EXECUTIVE COUNCIL

PUBLIC

Title: Review of the operation of Rural Tax Reliefs 2019

Paper Number: 38/19

Date: 24th April 2019

Responsible Director: Financial Secretary

Report Author: Head of Tax

Portfolio Holder: Roger Spink MLA

Reason for paper: This paper is submitted to Executive Council:

For policy decision
For policy update/information

Publication: Yes

Previous papers: 199/14 'Tax Reliefs to Support Rural Development"

List of Documents: Appendix 1 Summary of provisions and concerns

---

1. Recommendations

Honourable Members are recommended to approve:

(a) The repeal of the rural employment tax credit legislation in the Taxes Ordinance 1997 sections 28(3A) – 3(C)) (section 5.1.11);

(b) The repeal of the renewable energy technology tax credit from s.28 (section 5.2.4);

(c) Assets within the definition of renewable energy technology are provided with a rate of relief within s.116. (section 5.2.10);

(d) Revise the definition of renewable energy technologies that are used in Camp to explicitly name assets that qualify and provide an option for the Commissioner of Taxes to approve additional technologies as required (section 5.2.12);

(e) The 150% deduction for eligible renewable energy technologies to be effective for the first £50,000 of expenditure for the business (section 5.2.14);

(f) That renewable energy technology expenditure for non camp assets and camp assets in excess of £50,000 are given depreciation allowances at the plant and machinery rate of 40% (section 5.2.16);

(g) That an amended statutory definition of a "building" is introduced to emphasise that the building is a semi-permanent or permanent man-made structure with walls and a ceiling to enclose a space. Falkland Islands Government Tax Office ("**FIGTO**") to work with the AG's to produce a robust definition. (section 5.3.2);

(h) That s.116(9) is amended to make it clear that farmhouses continue to attract depreciation allowances regardless of where they are situated and that the rate of 10% straight line is reinstated (section 5.3.6);

(i) That the distinction between Plant and Machinery in Camp and outside Camp is removed and all assets are given the same rate of relief i.e. with a 40% on a writing down basis (section 5.4.5);

(j) The repeal of the tax holiday for new businesses either in Camp or in the Falkland Islands on the grounds that it is not workable (section 5.5.8);

(k) The development of a Taxes (Amendment) Bill for further approval by the Executive Council and passing by the Legislative Assembly to amend the Taxes Ordinance 1997 in order to reflect the changes outlined in paragraphs (a) – (j) above and to make any further changes to that Ordinance consequential on any of the above.

2. Additional Budgetary Implications

2.1 None

3. Executive Summary

3.1. Currently, as enacted, the beneficial policy implications of the 2016 rural tax relief package of measures (comprising rural employment tax credits, renewable energy technology tax credits, the tax holiday for new Camp businesses and enhanced depreciation allowances for machinery in Camp) are unlikely to be realised, largely because the eligibility of the reliefs needs to be clarified in order to encourage greater understanding amongst, and use by, taxpayers.

3.2. The rural employment tax credit under s28(3A) of the Taxes Ordinance 1997 ("**Taxes Ordinance**") (as amended by the Taxes (Amendment) Ordinance 2016) has given rise to various issues which are discussed in section 5.1 below. FIGTO recommend that the employment tax credit is repealed and consideration is given as to alternative incentives to rural business to assist employment and growth outside the tax regime.

3.3. FIGTO have received enquiries about the functioning of the renewable energy technology credit (as discussed below at sections 5.2). FIGTO has interpreted the legislation in the most beneficial way for the taxpayer, as required due to the lack of clarity in the current legislation. However, amendment of the Taxes Ordinance is required to address these uncertainties.

3.4. Further issues concerning depreciation allowances (**DAs**) are summarised in sections 5.3 and 5.4 concerning Farmhouses and machinery in camp.

3.5. Because of the problems to which it has given rise, FIGTO considers that the tax holiday for new businesses should be repealed – see section 5.5.

3.6. This paper addresses issues with the legislation and recommends substantial amendment and reform of the Taxes Ordinance to improve the operation and design of the package overall, supported by guidance for taxpayers as to the effects of the proposed changes.

4. Background and Links to the new Islands Plan 2018-2022

4.1. The policy objectives of the Rural Development Strategy of 2015 were to:
   a) Improve employment prospects of existing Camp businesses
   b) Help incentivise and support the establishment of new rural businesses in Camp through the tax regime
   c) Grow the rural economy and rebalance economic activity outside of Stanley
   d) Help support an increased Camp resident population.

4.2 In order to achieve these objectives, a number of tax incentives were introduced in 2016. The main elements of the package were:
   a) A 'rural employment tax credit' for new full time positions created in Camp
   b) A tax holiday for new business activities established in Camp or the Falkland Islands
   c) An enhanced rate of DA's for machinery in Camp
   d) A new tax credit for renewable energy technology investments in Camp

4.3 In a number of instances the policy intent of the Executive Council has been difficult to apply from the perspective of both the taxpayer in attempting to claim the allowance and also from FIGTO in administering the regime, due to the way the legislation has been drafted.

4.4 Three years after the Taxes (Amendment) Ordinance 2016 was passed to implement these measures, there is now an opportunity to review the extent to which the legislation has achieved its policy objectives.

5. Options and Reasons for Recommending Relevant Option

5.1 Rural Employment Tax Credit

5.1.1 The rural employment tax credit (which is provided for in sections 28(3A) – (3C)) has been placed in section 28 of the Taxes Ordinance which deals with the rates of corporation tax applied to a company's adjusted profits. It is available for 'a company in Camp' which automatically excludes it being claimable by partnerships which are the most common type of business structure in camp.

5.1.2 The credit is also only available in respect of new full time employment, which must deliver a 40 hour working week, and be for at least 6 months (section 28(3C) of the Taxes Ordinance). However the lack of a pro-rata within the legislation means that for a new post to be eligible for the credit, the 40 hour working week must be met over the whole year because no provision has been made for pro-rata or split year (for example over the summer season).

5.1.3 The current legislation also requires a minimum proportion of hours worked in the new employment to be carried out in Camp (75%) (section 28(3C)(d)). This is very difficult for FIGTO to verify and for the business to evidence.

5.1.4 Eligibility for the current credit is also limited to new employment carried out by a person 'resident in Camp'. For tax purposes, residency can be verified by cross checking records on the Immigration database to determine whether someone has been physically present within FI for enough days to meet the test each tax year (183).

5.1.5 Residency is separate to the address within a territory where someone has their main home. There are practical challenges relating to determining residency within camp, for example the Electoral Roll only records FI status holders address.

5.1.6 There is no current requirement for someone to have been appointed to the post for the credit to be available.

5.1.7 The amount of the credit available in the period is set to be the lower of the £3,000 (pro rated if less than 12 months), and the worker's remuneration in the role for the period. This will be especially relevant in the early periods where the credit could otherwise drive businesses to 'create' posts that would never be economic merely for the purpose of triggering the credit. The total credit for all relevant accounting periods in respect of the new post should be capped at £9,000 (£3,000 multiplied by three years).

5.1.8 It is unclear whether the credit is intended to be an additional deduction in computing the taxable income or a reduction in the tax liability for the period in question.

5.1.9 The current legislation has no provisions for the claiming of the credit, does not specify the evidence that needs to be submitted or provide for a declaration that the criteria have all been met; and has no separate mechanism for FIGTO to enquire into the amounts claimed and assess the credit due in the case of an overpayment of tax by virtue of the credit being under claimed. It would be necessary to develop a new procedure for processing claims.

5.1.10 The objectives of the employment tax credit are difficult to legislate for and in the current form would require a new procedure in FIGTO to be developed for claims to be made and enquired into.

5.1.11 <u>Recommendation</u>: The Employment Tax Credit legislation is repealed from S28(3A) and alternative incentives outside the tax regime are considered to target rural employment that can be operated through a simplified regime.

5.2 <u>Renewable Energy Technology</u>

5.2.1 A tax credit is available for investments by a company in 'renewable energy technology' under s.28(3A)(b), based on a definition of that technology within s.106(4). The credit is currently only available for investments in Camp and at an annual rate of 150 per cent for up to £20,000 of the total cost of the technology.

5.2.2 Eligibility for the credit is only available for companies. There is no policy rationale for this and the earlier ExCo paper on the subject made no reference to restricting its availability to incorporated businesses. As detailed in paragraph 3.3 FIGTO have had to interpret the legislation in favour of the tax payer. FIGTO are therefore currently applying the credit for companies and unincorporated businesses.

5.2.3 A tax credit is a reduction in the amount of tax payable. Currently S28(3A) provides that a company with the required investment could receive a maximum of £30,000 reduction in their tax liability.

5.2.4 Recommendation: The renewable energy technology tax credit is repealed from s.28

5.2.5 In the 2016 provisions a new category of qualifying asset for the purposes of DAs was introduced within s.116 for renewable energy technology assets (section 116(1)(f)). This is in addition to the renewable energy technology tax credit discussed above in section 5.2.

5.2.6 DAs are available to provide relief for capital investment in lieu of accounting depreciation. Unless an asset is within a general qualifying asset category or has been separately identified in a specific category, DAs are not available. DAs are never available in respect of land.

5.2.7 Until 2016 relief for renewable energy technology assets would have attracted DAs within the main category of 'plant and machinery' at s.116(1)(a), which affords a rate of 40% per annum on a reducing balance basis.

5.2.8 By separating out renewable energy technology assets from the main plant and machinery category, this means that relief is no longer available at the 40% reducing balance rate.

5.2.9 The separate renewable energy technology category however has not been given a rate of DAs to apply to it, so relief has been removed from these assets altogether.

5.2.10 Recommendation: Assets within the definition of renewable energy technology are given a rate of relief within S116

5.2.11 The statutory definition of "renewable energy technology" at s.106 reads: 'any technology that generates electricity or heat directly from natural resources or through the use of plant material that can be naturally replenished'. This definition is very wide; for example it could be interpreted to include the burning of peat or a coal fired power station.

5.2.12 Recommendation: A revised definition is used which explicitly names renewable energy technologies that are used in Camp currently; an option could be given for the Commissioner to approval additional technologies to allow the legislation to be future proofed. For example 'Technologies that generate electricity or heat wholly or principally from renewable energy sources rather than carbon producing combustion methods, including without limitation, solar or photovoltaic (PV) panels, wind turbines and hydroelectric plant'.

5.2.13 The value of the tax credit is currently set at 150 per cent of investments up to £20,000. We would recommend that the rate of enhancement (i.e the 'extra 50%' on the cost incurred) is maintained, but as a deduction rather than a tax credit

5.2.14 Recommendation: The 150% deduction is effective for the first £50,000 of expenditure in respect of an asset in camp (rather than £20,000); therefore the business would receive a one-time deduction of up to £75,000 i.e. the base cost of the asset is uplifted by 50%.

5.2.15 Location of renewable energy technology assets: The current legislation has inadvertently removed DAs for the assets in the non-Camp (Stanley and MPA) zones. Whilst there could be a geographical distinction between the level of relief given based on the location of the assets (which are normally permanent and not moving between Camp and non-Camp zones within tax periods) this doesn't appear to be in line with the policy to develop the whole Falkland Islands' economy and creates an arbitrary distinction within the DA code.

5.2.16 Recommendation: FIGTO recommend that non Camp and Camp assets in excess of the £50k qualifying for renewable energy technology DAs are given DAs at the plant and machinery rate of 40% written down allowance.

5.3 **Depreciation Allowances: Farmhouses**

5.3.1 Depreciation allowances at a 10% straight line deduction are available for buildings under s.116(1)(b). The current definition of "building" simply states what it is not rather than what it is. The current definition is "building does not include land or farmhouses, car parks or hard standings" (section 106(4)).

5.3.2 Recommendation: An amended statutory definition of a building is introduced to emphasise that the building is a semi-permanent or permanent man-made structure with walls and a ceiling to enclose a space. FIGTO to work with AG's to produce a robust definition.

5.3.3 The rural tax relief changes sought to grant a higher 25% rate of DAs to buildings in Camp and a change was therefore made at s.116(9) to distinguish between Camp buildings (25%) and buildings in areas other than Camp (10%).

5.3.4 However, the way the legislation has been written at s.116(9)(b) removes DAs entirely from farmhouses[1] in Camp. This is in contrast to previous tax policies which have sought to give a beneficial treatment to farmhouses (e.g. Extra Statutory Concession 4 which prevents a private use restriction from applying which would otherwise reduce the availability of tax relief relating to the farmhouse).

[1] A definition of farmhouse is at s.106(4) which states 'the principal residence of the farm owner, manager or any other person in control of the operation of the farm (that is used for residential purposes)

5.3.5 The original ExCo paper appears to envisage buildings in Camp other than farmhouses getting the enhanced rate of 25% (e.g. shearing sheds, outbuildings etc) while farmhouses receive the existing rate of 10%.

5.3.6 Recommendation: s.116(9) is amended to make it clear that farmhouses continue to attract DAs at the rate of 10% regardless of where they are situated.

5.3.7 An alternative option is to give all buildings in Camp the beneficial (25%) rate whether or not they comprise the farmhouse or other buildings used in the trade.

5.4 **Depreciation Allowances: 'Machinery in Camp'**

5.4.1 Depreciation allowances at a 40% reducing balance basis at s.117 are available for plant and machinery including vehicles and aircraft but not including ships.

5.4.2 The rural tax relief changes sought to grant a 60% straight line basis of DAs to 'Machinery in Camp' (section 116(6A)) rather than a 40% reducing balance allowance provided for in s117.

5.4.3 No definition of 'Machinery in Camp[2]' was introduced, and the concept of assets having different rates of relief depending on their physical location is difficult when they are designed to be moved e.g. vehicles.

5.4.4 Introducing a time barrier (such as the asset must spend at least 50% of its working time in Camp) in order to qualify for the enhanced rate would suffer the same difficulties upon application as the working hours requirement discussed at paragraph 5.1.9.

5.4.5 Recommendation: The distinction between Plant and Machinery in Camp and non-Camp is removed and all assets are given the same rate of relief with a 40% writing down basis.

5.4.6 A consequence of not accepting the recommendation at section 5.4.5 is that a workable 'Machinery in Camp' definition would need to be introduced (with wider application to Plant and Machinery) to ensure that the geographical location of the main business activity making the investment is used to determine which rate is available as this is fixed, rather than the moveable location of the machinery acquired.

5.4.7 Furthermore, if the recommendation at 5.4.5 is not accepted then the higher rate of DAs was introduced at s.116(6A)(a) granting relief at 60 per cent rate on a straight line basis would presents some practical difficulties in year 2 in terms of defining exactly what the depreciation allowance calculation should be.

5.5 **Tax Holiday for new businesses**

[2] Therefore FIGTO has had to interpret this to include plant and vehicles (other than vehicles without 4WD capability given the requirements for this within Camp) to be acceptable as business assets)

5.5.1 The rates of Corporation Tax and Income Tax on unincorporated businesses are 21% and 26%, determined by the level of taxable income in the accounting period and for non-incorporated businesses, the individual's other income sources and the Personal Allowance.

5.5.2 As part of the package of rural tax reliefs, a corporation tax[3] holiday was created at s.23(6-8) for companies in respect of business activities that are new to either Camp or the Falkland Islands.

5.5.3 Similar to issues raised at paragraph 5.1.2.8, the concept of residency between 'Camp' and 'non-Camp' zones is problematic. The issues relating to the residency of companies are even trickier. Whilst a company would have a registered address for correspondence and administrative purposes, this for practical reasons is likely to be within Stanley, and in some cases may be the residential property of the main company director. Attempting to establish where the central management and control of a company takes place within a territory is unworkable. There was no discussion of a residency requirement in the original ExCo paper, implying that these problems hadn't been thoroughly considered at the time.

5.5.4 The tax holiday applies to activities which are either new to Camp or new to the Falkland Islands only in so far as they are carried out by a company.

5.5.5 In order to distinguish between activities which are new to Camp and the Falkland Islands that are eligible for the tax holiday it would be necessary to determine which activities currently take place within Camp and the Falkland Islands. Separate profit and loss statements would be required between the new activities and any existing activities conducted by the company in the prior period.

5.5.6 Whilst reference is made in the original paper to guidance that would set out which activities are ineligible because they are already carried out in Camp this analysis was never undertaken. The collation of the business activities and properly defining their limits to work out accurately the size of the 'new' activity would be extremely difficult.

5.5.7 Related to this problem is what ExCo wants to count as 'new' to avoid giving a tax holiday to a substantial part of the current business community that is not incremental to what was there before.

5.5.8 Recommendation: The tax holiday is such a difficult concept to make workable without giving away tax revenues that should otherwise be assessed that FIGTO recommends that the provisions are repealed pending a future review of how to best support the development of a wider range of business activities within the Falkland Islands, especially outside Stanley.

[3] Incorporated businesses would have a liability for Corporation Tax, unincorporated sole traders or partnerships are assessed to income tax .

6 Resource Implications

6.2 Financial Implications

6.2.1 The changes are expected to widen the eligibility of businesses to secure the benefits of rural tax reliefs approved by ExCo in 2014 (paper number 199/14) and therefore reduce the yield for Corporation Tax and Income Tax by a small amount per annum. To date there has been little revenue impact of the intended policy changes because qualifying for the relief has been so difficult.

6.2.2 In the medium term the impact of wider eligibility of these reliefs should be a growing business base in Camp and increased employment prospects for those already resident outside of Stanley. Both these factors will help attract more people to become resident in Camp, at least on a seasonal basis, which was the original policy intention.

6.2.3 These changes should complement the existing forms of grant and subsidy funding already offered by FIDC and DofA respectively. No additional funding requirement is requested.

6.3 Human Resource Implications

None

6.4 Other Resource Implications

None

7 Legal Implications

7.1 Changes to the Taxes Ordinance 1997 (both those proposed and any consequential changes) will need to be enshrined in a new Taxes (Amendment) Bill for approval by the Executive Council and passing by the Legislative Assembly

8 Environmental & Sustainability Implications

8.1 None

9 Significant Risks

9.1 Doing nothing in this area risks the rural development strategy struggling to achieve its main objectives in tax-related matters and would result in FIGTO having to take a broad approach to giving the reliefs, which may result in tax revenue being lost.

10 Consultation

10.1 Consultation has taken place with the Portfolio Holders for Tax and Fiscal Policy,

11 Communication

11.1 A rural tax relief briefing document will be produced to support the revised legislation and distributed to tax payers who are resident in Camp and also uploaded to Treasury website to be accessible to all taxpayers and agents. In addition, a workshop will be held at Farmers Week 2019.

Appendix 1

Rural Tax Relief – summary of provisions and concerns

Description	Current Provision in TO 1997	Issue / Concern with the current legislation	Recommendation
Employment Credit	S28(3A)(a)	Only relates to companies	Recommend that the rural employment tax credit to repealed and alternative incentives outside the tax regime are considered to target rural employment that can be operated through a simplified regime.
£3000	£3000 for each year for 3 years provided the employment is for more than 12 months	Requires a 40 hour working week for at least 6 months difficult to comply with	
		Required 75% of the time spent in camp which is very difficult to monitor	
		Definition of resident in camp, difficult to define residency within a taxing jurisdiction	
		Provisions only require the post to be created and not to be filled.	
		No method of claiming the relief is provided for	
		Refers to a credit i.e. a reduction in the amount of tax payable. Should the credit be capable of creating a tax refund?	
Renewable Energy Technology – tax credit	S28(3A)(b)	Only relates to companies	To be amended to include all businesses regardless of legal form.
	"eligible for a tax credit, invests in renewable energy technology … annual rate 150% up to £20k of the total cost	Refers to a credit i.e. a reduction in the amount of tax payable. Does this mean that for an investment of £20k a tax credit of £30k is given?	Rather than a tax credit being granted an enhanced depreciation allowance should be granted.
		Could the credit give rise to a repayment of tax?	It is not recommend for the credit to create a tax refund. NB recommended DA's are provided on renewable energy technology not tax credits.
		Definition of renewable energy technology S106 "directly from natural resources … that can be naturally replenished". A potentially very wide definition.	Tighten the definition of renewable energy sources
		Is £20k the right level of cap for the relief?	

Appendix 1

		Currently an asset could be eligible for the tax credit and also a claim under the DA's	Move to a depreciation allowance so the expenditure on the asset only gets relief once.
Renewable Energy Technology – depreciation allowances	S116	Although a separate category of qualifying asset has been introduced this category has no DA rate attached to it.	If Camp renewable energy technology assets are given an enhanced allowance, recommended that non camp renewable energy technology are given 40% writing down allowances.
		Renewable technology assets outside camp do not receive any tax relief. (within camp they receive the tax credit)	Recommend that the relief is given at 40% WDA.
Depreciation Allowances - Farmhouses	S116 (1)(b)	Concerns regarding the definition of a building.	Include a legislative definition of a building
		S116(9)(b) removes DA's from Farmhouses in camp. Believe the intention was to give 10% straight line.	Legislation to be amended
Depreciation Allowances – Machinery in camp	S116(6)(a)	No definition of machinery in camp	Remove the distinction between camp and non-camp assets
		Problem because machinery in camp could be moveable.	
		S116 provides for straight line depreciation – the rate granted is 60% so after year 1 how is the relief given, is it the balance of the 40% or is another 60% given?	Make the allowance writing down allowance – this would be in line with the current 40% allowance.
Tax holiday for new businesses either new to the FI or camp	S23 (6)-(8)	Only applies to companies, not unincorporated businesses	Recommend that the tax holiday provisions are repealed.
3 years business is new to camp		How to define a camp resident company	Recommend that the tax holiday provisions are repealed.
6 years businesses is new to the Falkland Islands		How to determine if the business activity is new	Recommend that the tax holiday provisions are repealed.