Funding the Future

Jersey will fail the EU Code of Conduct rules - again

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Philip Ozouf, Jersey's finance minister said on his blog yesterday:

Supported by the Council of Ministers, I have today announced my intention to repeal those elements of Jersey's corporate tax regime which were deemed harmful by the EU Code of Conduct Group. A proposal has been lodged to remove the deemed distribution and attribution rules with effect from January 2012. This means that "Zero-ten", which means most companies pay tax at 0%, will be retained.

Some more followed, but that's the nub of it. This is an interesting development, backed by interesting claims.

Leaving aside the fact that Jersey could (as on so many other issues) have saved itself a lot of trouble if it had listend to my advice on this issue in 2005, advice which has proved the be exactly right despite all the abuse thrown at me from within the island since then, let me add another note of caution now.

The claim that getting rid of the deemed distribution rules will satisfy the EU is a little rash. To put it another way: I think it may well be wrong. Nothing is certain. It is just possible that this is all the EU requires, but Jersey has hung on vain hope about Europe before to its cost.

What the EU actually said was Jersey failed the first three parts of the Code of Conduct on Business Taxation. The Code has five tests:

1. Whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents

2. Whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base

3. Whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages

4. Whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD

5. Whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way

Removing the deemed distribution rule clearly satisfies test 2. It probably clears test 1.

Test 3 is another issue altogether. Test 3 looks at the motivation for construction of the tax system as a whole: it asks if the the whole system is designed to be abusive? Is it, as a whole, designed to offer advantages to those not present in the island? Note it doesn't require differentiation between people within and outside the island as do tests 1 and 2. This one is about whether the system is designed to artificially relocate transactions for tax reasons.

This is, of course, reflected in my definition of a secrecy jurisdiction. I say that secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. That regulation is designed to undermine the legislation or regulation of another jurisdiction. I usually add that to facilitate the use of that regulation secrecy jurisdictions also create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so, but that's not key in this situation.

What is important is that if it is considered that zero/ten as a whole was designed to artificially induce relocation of transactions to Jersey when there is no economic substance to their being recorded there then getting rid of deemed distribution does not keep the EU happy. Far from it in fact. The system can still fail under test three.

That is why the EU quite specifically did not say that deemed distribution was the problem it was addressing when making its decision last November. That is also why it has not said getting rid of deemed distribution will solve this problem. And that is io doubt why the UK has not said that either.

What the EU said was that Jersey has to correct all three failures before its tax system is considered acceptable by the EU. It is addressing two. It seems to be ignoring the third, entirely. I think the reforms to which Senator Ozouf refers will fail to satisfy the EU on Code test 3.

That could be very costly. Not just to Jersey but to its international clients and so to Jersey’s long term reputation.

I hope Sen Ozouf has a plan in place for when that happens. Jersey can’t keep having a tax system ruled unacceptable internationally and keep its status as a well regulated place. But that’s the prospect it faces.