

# **ZERO 10**

## **Introduction**

As you are probably aware there is going to be a new Tax regime in Guernsey which is due to commence on 1 January 2008.

The States have already agreed various matters in the May and July States meetings and these are as follows:

- 1) The rates of income tax payable by companies
- 2) The activities that will be subject to tax
- 3) The principles of distribution and deemed distribution regime (This includes anti - avoidance measures)
- 4) Companies will be collection agents
- 5) The alteration of allowances in relation to let property
- 6) The availability of interest relief in certain circumstances
- 7) The principal tax cap of £250,000 for individual tax payers
- 8) The position of penalties for failure to comply
- 9) Certain transitional arrangements.

## **Companies**

With effect from 1 January 2008 the corporate tax regime will change. The standard rate of income tax for companies will move from 20% to 0%.

In order to effect the transition to the new regime all companies currently taxed at 20% will be treated as ceasing business at 31 December 2007. This is so that the company's profits to 31 December 2007 can be quantified as they will be charged at 20%.

For example, if the company year end is 31 March 2007. The 2007 assessment will be based on the accounts to 31 March 2007 plus 9 months of the accounts to 31 March 2008 (This is normally what will happen, but where circumstances warrant it, some other basis may be agreed with the Administrator).

The remaining 3 months will fall into the new regime.

The standard rate of corporation tax will be 0% and this will apply to all company activities except:

- 1) Specified banking/finance activities - 10%
- 2) Activities regulated by Office of Utility Regulation (OUR) - 20%
- 3) Rental income from Guernsey Property - 20%
- 4) Property Development income - 20%

An income tax return will still be issued to all companies in January each year.

Although the standard rate of 0% will apply to most companies. It will still be necessary to submit annual accounts and tax computations with the company income tax return, unless it is confirmed that the company has:

- 1) No Guernsey employees (other than local director's)
- 2) No Guernsey resident members (member of a company means an individual who has beneficial interest or any part of a beneficial interest in a share or any part of a share in that company (but does not include an individual who holds only the legal title of any share or part of share)
- 3) No OUR regulated activities
- 4) No Guernsey rental or property development income
- 5) No banking activities.

It is anticipated that most companies who are currently exempt will satisfy the above conditions.

The Administrator has the right to decide not to raise an assessment on a company which is taxed at 0%. However, the company also has the right to ask for an assessment when the relevant return is submitted.

## **Distributions**

Distributions to be reported by companies fall into the following categories:

- 1) Actual distributions to Guernsey shareholders
- 2) Deemed distributions to Guernsey shareholders
- 3) Investment income arising where there are Guernsey shareholders.

There will be minor changes to the company returns issued in January 2009.

The tax treatment of a company's distribution of income (e.g dividends) will be determined by place of residence of a member.

Distributions to a Guernsey resident member will be taxable on the member at 20% although the company will be responsible for collecting the tax due and paying it over to the Income Tax Office.

Distributions to a non-resident member will not attract any liability to Guernsey Tax. However, the onus will be on the company to obtain evidence that the member is non-resident before it makes a payment without deducting tax.

## **Deemed Distributions**

Certain events will trigger a 'deemed distribution' and these will be treated as if an actual distribution had been made and again the company will be responsible for the deduction and paying over the tax to the Income Tax Office. This is not to be

confused with chargeable events in the United Kingdom which are connected to capital gains tax.

What are 'deemed distributions' and 'deemed distribution events'?

- 1) Dividends
- 2) Disposal of Shares
- 3) Death of a Share Holder
- 4) Share Holder leaves island
- 5) Migration of company
- 6) Liquidation of company
- 7) Receipt by company of investment income - this is always a deemed distribution.

Exemptions are:

- 1) Where a Guernsey resident shareholder has an interest in the company of 1% or less
- 2) Where the company's income has been taxed in another jurisdiction at the rate of 20%
- 3) Holdings in Guernsey exempt collective investment schemes
- 4) Holdings in utilities, to the extent that those profits have been taxed at 20%
- 5) To the extent to which the company's income consists of Guernsey rents or property development, where that income has already been taxed at 20% in the company's hands.

### **Investment Income**

Where a trading company's investment income does not exceed £500 in any year, by concession, the company may treat the investment income as part of its trading income for the purposes of calculating the undistributed profits and deemed distributions.

For deemed distributions if there is a 10% share holding

Proportion of Company undistributed profits            x            10%

Investment Income relating to Share holder            x            10%

This could be on the disposal of shares, the death of a Guernsey shareholder, the emigration of a Guernsey shareholder, migration of the company and the liquidation or striking off of the company where there is a Guernsey shareholder. Investment income will, in effect, always be deemed to be distributed.

An example of this is as follows:

Total Share holding in company 100 shares

Total held by share holder	30 shares			
Total undistributed income	£15,000			
Taxable on shareholder	30	x	£15,000	= £4,500
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	100			

Therefore the company will have to deduct 20% of the amount payable i.e. £4,500 x 20% = £900 and pay this over to the tax office. The individual will then have to declare the gross amount on his personal income tax return and in turn the credit of £900 will be processed to his personal income tax reference.

### Quarterly Returns

The intention is that companies will be required to complete new quarterly returns which will operate in a similar way to the ETI scheme with effect from March 2008. This will possibly be less frequent for investment companies. Further details of how the new regime will operate in this respect will follow in due course.

It is not yet known whether the Administrator will require nil returns for any quarter in which a 'distribution' does not take place.

Special provisions will apply to the income of a company which provides the services of individuals, where, had those services been provided directly by the individual himself, he would have been considered an employee - these are commonly known as service companies.

The companies will also be required to disclose investment income as deemed distributions. The plan is for these returns to be made on a quarterly basis but this may increase to half yearly or annually. There are practical issues here as the company may not know on a quarterly basis what the investment income will be. As such, to resolve this problem a system of agency assessments could be adopted by issuing interim assessments each year. The Administrator is currently reviewing this further.

With regards to pre 2008 taxed profits these will be on a first in first out basis where distributions are made after December 2007. As such, these distributions will be tax neutral and should therefore encourage early distributions of pre 2008 profits in order to avoid company tax pools.

Computations will need to disclose separate pools of taxable income. A pool for pre January 2008 tax paid profits, a pool for post December 2007 tax adjusted distribution basis profits, a pool for already taxed investment income.

Distributions will be treated as paid out of pre January 2008 profits (tax free) on a first in first out basis. Thereafter, the Administrator will allow companies to distribute profits in the most beneficial way i.e. from taxed profits before untaxed.

The company should only be able to offset losses arising from one source of income against profits from another source if they are taxed at the same rate. A company is allowed to offset future losses against its rolled up profits carried forward.

Double taxation and unilateral relief will continue to be available, although income which is relieved at a different rate will require separate pooling and it will be necessary to allow the credit to follow the income when distributed, so that the share holder can take advantage of the tax suffered by the company.

A letter is currently being drafted by Treasury and Resources to go to all companies to explain how Zero 10 should apply to them.

### **Foreign Owned Companies**

Whilst foreign owned companies are not normally required to complete returns, they will still be required to do so if they employ locally. In these cases the companies will need to submit financial statements that will allow the tax office to reconcile the accounting figures with the returns made under the ETI scheme.

Other Guernsey registered foreign owned companies will need to complete a section on the return (similar to the alternative certificate) to confirm that they have no Guernsey taxable income, no Guernsey resident shareholders and no Guernsey employees. In such circumstances it will not be necessary to submit financial statements.

### **Loans with Shareholders**

With regards to loans with shareholders, legislation is currently being drafted to deal with these. The intention is that the company will be required to pay tax of 20% on any loans made to Guernsey resident shareholders. There will also be corresponding provisions to relieve repayments of loans. This will only apply to loans made at other than commercial rates of interest, or on a commercial basis. Loans will be scrutinized where it is thought that the company has borrowed (with the exception that the interest would be allowed as a trading expense) merely to lend to its shareholders. The Administrator has advised that the legislation will be particularly complicated and it is likely to discourage the making of loans.

### **Personal Service and Employment Companies**

Personal service and employment companies are to be treated separately. The company will be required to operate the ETI scheme on income which it receives (expenses can be deducted as it is received).

## Company Groups

With regards to company groups, it is acknowledged that a number of transactions within the group could well give rise to all sorts of reportable positions, when in effect it is just money moving around the same pot. The intention is for transactions within a group to be 'ring-fenced'. There should be no tax implications in relation to intergroup transactions including situations where rent is paid from one group company to another property owning company within the group to keep things as simple as possible.

Distributions or deemed distributions will only be considered as chargeable events when a transaction breaks the ring such that it impacts on the shareholder. The legislation as it applies to single companies will need to include exceptions for groups of companies and may be complex.

There is some concern about when a deferred tax position could be reversed out of the financial statements in view of the move to a Zero rate. Legislation went to the States on 26 September 2007 and has been treated as being Law with immediate effect. As such any removal of the deferred tax provision will be backed up by legislation after 1 January 2008 and could provide sufficient comfort for auditors to agree to the removal of the deferred tax provision.

The Administrator accepts that certain parts of the deemed distribution anti avoidance legislation may create cash flow problems and even financial hardship. For instance, the death of a major shareholder would be a chargeable event where there are undistributed profits.

### Example

60% shareholder dies

Therefore 60% of the undistributed profits would be deemed to have been distributed on his death.

If the funds are unavailable in the short term as they have been invested in assets used within the trade, it may take time to liquidate sufficient funds.

As such a statement of practice will be drawn up allowing for a form of roll over relief which will effectively be a tax deferral mechanism for the charge.

The Administrator will be drafting a statement of practice .

Also on the death of a shareholder, different treatment will be available where the company is under joint ownership with a spouse. In these cases exemptions will be available on the death of one spouse.

## **Discretionary Trusts**

Companies owned by discretionary trusts are also an area of concern where there is a Guernsey resident beneficiary but a number of non Guernsey resident beneficiaries. In seeking to identify the Guernsey resident share holder trusts will be looked through with a view to identifying the ultimate principal beneficiary.

Where there is a Guernsey trust beneficiary who is so remote from the likelihood of receiving income, such a person is likely to be disregarded. The tax treatment will be subject to a statement of practice. The Administrator will, where possible, adopt a real world approach when dealing with trust matters.

## **Penalties**

The States have resolved that where a company has omitted income it should suffer a mandatory penalty of 20% of the understated income, with additional penalties equivalent to those already contained in the Law.

There will be a regime of penalties for late submissions, late payments etc. The Administrator realises that errors may occur in the early stages of the new regime and the Administrator has therefore agreed to bear this in mind and consider a light approach to these penalties.

## **Individuals**

The personal income tax return is to change to accommodate the changes to the Law. The return will extend to 6 pages and will include questions in relation to trusts and the ownership of companies. The question in relation to trusts and companies will be broad in nature and will relate to facts rather than figures. The reason for this is to determine whether there is any participation in entities by Guernsey residents so as to assist in establishing which companies will be required to provide distribution information and Individuals will be taxed on distributions and deemed distributions in any company.

A credit will be given for any tax already paid at the company level, for example on rents, in a similar way to dividend payments under the present regime.

An assessment will be on the amount of actual distributions made or on deemed distributions in proportion to their share holding in the company.

## **Property Income**

The statutory repairs allowance is to be reduced to:

2 ½% land excluding a quarry

10%	glasshouses
15%	dwelling house let furnished
10%	dwelling house let unfurnished
10%	all other buildings

The Wear and Tear allowance of 33 1/3% for furnished lettings is to be abolished.

Entitlement to claim annual allowances on let property will be abolished.

### **Let Property**

Interest will only be allowed against letting income of the same year.

Where there is more than one property, the income received and the interest received for all properties may be aggregated into one tax computation.

If an individual or a company acquire a loan to purchase land on which a property is to be built with the intention of letting the property, then the interest paid in the course of construction would be rolled forward and be available for off set in the year that the rental income commenced to be received.

Where interest is paid on a loan on a property which is let, relief is only granted for the periods which the property was let or available to be let (which means marketed). If you have a holiday home which you let for 6 weeks of the year then only 6/52 of the interest paid would be allowed in the year.

Where part of the principal private residence (PPR) is let, relief would only be restricted by the £400,000 limit and not by the rental income received.

With regards to the relief on the principal private residence if residence is interrupted for example for holidays, or business trips, the Administrator will have the power to disregard these absences for the purpose of granting relief.

### **Interest Relief**

From 1 January 2008, relief will generally only be available in respect of interest paid on loans:

- 1) On an individual's principal private residence (PPR) which is situated in Guernsey (subject to a cap of £400,000 on the amount of loan that will qualify for relief), the £400,000 is the maximum loan whether the owners are married or co-habiting. If the owners are co-habiting then they will be given a maximum loan of £200,000 which will qualify for relief
- 2) On let property
- 3) To meet expenditure incurred for business purposes

4) To acquire an interest in a business.

For Guernsey property only, relief would only be given where, at the time the relevant loan was advanced, the lender was a Guernsey based financial institution or other resident provider. This restriction would only apply to loans made on or after 1 January 2008.

In relation to a property loan, interest would only be eligible for relief to the extent that the loan was used for the acquisition, construction, reconstruction, extension or repair of the property. The term property would include structures within the boundaries of the principal building. Examples of this are a conservatory or swimming pool.

Where a property is held through a company but the beneficial owner has the mortgage in his name, interest relief may be allowed as if the beneficial owner owned the property direct. The same would apply to a loan taken out to acquire shares in a company that held the property.

Where an individual takes out a loan to acquire or construct any property situated in Guernsey (but not elsewhere) which was occupied as the PPR of a divorced or separated spouse, relief would be made to the borrower subject to the £400,000 limit (as if his PPR and that of his divorced or separated spouse was the same property).

Interest paid on a loan to build or renovate a property would be counted as eligible for relief, so long as it was in fact occupied as the claimant's PPR once building work had been completed.

For example:

An individual extends his existing £300,000 mortgage on his PPR by £150,000 which is used as follows:

£50,000	to build a conservatory
£75,000	to buy a holiday home in Spain
£25,000	on a car

Only the interest on £50,000 would be allowed for tax purposes.

The Administrator realises that there may be problems with current account mortgages and these issues are likely to be covered in a Statement of Practice manual which will hopefully be available shortly.

### **Life Assurance Premiums**

For years up to and including 2007, relief has been granted on ½ of the qualifying premiums.

Providing the States approve the budget it is proposed that for policies taken out prior to 31 December 2007 relief will be given as follows:

For 2008, 1/4 of qualifying premiums

For 2009, 1/8 of qualifying premiums

For 2010, no relief.

No relief will be available at all for 2008 onwards in respect of any policy taken out after 31 December 2007.

### **Issues Relating to businesses, trades and employment**

Interest would be allowed to a person who borrowed funds to lend a company in which he had at least a 10% share holding and was actively engaged in the company's business activities, so long as the company utilised the funds for a bona fide business purpose. This would include monies lent to an investment company to fund the purchase of its investments.

Interest paid on advances used wholly or in part to fund the personal drawings of a sole trader or partner in a business would not be allowable.

If a loan is acquired to buy a business or part of a business (including the purchase of good will), any interest paid on the loan would be allowed subject to the claimant being actively engaged in the business at the time the interest is paid.

Interest on a loan to an employee that is used to buy assets used wholly exclusively and necessarily for the performance of the employment, which were not provided by the employer, would be allowed. An example of this is the purchase of a lap top.

### **High Net Worth Individuals**

The States have resolved that a cap should be placed on individuals. A limit of £250,000 tax in respect of non-Guernsey income only is proposed.

## **General Issues**

### **Duty to Declare**

Where a person discovers that they have failed to declare any income which is chargeable to tax they have an obligation to disclose the income to the Administrator within 14 days of the discovery. The same applies if they have failed to deduct any tax which they are required to deduct.

## **Enforcement**

The period of time which records need to be kept for has been increased from 6 to 20 years. This will enable the Administrator to raise assessments for a longer period where income has been negligently omitted.

Irrespective of the tax rate applied for the purpose of calculating penalties the rate will be at the highest rate which is currently 20%.

As company's are now obliged to deducted tax in relation to distributions or deemed distributions similar penalties for failing to operate this system have been introduced, as would apply to the ETI penalties.

At present the maximum penalty for fraud is imprisonment for 1 year and or a fine equal to the amount that the Administrator could impose himself.

On a summary conviction, imprisonment may be for up to two years and/or a fine equal to twice the penalty which the Administrator could have imposed. If the Administrator could not impose a penalty the fine can be twice the level 5 on the uniform scale which at present is £20,000.

On conviction on indictment the penalties are increased to up to 5 years imprisonment and/or a fine not exceeding 4 times the maximum penalty which the Administrator could have imposed a penalty, 4 times level 5 which at present is £40,000.

## **Prosecutions**

The circumstances in which prosecution could be requested are contained in the False Documents and Domicile etc (Bailiwick of Guernsey) Law 1998.

## **Trusts**

In the first project the definition of "settlement" was extended to cover any person who provided funds or other property for settlement, or any entity owned or controlled directly or indirectly by the trustees of the settlement.

A new section has been added to the Law (section 65A) which requires any person who has at any time been the settlor of a settlement which is or has been in existence at any time during a Year of Charge, in which the settlor was resident in Guernsey, to notify the Administrator by 31 March in the following year.

If a person fails to notify the Administrator then assessments can be made on the basis that there has been a fraud and can go back to 1950. The same penalties would apply for failure to give notice of liability and would apply to any tax arising on the income of the settlement.

Another new section was introduced to deal with Employee Benefit Trusts (EBT) and similar schemes. The deduction would only be given to the paying business when the benefits come out of the scheme and are taxable on the employee.

Section 53 of the Law deals with the taxation of trustees and this has been revised to make it clear that, at the discretion of the Administrator, the expression “the person beneficially entitled” to income from the trust can include the settlor if the settlement is revocable under section 65.

Section 65 is also being further amended to make it clear that the expression “income that may arise under or be comprised in the settlement” includes the income of any company or other entity which is vested in or otherwise under the control (directly or indirectly) by the trustees (whether alone or with any other person).

Income received by the settlement retains its taxable status, even if accumulated to capital by the trustees.

Section 66, which deals with settlements on minors, is being revised to make it clear that even if the income of the settlement on a minor is treated as the income of the settlor, the liability of the trustee or any person beneficially entitled to income to be charged in their own names is not affected. This is irrespective of whether the settlor was resident or non resident.

### **Other Matters**

Treasury and Resources are also seeking approval for the several other changes in the Law:

- 1) To increase the period during which the Administrator may make an additional assessment in cases not involving fraud or willful default, from the present 6 years to 20 years. This is because with the new regime it may be longer than 6 years before a deemed distribution takes place so the Administrator will be able to issue an assessment if this income is not correctly declared.
- 2) To allow prosecution in respect of failure to notify chargeability and failure to submit a tax return. This is aimed at people who never complete returns.
- 3) To allow prosecution for offences to be heard by the Magistrates Court - at present all prosecutions requested by the Administrator must be heard through the Royal Court.
- 4) To clarify and amplify the circumstances generally in which the Administrator can request a prosecution.

Jersey and UK pension schemes will no longer be exempt from Guernsey income tax.

A settlor of a settlement will now be required to notify the Administrator of that fact by 31 March in the following year. The personal return will now include sections allowing for such a declaration to be made and will also require details of any companies in which the individual has an interest.

## **TAX ON REAL PROPERTY (TRP)**

The current system of rating properties in the Bailiwick is changing. At the moment it is tax on rateable value (TRV).

The current system dates back to 1947 for Guernsey and 1949 for Alderney and is underpinned by 2 main pieces of legislation.

It allows for the assessment of Annual Rental Value of property and this is calculated predominately by internal measurements.

Taxation tariffs are set as the annual budget and they are Administered by the States Cadastre department.

There are some short comings with the current system, for instance, allowances have been given for properties with large rooms or glasshouses in some, but not all Parishes.

The system is being changed as it is complex, inefficient and demanding on manpower, not easily understood and inequitable.

The current system relies heavily on the need for internal inspection of the properties which the Department feels is invasive and not the most appropriate use of available resources.

The new system means the following:

- 1) All properties to be measured using the same basis
- 2) Moving to objective measurements of realty
- 3) Concept of rental value to cease
- 4) Where ever possible, properties will be measured by plan view
- 5) Internal measurements will be used by exception
- 6) Internal features will not form part of the assessment
- 7) 1 sq. meter of area will equate to 1 unit value for buildings and 50 sq. meter's will equate to 1 unit for land.
- 8) Range of property categories to be increased
- 9) Detached buildings of less than 10 sq. meter's within the land parcel will be exempt
- 10) Flats to be assessed on a pro rata basis using a formula to compensate for communal areas, internal walls and roof overhangs.

Property owners will notice the following key changes:

- 1) In the majority of cases properties will be measured by plan view, with a multiplier being applied for each storey
- 2) Internal features, such as plumbing/bathroom fittings, central heating and connection to main drain will not form part of the new assessment
- 3) A greater range of property categories
- 4) The level of free allowance for land is increased to 1 vergee.

### **Commercial/Business (non-domestic) properties**

- 1) Same measurement criterion as domestic property
- 2) Multiplier to be applied to more than single storey structures
- 3) Proportionally, greater manual assessment required due to more complex nature of commercial buildings
- 4) For TRP tariff classification purposes, identification of use of commercial premises is necessary
- 5) Utility providers to be treated on the same basis as other commercial entities.

The categories into which these properties will fall are as follows:

- 1) Hostelry and food outlets
- 2) Self-catering accommodation
- 3) Marine and motor trade
- 4) Retails
- 5) Warehousing
- 6) Industrial and workshop
- 7) Recreational and sporting premises
- 8) Utility providers
- 9) Office and ancillary accommodation(regulated finance industries)
- 10) Office and ancillary accommodation (non-regulated finance industries)
- 11) Horticultural (building)
- 12) Horticultural (glasshouse)
- 13) Agriculture
- 14) Publicly owned non-domestic.

No actual rates for these taxes have yet been published. They will be covered in the budget.