Advisory Note

Guernsey Association of Trustees

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This note is intended for general release to any person interested in Guernsey's system of corporate taxation and the note is being issued in response to calls for clarification, at a time when mixed messages are in circulation concerning Guernsey's future corporate tax regime.

This Advisory Note covers the following points:

- **What is happening?**
- **What is the challenge?**
- **Why is the States of Guernsey meeting on Tuesday 27th October?**
- **Understanding the recommendation to the States**
- **Why do the Crown Dependencies need to worry about Europe?**
- **What next?**
- **Conclusion**

What is happening?

In response to pressure from certain EU member states (it is not known precisely which states), Her Majesty's Treasury ("HMT") has suggested to the Chief Ministers of Guernsey, Jersey and the Isle of Man, (the Crown Dependencies - "CDs") that the EU Code of Conduct Group ("EU CCG") considers the Islands' respective "Zero-10" [1] regimes of corporate taxation, no longer to be compliant with the "spirit" of the EU Code of Conduct for Business Taxation ("the Code").

In July 2009 the States of Guernsey initiated a review of taxation which is being undertaken by the Island's Fiscal and Economic Policy Group together with its Treasury and Resources Department. The review is presently in its "pre-consultation" phase and it is seen as logical to extend this work to include a review of the general rate of corporate tax. This review was initiated because the "Zero-10" regime[1], which is now in its second year, has fallen short of the capacity to deliver sufficient tax revenue to the Island to compensate for the absence of the previous tax regime which taxed company revenue profits and income at 20% (whilst enabling companies owned by non-residents to be exempted from such taxation).

What is the challenge?

In order to address the challenge, the three CDs need to understand which components of the "spirit" of the Code are in question. At the time it was introduced by the CDs, their "Zero-10" [1] tax regimes were confirmed as being within the Code. The Islands clearly wish to remain compliant with the spirit of the Code, as well as the letter, but equally they will not wish to introduce alternative corporate tax regimes which might subsequently also be challenged. Accordingly a period of consultation and review is to be expected.

With the current lack of support within the EU CCG it is clear that Zero-10[1] will not achieve Code compliance. Whilst no assurances have been received, it is believed that the lowest rates of corporate tax currently found in the EU (namely 10% in Portugal and Cyprus) provide the most useful indicator of what would be acceptable to the EU CCG as being compliant with the Code.

1 "Zero-10" is a system of corporate tax, adopted in all three CDs, that taxes most companies' business revenue profits and income, excluding capital profits, at a zero rate of tax, but certain companies (*broadly speaking banks and utility companies*) at 10%

Why is the States of Guernsey meeting on Tuesday 27th October?
The Chief Ministers of Jersey and the Isle of Man have, GAT understands, already given written assurances to HMT that they will undertake a fundamental review of their taxation systems with a view to remaining compliant with the spirit of the Code. Guernsey's Chief Minister is not empowered to give such an undertaking and is obliged to seek the sanction of the States of Guernsey before sending a similar written undertaking to HMT, such as has already been sent by the other two islands.

The EU CCG next meets on 18th November 2009 and GAT understands that Guernsey is unwilling to find itself in the position where Guernsey is pronounced as "non-compliant" with the Code whilst Jersey and the Isle of Man are not so pronounced. If this was to happen it would be entirely due to this technicality relating to Guernsey's machinery of government.

Understanding the recommendation to the States
Accordingly, the States of Guernsey will sit in session on Tuesday 27th October 2009 to consider the recommendation ***"that the current, planned, review of taxation proceeds on the presumption of a 10% general rate of corporate tax"***.

It is critically important to understand that the terminology used in the recommendation referred to above indicates a reference to a ***review*** that is already underway and that the review should proceed on the ***presumption*** of a 10% rate of corporate tax. Whilst the default position (or *presumption*) for modelling may be a 10% rate, it remains to be seen what works for Guernsey and this will only be determined after a thorough review and consultation

The Billet d'Etat[2] published on 19th October 2009, points out that:

- "it is important to bring forward proposals for a revision of the corporate tax system as soon as practicable, certainly in providing a report to the States, after full consultation and discussion, as early as possible in 2010".
- "As is standard practice, there would be full consultation with all stakeholders and with the public".
- "It is intended to work in full consultation with {the} other CDs {namely Jersey and the Isle of Man} by sharing technical expertise through a process of mutual assistance".
- "The preferred outcome would be a common, harmonised, approach to the maintenance of globally competitive tax systems, with the intention that there should be no significant differences between the corporate tax regimes of the Islands".

The full text of the Billet[2] is attached.

Why do the Crown Dependencies need to worry about Europe?
The EU has become increasingly more confident and assertive in dealing with non-EU states in a variety of different ways, and the EU has an increasing tendency to require a test of "equivalence" in allowing non-EU states to have non-discriminatory access to the EU market. Other non-EU states, such as the British Overseas Territories[3] are equal with the Crown Dependencies in their need to have non-discriminatory access to EU markets. The EU's sphere of influence includes imposition of regulatory standards, competition standards, consumer standards and safety standards.

2 A Billet d'Etat is an Official notice to States members, convening the session of the House, and explaining, with appropriate reference papers and advance reading material, the recommendations and motions to be considered at the session.

3 The British Overseas Territories are fourteen territories that are under the sovereignty of the United Kingdom, but which do not form part of the United Kingdom itself. They include the Cayman Islands, British Virgin Islands, Bermuda and the Turks and Caicos Islands.

The Crown Dependencies are unanimous in their desire to retain non-discriminatory access to EU markets and to remain compliant with EU Codes of Conduct, seeking, at all times, fairness and equality of treatment in what is generally referred to as a “level playing field” approach.

The CDs will take this opportunity to seek recognition from the EU of the steps they intend to take and it is to be expected that, among other things, proposals will be put forward for the establishment of full double tax treaties with all member states (noting that the Isle of Man has recently concluded such a treaty with Belgium).

What next?
A period of research and consultation will follow immediately, during which the CDs will work together to arrive at a satisfactory conclusion to this challenge. It would be prejudicial to guess, at such an early stage in the process, what the eventual outcome might be, but there are precedents within Europe:

- for passive investment companies to be “looked through” and taxed at the shareholder level;
- for participation exemption procedures to relieve taxation on inward dividend income and
- for territorial systems of taxation where income and profits generated internally or remitted to the jurisdiction, form the basis of taxation.

The Crown Dependencies will work closely with HMT and with the EU in order to arrive at a conclusion which satisfies any objections whilst preserving the Islands’ sovereign rights to manage their own internal affairs. Furthermore, the CDs are confident in their exemplary record of compliance with the EU’s standards of regulation and corporate governance where the Islands stand out head and shoulders above the rest of the world as compliant International Financial Centres.

Conclusion
We are confident that, as with so many of the challenges the Islands have faced and overcome in the last decade, this latest challenge will be faced head on, will be dealt with and will enrich and strengthen Guernsey, Jersey and the Isle of Man as compliant, neutral, fair, competitive and responsible International Financial Centres.

Guernsey Association of Trustees
Jon Heaume
Chairman

25th October 2009