

STATEMENT BY THE CHIEF MINISTER - THE HON P R CARUANA QC
TO THE HOUSE OF ASSEMBLY – 12TH JULY 2002

COMPANY TAX REFORM

During the Budget Speech last month I said that the outline of the Government's proposed Reform of Company Taxation in Gibraltar would be announced imminently. These reforms are forced upon us by external factors outside of our control.

History of the issue

It has been well known for sometime that the Government intended to reform company taxation in Gibraltar. The need to reform company taxation is not a matter of choice. A series of international factors, some affecting only the EU, and others affecting all finance centres globally, make the reform absolutely inevitable.

Without such reform Gibraltar cannot continue to operate a finance centre. Approximately 2000 people in Gibraltar work for the finance centre directly. The jobs of many hundreds more in all sectors of the economy rely, indirectly on the finance centre. Furthermore, a significant proportion of Government revenue also derives from the finance centre. Government uses this revenue to pay salaries in the public sector and generally to fund public services for the whole community. The finance centre accounts for about 25% of the economy of Gibraltar in terms of GDP. The continued survival and prosperity of the Finance Centre is therefore crucial to the economic survival and prosperity of Gibraltar.

Some of these international factors which make necessary the tax reforms are legally compulsory (e.g. EU State Aid Rules). Others are political initiatives deployed through political persuasion and pressure (e.g. EU Code of Conduct of Business Taxation). In both cases the fundamental requirement is the elimination from the tax system of discrimination between residents and non-residents. In other words the new company tax system must treat all companies the same, whether they are offshore or onshore, whether they are owned by residents or non residents, whatever sector of the economy they are trading in.

At the same time, there is a need for Gibraltar's Finance Centre to be internationally competitive and to offer products and services that will be attractive to international clients. Our corporate tax regime is a crucial element of this.

The objectives of the Reform

From the outset the Government has identified 4 essential objectives, all of which had to be met by the Reforms. These 4 objectives are the following: -

- (1) The new company tax regimes should not transfer any tax burden to individual taxpayers, i.e. personal tax rates should not bear any share of the cost. Indeed the Government has during the last 6 years already introduced substantial reductions in the personal tax burden, and will continue to do so;
- (2) Current Government revenue from company taxation and exempt status fees (about £17 million per annum in total) has to be maintained and therefore has to continue to be paid by the corporate sector in some form or other;
- (3) The Reform must deliver certainty of compliance with EU legal factors (i.e. State Aid Rules) and other international initiatives that the Reforms are

intended to meet and satisfy. This basically requires that the same tax regime should apply to offshore and onshore companies;

(4) The Reform must ensure the continued survival and prosperity of the Finance Centre.

Consultation

The Reforms follow a very lengthy and intense process of consultation with all sectors of the finance centre industry and with the Government's European Union lawyers, local lawyers, accountants and other advisers. Many proposals have been suggested and considered. Such are the complexities of the four objectives (particular State Aid Rules) and their inter-action with each of the other objectives that the Government is certain that only these reforms are capable of meeting all four essential objectives in full measure.

The Reforms

The main elements of the new company taxation system, that will apply to all companies in Gibraltar, whether local or international, whether doing business locally or abroad, are as follows:-

1. Company profits tax will be ZERO. Tax exempt status and tax qualifying status will be abolished.
2. A new "Company Payroll Tax" (similar to what exists in Bermuda and elsewhere) will be introduced in respect of employees in Gibraltar. This will be charged at a sum per annum per employee. This payroll tax is a tax on the company and is payable by the company only.

3. A new Business Property Occupation Tax will be introduced in respect of property occupied in Gibraltar by companies for business purposes.
4. The Payroll Tax and the Business Property Occupation Tax together will be capped at a sum equal to 15% of profit. Since all local companies presently pay tax at the rate of 20% or 35% of their profit, it follows that all local companies will necessarily be better off than they are at present. In other words, these new taxes will only be paid if there is profit, and then upto a maximum aggregate sum of 15% of profit. No company will pay, in respect of both taxes combined, more than 15% of profit. If there is no profit then there is no liability to pay these taxes.
5. In addition, all companies will pay an annual companies registration fee of £300 p.a. (if the company has income) or £150 (if the company has no income) inclusive of current annual return fees.
6. In addition, and subject to EU clearance under State Aid Rules, two sectors of the economy only will pay a new tax on profit. The sectors are financial services providers and utility companies. The intended rate of profits tax for financial services providers is 8%, and will be subject, aggregated to the other taxes, to a maximum cap of 15% of profit.

Intended timescale

The Government had hoped to implement these reforms with effect from 1st July 2002. However, due to delays relating to necessary consultations with the EU Commission, this has not been possible. It is not desirable to commence these reforms part way through a tax year, nor retrospectively. Accordingly the Government intends to introduce the Reforms on the 1st July 2003 (the start of

the next tax year). But we are making this statement now to eliminate uncertainty in the Finance Centre, as far as its international clients are concerned.

Winners & Losers

All local companies will be significantly better off under the new tax system. This will reduce the cost of doing business in Gibraltar and will thus hopefully provide a boost to employment. These measures will bring many “offshore” financial service providers into the tax net for the first time. Those banks, and other (mainly financial services providers) currently themselves operating under tax exemption or qualifying status certificates will obviously be worse off. The latter have been consulted through their sector associations and representatives. In addition the most adversely affected companies have been consulted individually and at the highest level.

The Government wishes to acknowledge the understanding shown by all these companies from the outset, and to thank them for the continued commitment that they have shown to Gibraltar, despite the adverse effect on them of these tax changes which they recognise have been forced upon Gibraltar and other reputable finance centres.