (PRC) in their policy letter, The Tax Review Phase 2 (the Policy Letter) to address the structural deficit.

GST

At the core of the Policy Letter's proposals is the introduction of a broad-based Goods and Services Tax (GST) which, at a rate of 5%, is estimated will raise £68m.

As the Policy Letter states, this is a regressive tax and, although its negative impact on people on lower incomes can be mitigated to a degree, there are other issues that also need to be considered.

There is a real cost of living crisis in the Bailiwick of Guernsey. In particular, food and housing prices have been increasing above the headline inflation rate, and at the same time earnings have not been keeping pace with prices. A broad-based consumption tax will increase the cost of living in what is already an expensive jurisdiction – the second most expensive in the OECD rankings when it came to the cost of housing at 27% of household income¹. The result is that people who were 'just getting by' are now really struggling to live. Increased food costs, mortgage costs and rental charges have hit many households in Guernsey and Alderney, with knock-on impacts on the economy and health services.

Income inequality has become a growing issue, getting steadily worse since the financial crash of 2008 and deteriorating further since the pandemic, Brexit and the war in Ukraine. Guernsey has one of the highest levels of income inequality globally: the top 5% of households in terms of income have 19% of all earnings in the island, whereas the bottom 50% of households earn just 27% between them.² 21% of children live in households that earn less than 60% of median earnings – in other words, one in every five children lives in relative poverty.

¹ Guernsey Annual Better Life Indicators Report - <https://gov.gg/CHttpHandler.ashx?id=162849&p=0>

² Guernsey Household Income Report 2019 and 2020 - <https://gov.gg/CHttpHandler.ashx?id=148937&p=0>. Guernsey's Gini Coefficient (a standardised measure of inequality) is 0.4, which would rank us among the top 5 most income unequal jurisdictions in the OECD.

More people are going to food banks. The Guernsey Welfare Service have said that they are seeing a sharp increase in people needing help.

The Citizen's Advice Annual Report for 2021 stated:

No doubt with the rise in inflation, this is going to impact further on those who are already struggling, as well as those who have just managed to survive thus far. With that in mind, we will no doubt see an increase in the need for our dedicated Money Advice service over the coming year.

Indeed, the PRC Treasury Lead, in his former capacity as Chairman of Citizen's Advice stated in that same report:

We look ahead to a year which is likely to include new and developing challenges, refugees, rising cost of living, rising debt and a housing crisis.

Whilst the Policy Letter says that inflation is expected to reduce in the next two years, this ignores the fact that real wages have not been keeping pace with price increases. A person on median wages is worse off today than in 2007. Median wages are up by 29% but compound inflation has been 32% (rounded) between 2007 and 2018.

Acknowledging the regressive nature of GST, the Policy Letter includes a couple of mitigations through the income tax system: an increase in the personal income tax allowance of £600 and a reduced income tax rate of 15% for the first £30,000 of taxable income. The cost of these measures amounts to £29m. This support is not targeted at those who most need it and so becomes a universal benefit for all – but the cost of implementation adds to the need to increase additional revenue, resulting in 43% of annual GST revenues being used to mitigate its introduction.

In addition, the introduction of GST will have a £12.5 million capital, operational and benefit uprating cost, bringing the total opportunity cost of introducing GST to £41.5 million (£29m+£12.5m). Taking away the Personal Income Tax Allowance cost (£29m) and the ongoing GST-related costs (£2.6m), the net revenue-raising amount of GST is £36.1m (£67.7m-£29m-£2.6m).

The Fairer Alternative tax proposals can raise more revenue without the need to introduce GST. It is inevitable that the only way GST can contribute a substantial net revenue increase to the States is for the rate to rise above 5%. When the rate does rise, this will wipe out the costly mitigating effect of the measures proposed and worsen the regressive nature of GST.

The vast majority of the burden of GST will be borne by households (circa £54m). Households have already had to shoulder the majority of tax increases since the introduction of Zero-10.

Corporate tax receipts went from £172m in 2007, representing 47%, to £185m, representing only 39% in 2021. The total tax take from corporates as a proportion of total tax has not yet recovered from the introduction of Zero-10. It is fairer, therefore, that most revenue raising measures are focused on the corporate sector rather than households – which is what is proposed in this alternative approach.

Although most of the revenue raised by GST will effectively come from households, the introduction of GST will also impact businesses. It will affect competitiveness and create more administration, on top of the simultaneous introduction of the secondary pensions regime. Whilst big businesses may have the ability to absorb this added cost, it will be the smaller locally owned businesses that will suffer the most. As noted by PRC's Treasury Lead, it became very evident during the COVID pandemic, when a suite of support packages was put in place to support businesses that were impacted, that many small entities had little – if any – reserves to fall back on, and many micro businesses were therefore very vulnerable to adverse external events.

One benefit of GST that is cited in the Policy Letter is that tourists will contribute £6m. However, a plus for the islands has been their 'VAT free' status which, the industry argues, has attracted visitors. That unique selling point would disappear with the introduction of GST.

Indeed, Locate Guernsey, Visit Guernsey and Guernsey Finance on their websites all make a virtue of the fact that Guernsey does not have a VAT or a goods and services tax. This sets us apart from our nearest competitor Jersey – which the Policy Letter states has seen no ill effects of introducing a GST. However, this is disputed by those who have lived and worked in Jersey, such as Deputy Sam Mezec, who wrote a scathing attack in an article published in the Guernsey Press in December 2022³ in which he called the introduction of GST a failure. He stated:

Promises were made, like the promises being made now, but they were not kept.

³ <https://guernseypress.com/news/voices/2022/12/12/gst-has-been-a-failure-in-jersey/>

There is also evidence that the accounting for, and collection of, GST in Jersey has been an issue for businesses. The following is a quote from Mrs Catharine Walter:

We owned property in Jersey and we found the administration of GST quite time consuming. Our staff were not used to doing it so had to be trained in the process. It is a time-consuming process, every invoice has to be entered onto the accounts system and then an additional entry for the GST. Not all the invoices separated out the GST, for example items bought from shops like B&Q just said GST included so you have to calculate the amount.

The staff has to add the GST to invoices we sent out to our tenants. The quarterly return was quite time consuming.

Basically, it is quite a lot of additional administration especially for a relatively small company. The property was sold at the end of December 2019. One reason was the administration involved in having a property in a jurisdiction with GST.

In a recent article⁴ by Lord Digby Jones, former Director-General of the Confederation of British Industry and Minister of State for Trade and Investment, he stated:

If you want to diminish the long-term chances of Guernsey competing in the world's race for success, just introduce GST. And once embedded, the rate won't stop at 5%. It's political heaven – business is the unpaid tax-collector, you can nudge it up every so often – and they're even bribing the less well-off with their own money to accept it.

In his report of 2013, Professor Dominic Swords on the Impact of GST to the Bailiwick of Guernsey⁵, he arrived at three main conclusions:

- *Likely very negative impact of a GST on some key sectors - in particular retail, travel, tourism and hospitality.*
- *With a large proportion of small and micro businesses within its economy the impact of GST would have a disproportionate and negative effect on growth*

⁴ 'Everyone Must Play Their Part', Guernsey Press 14 December 2022

⁵ The Impact of Introducing a Goods and Services Tax to the Bailiwick of Guernsey, Professor Dominic Swords, Henley Business School 2013

and innovation in these sectors. It would place a large administrative and compliance cost on these local businesses.

- *While measures can be taken to offset the impact of GST it causes greater complexity and costs in the tax system which will both distort employment market incentives and also further damage the islands' low and simple tax reputation.*

Social Security Contributions

The restructuring of the Social Security contribution system is long overdue and welcome. The proposed changes will result in a more progressive structure, albeit they will have effectively created a parallel income tax system and another new universal benefit in the form of an allowance.

The changes also markedly increase employer contributions, such that an additional £19m is estimated to be raised. As the focus of the public debate so far has been on GST, this fact has largely fallen under the radar. However, this is a significant extra cost to businesses on top of the proposals to introduce GST, as well as the introduction of secondary pensions.

Other Considerations

There is no real focus in the Policy Letter proposals on the potential to reduce the cost of government. Whilst it is proposed that there should be a real terms freeze on Committee budgets, this does not extend to Health & Social Care, which comprises well over a third of general revenue expenditure. Given the proposals to increase taxes by 10% of current revenue expenditure, and to introduce a new tax that can easily be increased as expenditure rises, more needs to be done by government to show it has done all it can to reduce the burden on the taxpayer.

Another concern is the timing of the proposals themselves. Were a new tax not being proposed it may not be such an issue. However, although the legislation is in place enabling a GST, additional legislation will be required before it can be implemented.

Possibly of more concern is the impracticality of implementation by the end of term. It will certainly be exceedingly tight, requiring changes to IT systems in a relatively short timescale.

Section 6.63 sets out the new annual costs which range from £930k to £1.06m. Primarily this will involve the recruitment of more staff to Revenue Services and the Guernsey Border Agency. Given the problems of recruiting staff now, with significant vacancies, it is optimistic to believe that all posts will be filled in the next 2 years. This at a time when the Revenue Service has backlogs in the processing of income tax returns.

In addition, the capital costs associated with the introduction of GST should not be dismissed lightly. Section 6.67 shows that these could amount to £2.435m. That the design, development and testing of a system can be achieved in two years is questionable, especially given that there is already a major project to replace the Revenue Service's systems.

A Fairer Alternative

There are, therefore, considerable concerns over the proposals put forward in the Policy Letter. That additional revenue is required is not in doubt. However, a restructure of the tax system centred on the introduction of GST is not the only way of raising the money necessary to fund public services in the Bailiwick. This report sets out a fairer alternative model that takes a multi-dimensional, multi-phased approach without the inequities of the Policy Letter proposals.

The Alternative Approach

Introduction

In his report on the introduction of a Goods and Services Tax in Guernsey, Professor Dominic Swords⁶ concluded:

Before deciding whether or not to introduce a GST it is urged that a more thorough re-assessment of the future vision for public services in the islands should be at the centre of the task of solving the fiscal challenge. Taking a fundamental strategic review of spending should be a precursor to a decision about the revenue side of the equation. One important principle is that decisions need to be seen against the context of the whole tax and spending system and not assessed on a tax-by-tax basis.

It would be inadvisable to put into operation a short-term fiscal fix without first fully exploring and challenging assumptions about the future of public sector spending in relation to the ageing population.

He proposed the following options:

- *If additional tax revenues are required they should optimise the use of existing tax mechanisms first before considering an entirely new tax.*
- *Any increase in tax take should be designed and targeted so as to avoid damaging the long-term development of Guernsey.*
- *Should go hand in hand with a thorough review of long-term commitments to public sector provision – should have a clear vision of what the state should and should not provide.*

This approach is still valid and it is important to consider the need to raise revenues through an analysis of the components of the structural deficit.

⁶ The Impact of Introducing a Goods and Services Tax to the Bailiwick of Guernsey, Professor Dominic Swords, Henley Business School 2013

The Structural Deficit

The concerns over developing a structural deficit are not new: they go back to 2006⁷ when the States voted to adopt a new corporate tax system known as Zero-10. The standard rate of corporate income tax became 0% with effect from 1st January 2008. (Jersey and the Isle of Man brought in similar changes to their corporate tax regimes.) This meant the amount collected from corporate tax halved. To offset that drop, Social Security contribution rates and business TRP were increased.

None of this could happen overnight, so it was agreed that reserves would be used until such time as Guernsey balanced its books, which was expected to be within three to five years.

Savings were to be achieved through what was originally called a Fundamental Spending Review and later became the Financial Transformation Programme (FTP), with £31m of recurring savings to be delivered by 2014. It had a rocky start, with a change of approach being introduced part way through, but by the end of the FTP it was declared that £28.7m savings had been achieved. Whether such savings were sustainable is a matter of debate, but the expectation that GST should need to be introduced went away at that point as balanced budgets returned, at least in part because of the savings delivered by the FTP.

However, since then, finances have worsened, with bigger calls on the public purse from States committees. Just like in 2006, it is important to understand the extent of the problem and how government can address it in a systematic, multi-dimensional and multi-phased approach.

⁷ Billet d'État 28th June 2006: Policy Council, 'Future Economic and Taxation Strategy'

General Revenue Expenditure

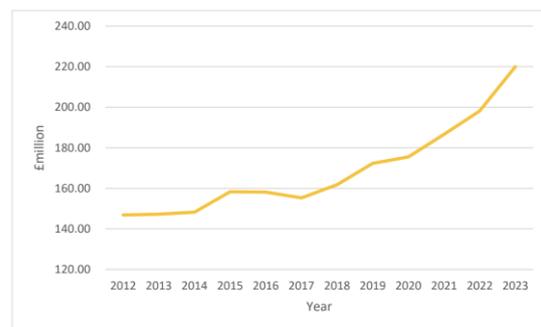
As part of the government’s responsibility to the taxpayers of the Bailiwick of Guernsey, it is essential that it does all it can to minimise the rise in its expenditure.

Budget Reductions

Before increasing revenues, it is essential to control expenditure and make savings.

Some attempt has been made in the Policy Letter proposals to do that, but it is of a limited extent: a no real terms increase for 2024 and 2025, excluding the budget of Health & Social Care (HSC). Excluding direct COVID costs, HSC’s general revenue budget has increased by over 11% for 2023 alone.

This is 5% more than *any* budget in the last 8 years. The narrative has been that this is due to the ageing population. However, extra funding has not only had to be provided to manage COVID, but to deal with the backlogs arising from COVID, as well as issues arising from difficulties in recruiting specialist consultants. This has led to an increase in the non-recurring budget of £5.9m to fund an orthopaedic waiting list initiative over 4 years, and a recurring budget increase of £1.35m to fund additional capacity in the critical care unit and an additional general physician as a result of increased demand.



Health and Care Expenditure 2012-2023

This is not a situation unique to HSC. Similar issues arise for Education, Sport & Culture, with additional expenditure provided to deal with ‘COVID recovery’. At the same time, overall government expenditure in 2023 has been budgeted to increase by over 8%.

It has been over five years since specific savings targets were put in place and in that period substantial increases in budgets have occurred.

It is important that intent is shown immediately. Given the nature of the way budgets are put together, it will be too late to do more than reduce individual

budgets or for Health & Social Care to contribute to savings targets for the next financial year. It is therefore proposed that for 2024 all other committee's baseline general revenue cash limit should be subject to a 1% real-terms' reduction.

However, more can realistically be achieved in 2025 and it is therefore proposed that the total general revenue budget should be subject to a further 1% real-terms' reduction.

Structural Change

A budget reduction is not enough. A more structured approach is also required that looks at what government does, what it should do, what should be done by others and what should be ceased altogether.

We have an ageing population. This is a good thing as more of us are living longer. It is not just about how many people get a birthday card from the King on their 100th birthday. Thanks to the advances in medicine, those born with conditions that, in the past would not have seen them reach adulthood, are now living longer.

However, as our population ages, that does clearly put more pressure on services, as individuals tend to need more health and care services in older age. Together with medical inflation and rising expectations, it means the current delivery of health and care is unsustainable. Modelling done by KPMG suggested that real terms public spending on health and care would increase from £193m in 2017 to £214m by 2027 if nothing is changed in the way that health and care is provided.

A structured reform is therefore required, which has already been acknowledged by the States in agreeing the recommendations of the 2017 policy letter by the Committee of Health & Social Care, "A Partnership of Purpose: Transforming Bailiwick Health and Care"⁸.

⁸ Billet d'Etat XXIV 2017 [CHttpHandler.ashx \(gov.gg\)](#)

Resolution 4 of that policy letter states:

“To direct the Committee for Health & Social Care to work together with all health and care providers to produce a schedule of primary, secondary and tertiary health and care services that shall be publicly available as the Universal Offer either fully subsidised or at an agreed rate;”

Resolution 5 states:

“To direct the Committee for Health & Social Care, the Committee for Employment & Social Security and the Policy & Resources Committee, together with any non-States’ bodies affected, to consider how the current States’ funding of health and care can be reorganised to support the Universal Offer and, if necessary, to report back to the States at the earliest opportunity;”

However, this is not just an issue for HSC. Whilst there is a correlation between a person’s age and the need to use health and care services more, the correlation is different dependent on how wealthy an individual is. The poorer someone is, the more likely they are to live more of their years in poor health and require health and care services, even if (which is likely) they die younger.

So, whilst there is truth in that an ageing population is likely to result in more pressure on health and care services, the extent to which it does can be influenced by the actions of government. The greater the inequality, the worse the situation gets. This has been demonstrated by the work of Sir Michael Marmot who describes the importance of the social determinants of health. In his book, *The Health Gap*⁹ he states,

If, as I conclude, the main causes of health inequalities reside in the circumstances in which people are born, grow, live, work and age – the social determinants of health – then action to reduce health inequalities must confront those circumstances and the fundamental drivers of those circumstances; economics, social policies and governance.

⁹ Michael Marmot, “The Health Gap”2015, Bloomsbury

It is therefore important to understand that the issue is not just about looking at the cost of government in the short term if finances are to be controlled in the medium to long term. It may mean, for example, that more funding needs to be provided in areas that are currently under-resourced if costs further down the line are reduced. Preventative interventions like these are typically far more cost-effective than reactive measures, in healthcare and other areas of government.

Over the years, services have been added and changed but no one has looked holistically at what precisely government should be doing, what it should not do, what could be done differently or by others.

Commissioning is key. Work has been undertaken this term to improve the process, although it has stalled with the lack of resources to take it further. However, there are huge opportunities that are not currently being exploited. Our heritage offering, for example, could be boosted if it was commissioned out and distanced from direct political involvement. This is already done in Jersey to good effect.

Such a review will need to incorporate what is provided in Alderney. The States has agreed to this principle already through the successful amendment to the Alderney Runway Rehabilitation Policy Letter which, among other things, seeks to look at the relationship between Guernsey and Alderney and to ensure that the arrangements to support the relationship are fit for purpose for the 21st century, reflecting current and anticipated operational and funding needs.

This can't be done by Committees individually. A systematic approach is required that is politically led. The importance of this work, together with the independence that is needed, means that it should not be undertaken by a sub-Committee of the Policy & Resources Committee.

Instead, this report proposes that a States' Investigation & Advisory Committee (SIAC1) be established by Resolution of the States.

However, it is essential that this process should have the direct input of the public. Governments tax their community with their community's consent. Changes to taxation requires consideration of difficult and competing interests. For the fairest and most effective balance to be struck, it is essential to understand, with input from the community, the community's relative importance of various functions and services of government.

Mechanisms for active consultation need to be effective and meaningful. This will require some thought to ensure that the process is democratic, reflects a broad cross-section of the population and is not just a tick box exercise which is, unfortunately, how the communication exercise for the Policy Letter was regarded.

Capital Requirement

A large part of the modelled structural deficit is the assumed capital requirement of £76m a year.

This is calculated as 2% of GDP, a principle agreed by the States in 2020 as part of the Fiscal Policy Framework, which provides the fiscal rules within which the States says it will operate. The figure of 2% was not based on either evidenced need or historic capital spending patterns. The last time it reached that level was in 2012 as a result of major expenditure in that year on Guernsey's runway.

Indeed, the 2% target is not what was originally proposed by the then PRC. The original proposal in 2019 was that it should be 1.5%.¹⁰ Using this number would reduce the size of the projected deficit by £19m.

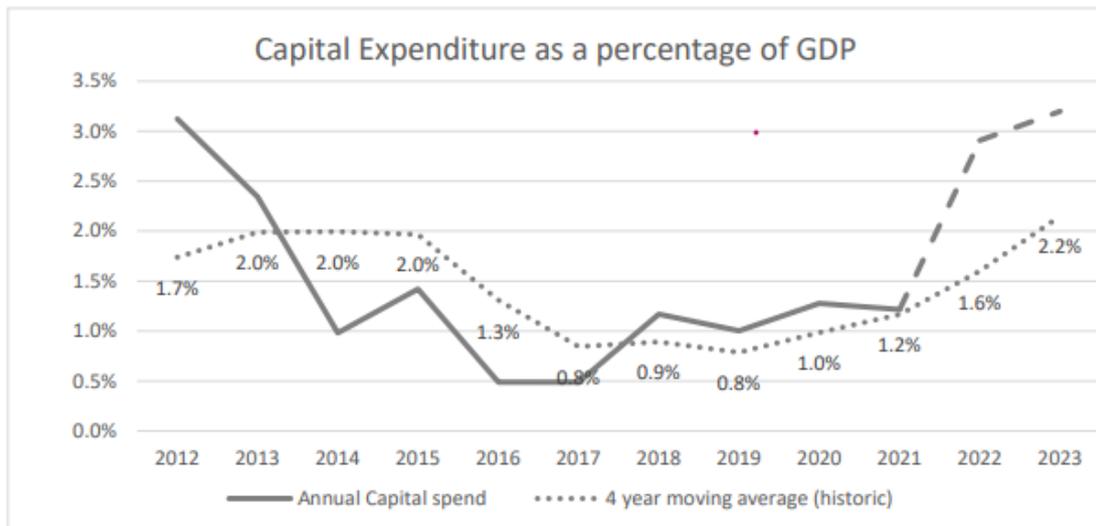
Even at that time it was understood that it was ambitious, given only 1.4% had been achieved in the previous 10 years and only 1% in the previous four. The requirement as advised by Treasury was 1.5% over 4 years, but as a result of a successful amendment by Deputies Roffey and Green, this was changed to 2% over 8 years.

There was no specific financial logic behind this increase, and nor is the rationale for the increase justified in relation to how our GDP is calculated.

Gross Domestic Product is a measure of the size of an economy. It is in essence the sum of employee remuneration and corporate profitability. However, in Guernsey's case, the size of the financial services sector distorts this calculation, meaning that seeking to judge the 'right level of capital expenditure' by reference to other jurisdictions' expenditure as a percentage of GDP is problematic.

¹⁰ Review of the Fiscal Policy Framework Billet d'État I 2020
<https://www.gov.gg/CHttpHandler.ashx?id=122178&p=0>

We have a very high GDP per capita relative to most other jurisdictions in the world (we are in the top 20 globally), but we don't have a commensurately greater need per capita for infrastructure, for example, than comparable populations. Rather than basing our target for future capital expenditure on an abstract percentage of a number that bears little (if any) relation to the community's needs, it would be more robust to estimate our expenditure requirements based on known projects in the capital programme.



The figure above illustrates the four-year rolling average of capital expenditure. It is estimated that the rolling average will only reach 2.2% for the first time in 2023, although there is uncertainty given the problems experienced in the development of the secondary education model in particular and the islands' delivery capacity. The historic trend shows that the average rate of capital expenditure tends to fluctuate between around 1% and 2% of GDP.

Of course, Government needs to take account of its capital requirements. The need for infrastructure like schools, hospitals, roads and everything else that keeps the Bailiwick running cannot and must not be ignored.

Indeed, the Funding & Investment Plan (F&IP), part of the Government Work Plan, sets out the funding needed to achieve the objectives of the Plan. The last iteration showed that £439m of major capital spending was required.

However, it is generally agreed that the States is trying to do too much and does not have the capacity as an organisation to invest in the level of capital identified. This is putting undeliverable expectations on the construction sector and is in danger of crowding out the private sector with the number of

projects. The result is more temporary construction workers brought into the island to enable the work to be done, largely without the benefit of their incomes being spent in the island.

This is not a situation unique to Guernsey. For example, as stated in Jersey's Fiscal Policy Panel Medium Term Report published in July 2022, 'it will be increasingly important to ensure projects are carefully scheduled and so the historic tendency to submit overly-ambitious timetables for capital projects should be eliminated if possible.'

Government projects are budgeted to enable the relevant subject matter experts to be used for a period so they can provide valuable input. However, it has been incredibly difficult to find the people to backfill their jobs, with the result that there have been considerable challenges with completing projects on time. Transformation projects that involve IT solutions often just end up being IT projects, without considering how the underlying processes should change due to the lack of dedicated resources and, consequently, in the end fail to deliver any meaningful transformation. We need to stop trying to do everything so that instead of doing lots of things badly we do fewer things well. That means more detailed planning is required.

For these reasons, it is proposed that Principle 6 of the Fiscal Policy Framework should be amended to state:

Capital expenditure over any States term should be maintained at a level which reflects the need for long- and medium-term investment in infrastructure and direct capital expenditure by the States should average no less than 1.5% of GDP per year averaged over a four-year period.

At the same time, to enable better understanding and planning for the long-term capital requirements to be funded from general revenue, it is necessary to review the existing capital portfolio to assess which projects should be continued on what timelines and how each should be financed.

Action and Delivery

The SIAC1 will need to report back with proposals and recommendations in a timely manner and it is therefore proposed that is and by the end of the current States' term.

The overall aim, terms of reference and membership of the SIAC1 is set out in Appendix 1.

Revenue raising measures

It is necessary to raise revenues. Whilst this report explains why the accuracy of the structural deficit can be questioned, the fact that there are nevertheless significant pressures on finances is clear.

The Policy Letter proposals focus on the introduction of a GST, with mitigations, at least in the immediate term, together with a restructure of social security contributions. A more rounded approach can raise a similar sum in the short term, but without the need to bring in GST at this time.

Corporate Taxes

The share of tax from corporates reduced substantially as a result of Zero-10. Over the ensuing years, as a result of active steps taken by the States over the period from 2012 to 2020, more has been clawed back.

However, corporate taxes (direct and indirect) as a percentage of total tax take are still not back up to 2007 levels. In 2007 they represented 47% of general revenue and in 2021 were 39%. This effectively means that corporates are paying the equivalent of £37m less in tax today as a proportion of total tax than they were in 2007.

It is therefore suggested that the bulk of revenue raising measures should be focused on corporates rather than households, who have already shouldered a significant increase in tax burden since the introduction of Zero-10. The alternative revenue raising proposals set out in this report help recoup £30m from the corporate sector.

Proposition D)4) of the Policy Letter states:

To direct the Policy & Resources Committee to engage with industry and the Crown Dependencies in order to develop proposals for raising further revenues from the corporate sector without unduly negatively impacting Guernsey's competitive position or compliance with international standards; this work to include developing proposals, which should be presented to the States for consideration no later than November 2023, for an alternative corporate vehicle or other appropriate form of entity or taxing structure which will be subject to income tax at 15% or such other rate or basis as the review may determine.

This makes very good sense. However, this is another example of where matters have not been taken far enough. Whilst proposition D)4) references the need to negotiate with industry and the Crown Dependencies, apart from referencing a new corporate vehicle for tax purposes, it is vague as to the nature of the discussions.

It is believed that, due to the importance of this area, just as with States' spending, work on investigating changes to the corporate tax system should not be left to a sub-Committee of PRC. Having consulted with officers, this alternative proposal includes a separate Investigation & Advisory Committee (SIAC2) focused on corporate tax related issues. Areas to be considered are set out below.

Extension of Zero-10

There is merit in considering the viability of amending the Zero-10 corporate tax regime by extending its scope or raising the general rate of tax from 10% to 12.5% or 15%.

Voluntary taxation vehicle

The Policy Letter proposals include an investigation into voluntary tax vehicles. There is merit in doing so: the SIAC2 should consider an alternative corporate vehicle or other appropriate form of entity or taxing structure which will be subject to income tax at 15% or such other rate or basis as the review may determine.

Territorial tax

It was surprising, given previous work that has been done, that no explicit mention is made in the propositions to territorial tax. Full consideration should now be given to this issue.

Taxe d'abonnement

There is also merit in considering Luxembourg's tax known as 'taxe d'abonnement' whereby a low base rate of tax is charged on assets under management. There should be engagement with the fund sector to consider whether there is viability of adopting such a system in Guernsey.

Company distributions

Under the current income tax system, if a company's income is taxed at a rate of less than 20% then a tax charge will arise when a distribution (or dividend) is paid to a Guernsey resident beneficial member of the company. The company is responsible for deducting the tax due from a distribution and for paying it to the Revenue Service.

Guernsey resident beneficial owners do not need to pay any taxes for so long as the profits are retained in the business. When profits are retained in the business, they are not being used for re-investment, nor they are being circulated into the economy via distributions. It is passive money that is not contributing to the economy in any shape or form, and its value is eroded over time through inflation. Although it is difficult to identify, anecdotally it is believed that there is a considerable amount of profits that have been retained in local businesses and investment companies owned by resident individuals and, consequently, tax on these retained profits can effectively be permanently deferred.

At a time when reserves are being depleted, it is proposed that something should be done to incentivise distributions. Accordingly, it is proposed work should be undertaken to determine whether there is an opportunity to raise revenue from this area.

Action and Delivery

The SIAC2 will need to report back with proposals and recommendations in a timely manner and it is therefore proposed that is by the end of the current States' term.

The overall aim, terms of reference and membership of the SIAC2 is set out in Appendix 2.

Corporate Contribution

EY referenced the ability to raise a corporate levy in their report appended to the Policy Letter. Indeed, a levy has been incorporated in the revenue raising measures. However, this is purely a GST-related measure to ensure international financial services entities pay some contribution given that their services will generally be exempt from GST. Guernsey Finance states in its report, “Fiduciary Duty in the 21st Century”¹¹:

It is widely understood there are significant financial risks for companies that relate to the cost that they are placing on society. Currently, the social and environmental costs are borne by governments and society more broadly than the companies that are partially responsible for them.

It is understood that levies have been introduced in other competitor jurisdictions such as Luxembourg and similar could be achieved here.

A levy for the benefit of community and infrastructure could be raised against companies. EY considered a variety of high-level options for a levy in Section 4 of their review, which is appended to the Policy Letter. The EY report concluded that, unlike the introduction of changes to the corporate tax code, a flat levy would not have any identifiable impact on the GVA as it would be seen as a small increase to doing business in Guernsey.

Provided that the charge is set at a reasonable level, the added burden may be expected not to outweigh the benefit of Guernsey's other features... prima facie, there may be scope for this option.

EY further concluded that:

The option broadens the "tax" base and brings within charge those economic operators which do not currently contribute through the tax system.

Preliminary work undertaken by EY has identified the feasibility of a levy to raise revenue in the £20 million envelope. The levy would primarily focus on raising revenue from businesses that otherwise do not make a tax contribution within the finance and professional services sectors. The contribution will be perceived as an additional small increase in the cost of doing business and will not affect Guernsey’s corporate tax position.

¹¹ [Fiduciary Duty in the 21st Century | We Are Guernsey](#)

The contribution will be administered through the Guernsey Registry as part of the annual validation process.

Therefore, the introduction of a Community and Infrastructure Contribution levy meets key criteria for raising revenue in the immediate term - prioritising revenue from corporates, diversifying the tax base and being sensitive to Guernsey's competitiveness. The CIC can be tapered or removed completely in future, depending on other options identified through SIAC2. The scope of raising £10 million is a halfway point well below the upper limit of £20 million identified by EY.

Accordingly, there is a case for raising £10m from this source and it should be put in place in 2025.

Social Security Contributions

The changes to social security contributions will make the tax system more progressive and, as such, for the most part, these changes should be implemented now.

However, there are a few areas where additional changes could be made which make the system more progressive.

Basic Allowance

The Policy Letter proposals have effectively turned social security contributions into an income tax, with a personal allowance for everyone. Personal tax allowances as they are currently structured are a useful means of benefiting low- and middle-income earners.

However, unlike Income Tax, there is no consequent tapering of this allowance above a specific income band. It is inappropriate, given the growing inequality, that such a universal benefit is introduced. It makes sense that this benefit is treated in the same way as income tax and at the same income level.

The current system also includes a tapering of the allowance for higher earners such that it is reduced by £1 for every £5 earned over £90k. It is proposed that, to make the system more progressive, that tapering starts to take effect from an income level of £80,000 rather than the current £90,000.

Post-retirement age employees

One issue with the current system is that, whilst those employees over retirement age have a reduced rate of contributions, a similar reduction is not given to the employer. It is believed that this does not support increased productivity of the workforce and encouraging people to be economically active for as long as possible. As such, it is recommended that employer contributions are reduced for those over retirement age by 1%.

Income Tax

There are a number of changes that could be actioned which would make the system more progressive and raise more funds, be it on a recurring or one-off basis.

Personal income tax allowance

As referenced above, it is proposed that tapering of the personal allowance starts at an income level of £80,000.

Minimum tax contribution

Presently there is a maximum tax cap for High Net Worth Individuals to limit the amount of income tax payable by an individual resident in Guernsey to £300,000. However, there is no *minimum* tax requirement: this should be investigated.

Other Revenue Generating Measures

TRP on non-domestic parking spaces

Whilst there are specific TRP Codes for non-domestic garaging and parking, currently only parking spaces which are part of a specific structure are taxable at an enhanced rate. This means that other spaces, whilst designated for parking, are not charged TRP at a parking tariff. It is believed that there is potential to raise at least half a million pounds from non-domestic, non-public parking areas and that this should be investigated, as it is a potential source of increased revenue that aligns with other States policies.

Cruise Ship Carbon Emissions Levy

Whilst the Policy Letter proposals do not include specific environmental taxes to be introduced now, it is suggested that these could raise up to £10m. There is, however, an opportunity to consider a specific tax raising measure now.

As is custom around the world, the States of Guernsey charges cruise liners a 'Head Tax' based on the number of passengers. These have historically been quite low at around \$4-\$15 per passenger. Guernsey's rate for 2023 is £3.

Recent research published in the Marine Pollution Bulletin¹² found that cruising is a major source of environmental pollution and degradation, with air, water, soil, fragile habitats and areas and wildlife affected. Cruise ship emissions are also included in scope 3 of Guernsey's greenhouse gas emissions and so contribute negatively to Guernsey's carbon footprint.

Available research suggests that a large cruise ship can have a carbon footprint greater than 12,000 cars. Passengers on an Antarctic cruise can produce as much CO₂ emissions over the course of an average seven-day voyage as the average European in an entire year. Within the Mediterranean, cruise and ferry ship CO₂ emissions are estimated to be up to 10 per cent of all ship emissions.

A 2007 study found that emissions factors for cruise ships journeying to New Zealand were at least three times higher than emissions factors relating to international aviation. Energy use for staying overnight on a cruise vessel was 12 times larger than the value for a land-based hotel.

The possibility of a green levy has been considered by other jurisdictions, such as Australia. Alaska has introduced a significant premium to take account of their environmental impact.

There is potential to raise at least £500,000 more revenue from this source, which again supports other States policies and targets.

¹² http://www.exeter.ac.uk/news/homepage/title_879425_en.html

Visitor Levy

The Policy Letter references the benefits of GST in raising money from visitors. As referenced previously, having 'GST Free' status is one of islands' attractive propositions.

However, in the absence of GST it is considered important that, for the purposes of diversifying the tax base, that a levy be raised from visitors in the same way as many other places around the world. More than 40 countries and holiday destinations have a form of visitor levy, including Croatia, Paris, Barcelona, Balearic Islands and New Zealand. A common approach is to include a small additional charge to overnight stays for commercially let visitor accommodation. According to research done by the Welsh Government¹³, which is investigating the opportunity of introducing such a levy, there is little evidence to suggest they have a negative economic impact where they are proportionate. There is also limited evidence around displacement effects.

It is proposed that such a contribution should raise up to £2m and so place a lesser burden on visitors than would the introduction of GST and be a more competitive proposition.

Alternative Sources of Capital

Sustainable Bonds

As referenced earlier in this paper, Principle 6 of the Fiscal Policy Framework only relates to direct capital expenditure by government and not capital required for incorporated and unincorporated entities¹⁴, such as Guernsey Electricity or Guernsey Water.

Other sources of capital should be considered that put less pressure on the taxpayer and take into account the obvious intergenerational issue: today's taxpayers who may not benefit from capital projects should not bear the greatest burden. Indeed, section 2.7 of the Policy Letter states that 'Once those reserves have been used an alternative source of funds will be needed to continue to meet all the States' funding requirements and invest in infrastructure'.

¹³ [A visitor levy for Wales | GOV.WALES](#)

¹⁴ Fiscal Policy Framework Update 2016 <https://www.gov.gg/CHttpHandler.ashx?id=105659&p=0>

One such opportunity is through the issue of a Sustainable Bond. Guernsey's financial services sector has really embraced Green Finance and quite rightly so. Globally, green and sustainable finance is expected to be worth \$2.3 trillion by 2023 according to the World Economic Forum. This is no fad. For the United Nations, green finance plays an important role in delivering several of its Sustainable Development Goals. Its Environment team is already working with the public and private sector organisations in an attempt to align international financial systems to the sustainable development agenda.

The UN Financial Centre for Sustainability (FC4S) say that governments showing top/down commitment see exponential growth. However, whilst industry is doing its bit, the States is not, which could potentially undermine the progress of Guernsey's green and sustainable finance sector.

Much of the capital requirement is related to the trading entities. Guernsey is leading the way in terms of Green Finance. GFSC has developed the Guernsey Green Fund Kite Mark and is very much something that Guernsey Finance is promoting as an offering from the finance sector. However, it has become apparent that Guernsey is talking the talk but Government is not walking the walk. If we are serious about Green Finance – and we should be, as not only is it an agreed strategy in terms of our economic development but the world is demanding it – then government must demonstrate that it meaningfully supports its own policy.

In September 2021, the Isle of Man Treasury listed a £400m Sustainable Bond on The International Stock Exchange. This was in line with the Isle of Man's Sustainable Financing Framework which is aligned to the International Capital Market Association (ICMA) Green Bond Principles, ICMA Social Bond Principles and ICMA Sustainability Bond Guidelines, and which has received a Second Party Opinion from Sustainalytics. The eligible projects covered in the Sustainable Financing Framework include clean transportation, energy efficiency, affordable housing, education and healthcare. Guernsey should be looking at doing something similar.

Other Opportunities

There are a number of other matters arising from the work in developing this report that should be considered.

TUPE

One difficulty that has been encountered when consideration has been given to commissioning out services in the past is the fact that Guernsey lacks legislation similar to the UK referred to as Transfer of Undertakings (Protection of Employment) legislation, commonly known as TUPE. When States employees were transferred to Agilysis as a result of the contract with that entity, an Ordinance needed to be made under section 10 of the Transfer of States Undertakings (Protection of Employment) (Guernsey) Law, 2001 ("the 2001 Law"). Its purpose is to provide a simple mechanism to give appropriate TUPE protections to the States' IT employees being transferred to a separate corporate entity, as part of the Future Digital Services (FDS) project.

The main effect of the Ordinance was to enable such employees to be transferred without their contracts of employment being terminated; to provide that the dismissal of such an employee for a reason associated with the transfer shall be regarded as unfair for the purposes of the Employment Protection (Guernsey) Law, 1998; and to provide that after the transfer, the employees should continue to enjoy pension arrangements broadly comparable to those provided to them under the public servants' pension scheme immediately before the transfer.

Clearly, requiring an Ordinance every time a service is transferred is inefficient and costly. To better enable government to more swiftly and nimbly transfer services, if and when appropriate, it would be preferable that a TUPE law is now put in place and that work should be undertaken to put that into effect.

Public Servants' Pension Scheme

The Public Servants' Pension Scheme is a defined benefit scheme based on the career average earnings of employees. This arose from changes made in 2016 from a defined benefit scheme based on final salary. These changes helped to limit the exposure of the States. However, unlike a defined contribution scheme, it is the States, as the employer, that takes all the risk. This is out of kilter with the private sector where virtually all defined benefit schemes were closed many years ago. The Pension Scheme should be closed to new entrants and an alternative scheme put in place to limit the exposure of the States and the demands on the taxpayer.

Subsequent Actions

A range of actions have been proposed in this paper. It will be important that the effect of the implementation of some of the measures, and the information derived from the investigations, are properly monitored and recorded.

These will include: implementation of those opportunities presented by the SIAC1 and SIAC2 and subsequently agreed by the States; the implementation of the proposed revenue raising measures; and other opportunities to raise revenues.

It is therefore proposed that the Policy & Resources Committee provides an estimate of the structural deficit, if any, in subsequent annual budget reports.

In addition, it will be necessary to determine the outcome of the work set out in this report and the impact that this has had, or is expected to have, on the States' finances. It may be that it is determined from this work that further revenue raising measures are still required. Clearly, this report will be needed in the early part of the next term in order to implement any measures as appropriate in that term.

It is therefore proposed that the Policy & Resources Committee report back on the impact of the measures arising from the propositions recommended in this report by June 2026 and, if required, set out any measures necessary to address the sustainability of the financial position.

Conclusion

It is clear that there are inherent weaknesses in the Policy Letter. Equally, there is a fairer alternative. Whilst the Policy Letter is focused almost exclusively on tax rises, there are opportunities to reduce the structural deficit that involve government stepping up to the plate and demonstrating that it has done all it can before any new taxes need to be introduced.

Whether or not GST is inevitable, it is not necessary now and should not be introduced before the community is satisfied that government is getting its house in order or that the burden of taxation is considered fair.

This report sets out the fairer alternative.

Appendix 1

The States Investigation & Advisory Committee 1 (SIAC1)

Overall Aim

To determine the role and size of government, as an important precursor to establishing the revenues that need to be raised to fund the services that are needed by the community.

Terms of Reference

- 1) To identify the provision and cost of services funded by the States through its committees and to identify which services should continue to be provided by the States, which services should be commissioned to a third party, and which services should be changed or ceased, taking into account the views of the community as per 2);
- 2) To actively consult and seek the views of the community through participatory dialogue that enables and ensures effective and meaningful public involvement in the process set out at 1);
- 3) To identify and review planned expenditure identified as non-recurring or one-off, with particular regard to COVID and recovery-related expenditure, to ensure that it does not become embedded as recurring annual expenditure;
- 4) In order to enable better understanding and planning for the long-term capital requirements to be funded from general revenue, to review the existing capital portfolio to assess which projects should be continued on what timelines and how each should be financed, including consideration of alternative financing sources (e.g. borrowing, sustainability bonds, joint ventures etc.);
- 5) To consider, if appropriate, other ideas and opportunities as they arise in relation to expenditure that would improve the net financial position or sustainability of the States of Guernsey in the longer-term; and
- 6) To report back by the end of the current States term with proposals and recommendations.

Membership

There shall be 7 voting members, comprising:

- 1) Five States Members approved by the States; and
- 2) Two Non-States Members nominated by the SIAC1 and approved by the States.

The Committee shall elect one of the States Members to act as chair.

Appendix 2

The States Investigation & Advisory Committee 2 (SIAC2)

Overall Aim

To consider changes in the corporate tax system.

Terms of Reference

- 1) To engage with industry, Jersey and the Isle of Man to develop proposals for raising further revenues from the corporate sector without negatively impacting Guernsey's competitive position or compliance with international standards; this work to include consideration of the following:
 - a. The viability of amending the Zero-10 corporate tax regime by extending its scope or raising the general rate of tax from 10% to 12.5% or 15%;
 - b. An alternative corporate tax regime using a territorial basis with a general rate of 15% to include consideration of:
 - i. The source rules for particular categories of income, including but not limited to:
 1. Banking income;
 2. Insurance income;
 3. Franchise income; and
 4. Income from intellectual property.
 - ii. The desirability of a new 'Participation Exemption' in the Guernsey tax system;
 - iii. Any necessary amendments to Guernsey's Unilateral Double Tax Relief provisions;
 - iv. Any Economic Substance Test which may be necessary or desirable;
 - v. The rates of Guernsey withholding tax on dividends, interest and royalties paid by Guernsey residents to non-Guernsey residents.
 - c. An alternative corporate vehicle or other appropriate form of entity or taxing structure which will be subject to income tax at 15% or such other rate or basis as the review may determine.
- 2) To engage with the fund sector to explore the viability of the adoption of a system of taxation similar to Luxembourg's 'taxe d'abonnement'.

- 3) To consider, if appropriate, other ideas and opportunities as they arise in relation to tax that would improve the net financial position or sustainability of the States of Guernsey in the longer term;
- 4) To better understand the scale of accumulated untaxed, undistributed profits in Guernsey-resident companies since the introduction of Zero-10 in 2008 and the abolition of the deemed distribution regime in 2012, and if appropriate, having regard to compliance with international standards, to include consideration of:
 - a. The viability of extending section 67 of the Income Tax Law to provide appropriate anti-avoidance legislation, particularly in respect of closely held investment holding companies;
 - b. Incentivising earlier taxable distributions; and
 - c. Any other mechanisms to increase revenues from this source of profits.
- 5) To consider, if appropriate, other ideas and opportunities as they arise in relation to tax that would improve the net financial position or sustainability of the States of Guernsey in the longer term.
- 6) To report back by the end of the current States term with proposals and recommendations.

Membership

There shall be 7 voting members, comprising:

- 1) Five States Members approved by the States; and
- 2) Two Non-States Members nominated by the SIAC2 and approved by the States.

The Committee shall elect one of the States Members to act as chair.