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Article : The Treaty on the Functioning of the European Union 'the Treaty': The Constitutional position of the European Union Institutions on Jersey's Zero-Ten régime.

Monday, 14th March, 2011

Given the current debate upon the Zero-Ten régime both on and off Jersey ("the Island"), it may be worthwhile rehearsing the competence, or rather lack of institutional competence of the Council, ECOFIN, the Commission and the European Parliament over the corporate tax régime adopted by a Crown Appendage[1].

Effectively, the political, not the legal debate initially related to harmful business tax competition between the Member States themselves. According to official documentation, this discussion was initiated by the Commission at the informal meeting of Ministers for Economic Affairs and Finance in Verona in April 1996 and given more substantial shape at the informal meeting in Mondorf-les-Bains in September 1997.

Even a cursory reading of the report, in the "C" category[2], of the Conclusions of the ECOFIN Council meeting on 1 December 1997 concerning taxation policy disclosed in OJ 98 C 2/01 – 6, shows that this is an acknowledged political, and therefore extra-constitutional self attribution of "powers" or, perhaps more accurately, influence of a political nature. This point is conveniently omitted in some commentaries. As the reader will see by the end of this tome, Jersey has managed subtly to maintain its Zero-ten régime notwithstanding. It has simply chosen a zero-rate with upgraded anti-avoidance rules, which cannot be criticised at least without the European Union modifying its approval of the Zero-Ten principle taken in 2003.

However, this and the reports and working papers required by this unconstitutional cabal had to remain without the sphere of fiscal competence of the Union, which is strictly limited to the indirect effect that Direct, as opposed to Indirect Taxation can have on the operation of the Internal Market. There is no further Treaty or for that matter political competence granted independently to the Commission or the Council in the area of Direct Taxation, which therefore remains within the exclusive sovereign competence of the Member States.

The attempt by the Member States within the Consilium to arrogate jurisdiction at the Union level concerning third jurisdictions into that body is a matter of constitutional concern both at the Union and the international level. If it is outside Treaty powers and competence, the legal action taken is void. Fortunately, the United Kingdom is unable to force this upon the Islands as a matter of "internal" sovereignty. The EU Treaties as amended exclude Jersey Guernsey and the Isle of Man from the definition of associated and dependent territories within Union

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[1] *This is the correct term: the current fashionable term "dependency" incorrectly implies that an abnegation of domestic sovereignty has taken place.*
[2] *information and non-legal documentation.*

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competence, as these islands have never fallen within the strict constitutional definition of this term. This fact has to be regularly drawn to the attention of United Kingdom politicians and civil servants, and increasingly now to foreign politicians and civil servants acting on mistaken suppositions. The Islands are not associated territories or dependencies in the correct sense of the term. The negotiations of the terms of the accession of the United Kingdom prior to 1972 were finally conducted upon the basis that the Islands were neither associated nor dependent. Otherwise, why the special arrangements?

The issue of Union competence is further distanced in that the Internal Market does not extend to Jersey in its entirety, only insofar as access to the internal market in goods and agricultural goods is concerned. The Union's institutions' competence is therefore limited to matters concerning the common or internal market in goods and agricultural goods. Both Direct and Indirect taxation are excluded from their competence by the third protocol to the Act of Accession of the United Kingdom to the European Communities of 1972, set out in full in English in Annex 1, and which stems from the United Kingdom's own lack of competence in the Islands domestic affairs, taxes and services alike.

Within the Union itself, direct taxation is also outside the full competence of Union legislation and principle. For example, it is current French fiscal policy that, as income tax is outside the competence of the Union, there is no right available to an EU national to invoke the non-discrimination provisions of the Union against an assessment under article 164C of the *Code Général des Impôts*. The European Court of Justice has yet to state the contrary, but has added a proviso to this using the overriding Lisbon Treaty non-discrimination right, and the right to "reside" defined in articles 18 and 20[3]. Still, this only goes to show that no Member State is prepared sacrifice its own fiscal sovereignty to do otherwise than pay lip service to the principles which they are placing on other's shoulders through the Consilium High Level Working Party, of which more anon.

To further illustrate the lack of Treaty competence, the Charter of Fundamental Rights of the European Union, which draws upon the European Convention of Human Rights makes no mention of Article one to the First Protocol, which bars expropriation, but imports lawful taxation as an exception. Had the Union any competence in matters of direct taxation, the ECHR tax exception to the ban on expropriation would have had to have been inserted into the Union Charter. Having no competence in direct taxation, the Union could not address this issue in the Charter. It is ironic that a Union committee, already outside Treaty legal competence, should consider itself able to act in the manner in which it has. Had the HLWP been subject to normal Union discipline, certain of the apparent errors in its logic and rationale might not have been committed.

3 Case C-155/09: Commission v Greece: judgement of 20th January, 2011

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As an aside, this does not explain why, from the French *assemblée* to the European Council, the fact that a Jersey Exempt Company, prior to its dissolution, was involved in the trading of Bananas into the European Union under the inclusion of the Bailiwick in the Common market of agricultural goods is now being held up as a justification for including the whole of Jersey's corporate tax régime in the "debate" despite the whole operation and the transactions involved being entirely compliant.

The position of the Crown Appendages; that is Guernsey, Jersey and the Isle of Man, is entirely separate from that of the dependant and associated territories defined in the Treaty of Accession of the United Kingdom[4]. This point will be elaborated later in this study. Suffice it to say that constitutionally the Islands do not fall into this category of jurisdiction, as their relationship with the United Kingdom predates this category by about a millennium[5] which is why they have a separate arrangement with the European Union.

"Zero-Ten" is an updated method of taxing companies. The principle adopted is no more than a fundamental principle of Jersey Taxation, adopted prior to the German occupation in the 1940s and continued through it, that as Jersey has no technical sovereignty or ability to tax non-residents, Jersey income taxation is only applied to Jersey residents, or on Jersey source income. The same principle has historically been applied to companies owned by non-residents. The OECD criticism of exempt corporate taxation, in itself questionable, and the European Commission's initial comments led the Island to restructure its corporate taxation to a zero-rate applicable across the board, saving for certain financial institutions such as banks and fund managers, who were taxable upon the remuneration and fee income that they obtained through the management of both resident and non-resident capital. These were subject to a 10% rate: hence the term Zero-Ten.

However, allowing a zero rate across the board would have enabled Jersey residents to hold undistributed reserves tax free in Jersey companies or even in foreign companies administered from Jersey without paying tax, until their distribution. The concern as to this fairly blatant and crude method of avoidance or damage to the revenue was dealt with by a set of anti avoidance provisions referred to as the deemed distribution and attribution rules.

To summarise the deemed distribution and attribution system[6]:

[4] *The Third Protocol to the Act of Accession of the United Kingdom to the European Communities: order available in French from http://eur-lex.europa.eu/en/treaties/index.htm#accession .*
[5] *The Islands were annexed by William Longsword in 933 A.D. from Britanny, and were therefore within the Duchy of Normandy in 1066.*
[6] *A fuller summary is available on the Comptroller of Taxes Website:*

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Under the current Zero/Ten tax regime, certain companies no longer pay corporate tax; the tax is instead paid by the company shareholders when they receive dividends from the company's profits.[7]

- Deemed distribution and full attribution were introduced, as an anti avoidance measure, and, although different rules apply, the two regimes are usually referred to together as 'deemed distributions'.
- Deemed distribution applies to companies that carry out an active business and are taxed at 0%. If the company does not pay dividends of at least 60% of its profits, the shareholder is taxed as though the dividend had in fact been paid. Any remaining profits paid out by the company are taxed when the company is sold or when the shareholder dies or leaves Jersey.[8]
- Shareholders or companies that are taxed at 10% are also taxed on any undistributed profits when the company is sold or when the shareholder dies or leaves Jersey.

- Full attribution applies to companies that hold investments like bank accounts or shares in other companies. Jersey resident shareholders of these companies are taxed as though they had earned the company's income themselves.

The Commission accepted that a generalised Zero-Rate concept was not in itself open to criticism, and asked, at least in public, for a further consideration of Jersey's full attribution and deemed distribution policy to ensure that there was no discrimination falling foul of its conceptual analysis and brief in the ECOFIN Resolution. This Resolution provided the political, not legal, basis for its intervention. The full attribution and deemed distribution provisions tax Jersey residents owning shareholdings in Jersey companies, directly or indirectly, on their share of distributable profits. This is in essence an anti-avoidance measure preventing Jersey residents from escaping their fundamental liability to income tax through nil-rate companies, and are subject to further anti-avoidance measures destined to halt the use of offshore trusts and companies to avoid taxation.

7 *Income Tax (Jersey) Law 1961, as amended, arts. 81B-P*

[8] The remaining 40% is left to enable provisions to be constituted up to that amount without triggering a deemed distribution or attribution assessment.

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This work was entrusted to the High Level Working Group, which has recently released its findings, which are not supported by any technical argument, but made a statement of perceived principle.

Whilst the findings were leaked to and immediately published by Tax Research UK LLP on February 8th, 2011[9], as usual briefed or rather consulted by an EU official before anything is done, these findings were published officially by the States of Jersey on 15th February, 2011 as follows:

> *The High Level Working Party (HLWP) discussed the current scope of the Code of Conduct on business taxation in line with ECOFIN conclusions of 7 December 2010 (doc. 17380/10 FISC 149).*
>
> *The HLWP took the view that personal income taxation falls, as a general rule, outside the scope of the Code. However, certain aspects of such taxation may be taken into account in specific circumstances.*
>
> *The regimes of the Isle of Man and Jersey (doc. 16766/10 FISC 139 point 12) fall under the scope of the Code of Conduct due to the following reasons:*
>
> *1. Shareholders are not taxed exclusively on actual distributions, but also on deemed distributions. The combination of both ensures current taxation of business profits at shareholder level.*
>
> *2. Current business profits are effectively taxed at shareholder level via deemed distribution or attribution provisions. The mechanism is designed as a system based on shareholder and company taxation to ensure combined taxation of business profits.*
>
> *3. The mechanism, whereby current business profits are taxed at shareholder level via deemed distribution or attribution provisions, only applies to resident shareholders thus creating an instrument to protect the national tax revenues and to attract non-resident shareholders.*
>
> *4. The mechanism is an alternative means of taxing domestic business profits rather than an anti-avoidance measure.*
>
> *These conclusions are without prejudice to any further clarification of the scope of the Code of Conduct made necessary by examination of other regimes with potentially damaging effects.*

The argument at §1 is technically false in that there is no taxation of actual distributions once taxed under the full attribution and deemed distribution rules. This is therefore a point of

[9] The Consilium are apparently alleging that it had been made "public", *quare* whether actually publicised on 4th February, 2011 under a reference: document 6054/11.

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fundamental error, and the position upon which this is based is therefore false. The Commission incorrectly briefed the HLWP.

There is no effective taxation of current business income at shareholder level. Even if there were, and the shareholders required to make a calculation of profit as against loss depreciation and loss carryforwards, which they are not, it would not be current, as it is not taxed in the same year as its realisation. If this were the case, then why the *de minimis* shareholding rules?

The deemed income is only taxed once, under a rule designed to prevent avoidance. If insufficient income is actually distributed, the full 60% deemed distribution rule applies, which makes allowance for any provisioning requirements. In a manner comparable to the French *société de personnes*, and in particular the *Société à responsabilité limitée*, the taxpayer resident in Jersey is taxed upon the income deemed distributed to him immediately, and any further distribution of those taxed profits to him is not taxed. That this is not "business" income is clarified by the fact that a Jersey resident shareholder cannot claim loss relief against his tax liability on this attribution and deemed distribution basis. The distribution, deemed or otherwise, is calculated post loss carryforward and post allowable expenses, and what is more calculated after group loss relief. If that is not distributed investment income what is? It cannot therefore be business income in the sense that this term is used in Europe or elsewhere. It can only be assimilated to investment income. What is more, unlike the French member of an Sarl, the Jersey resident shareholder is not taxed on an arising basis, but the income is deemed to arise to him in the tax year following the financial year of the Company.

To assert, not even argue, at §4 on such an unsupported basis that "*The mechanism is designed as a system based on shareholder and company taxation to ensure combined taxation of business profits.*" is mere assertion, it is not legal, nor for that matter political nor economic argument. There is no taxation of business profits in this system. There cannot be, as the attribution and deemed distribution assessment is on what is economically at the stage of a dividend, not a business profit. There is no combination. It cannot support the political, not technical, assertion: "*thus creating an instrument to protect the national tax revenues and to attract non- resident shareholders.*"

The HLWP have failed to establish one important part of any legal argument namely the definition of "business taxation". It is clear that their "definition" is neither a legal nor an accounting one: therefore any tenet or assertion made on this ethereal basis is simply not[10] acceptable from the legal point of view. Given that this is political, of course, no one is ever certain as to what is meant in any event. What is of concern is that even a Body composed of the

[10] *de jure …*

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fiscal representatives of 27 Members States is unable to define what is meant by "business taxation".

All that the learned experts have done is to set down one undisclosed and undefined method of taxation of corporate business profits, as being the benchmark, and then make an unfounded assertion that the Jersey analysis of business profit as being subject fundamentally to one schedule of income tax rather than another is wrong or improper. That is not a basis for determining unilaterally that the structure of taxing Jersey resident shareholders is any more or less unfair than the structures proposed and currently implemented elsewhere by the Member States in Europe. In other words the Jersey system is being judged against a set of draft concepts in current undisclosed evolution. Extrapolating to the extreme, this may mean that the Commission is seriously[11] considering a turnover based system of corporate taxation rather than what is currently understood to be a business profits tax.

How can the notion of the taxation of 'business' profit be equated with the fact that no Jersey shareholder can claim loss relief within this system? The Jersey resident shareholder is not assessed on "current business income"; neither is the non-resident shareholder. He is assessed on a deemed distribution basis on the net taxable profit available for distribution attributed to him after allowances and loss relief. It is at that point that the income is no longer business income, as the taxpayer concerned, barring an intervention in an AGO, has no effective control or responsibility for what constitutes that profit or a loss. That lies with the directors. Were the assertion at §2 to be applied to the régime applicable to a French *société de personnes*, taxable as these are either on a translucid basis or by option on a corporation tax basis, the total inconsistency and inadequacy of these assertions becomes immediately apparent. Europe should not be further expanded to include witless and irrational assertions of this unsubstantiated type, anathema to western European standards of logic and rationality.

The admission at §3 that the full attribution and deemed distribution rules are an anti-avoidance mechanism – *"to protect the national tax revenues"* - is then promptly forgotten in the following §4.

4. The mechanism is an alternative means of taxing domestic business profits rather than an anti-avoidance measure.

The use of the terms "is" and "alternative" is an abuse of logic and language.

[11] *The fact that the present Tax Commissioner was trained in an ex soviet bloc country might explain this tendency.*

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This is shoddy and unreliable work, and has either been undertaken by an inexperienced analyst, perhaps from the Eastern bloc suffering from a lack of elementary fiscal education as to what is a net profit, or someone with a purely political, rather than legal motivation.

As will be demonstrated later, this statement, if applied to the draft parent subsidiary directive would render the entire EU dividend process 'unlawful", if it is to be law and not mere Hungarian political gerrymandering which is to govern the question.

The remainder of the HLWP's conclusions are therefore based on a false premise. The experts may have flown too close to the midpoint of their heliocentric universe and inadvertently drawn an EU Member State's own domestic system into the debate; France.

To cite Talleyrand's invective during the Congress of Vienna, when describing the Congress' preparatory protocol between the Four Powers, to which the Consilium is beginning to develop a worrying similarity; 'If it means so little, why did you sign it?" [12] The answer lies perhaps in the fact that, as a political, not a legal statement, the Report is to all intents and purposes, meaningless. Why bother to be precise and logical in a matter of fiscal importance?

What is a matter of further concern is that certain lobbyists appear to have had immediate access to the papers, even before the jurisdictions concerned, which would imply that there are members of the ECOFIN, the HLWP, or the Commission's experts who are deliberately leaking confidential documentation to pressure groups for political purposes. This has been previously admitted by one lobbyist in the Press[13], and in effect may mean that the ECOFIN and HLWP political process may now have become one governed by European Institutional law, which could render it void. Mr Murphy appears to have had access to the HWLP paper, *(doc. 6054/11),* before it could be found on the EU website[14]. Jersey Finance have since published it, I understand, to ensure that the debate continues on official, rather than "leaked", therefore unreliable, information.

12 *Also "Il y a une chose plus terrible que la calomnie, c'est la vérité." and "Brevity should not be purchased at the price of accuracy".*
13 *Mr Murphy, Tax Research LLP letter to Jersey Evening Post of 16th December: '.... the European Commission has found that the zero-ten systems of each Crown Dependency (including, implicitly, Guernsey) failed to comply with the code of conduct. This was not a UK decision. I stress, the technical analysis was done by EU staff. I have seen their work and the rulings are unambiguous. They have been adopted by ECOFIN on behalf of the European Commission as a result'. Philip Kermode has denied any leak from the Commission in a letter to the author of 9th March, 2011, and has laid the blame at the doors of the Consilium.*
14 *Dated February 8th, 2011http://www.taxresearch.org.uk/Blog/2011/02/08/zero-ten-is-dead-and-still-jersey-cant-face-the-truth-probably-because-its-too-painful/*

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In an attempt to salvage the situation, in a letter dated 9th March, 2011 to Chambers, Philip Kermode, Director of DG TAXUD, European Commission, confirmed that the Code of Conduct, and therefore, logically, the Report of the High Level Working Party is not a legally binding instrument, but rather a political document with no legal effect or authority. He further confirms that the term "authoritative" as used in this context merely means that the Code of Conduct Report at the end of the Presidency concerned as merely a political document, and only if adopted unanimously constituted a political "obligation" to live up to a "political commitment", which could refer for example to the removal of those features of a régime that have been "assessed as harmful".

In relation to Jersey, Mr Kermode confirms that "Jersey is not part of the EU, however the United Kingdom has committed, within the framework of its constitutional arrangements, to ensure that the principles of the code are applied in its dependent and overseas territories. How the UK enforces this in its dependent and overseas territories is an internal matter between the UK and its dependent and overseas territories. In addition to this, Jersey has unilaterally committed to apply the principles of the Code of Conduct, and to respect the decisions of the Code of Conduct group. How Jersey follows up this unilateral commitment is first and foremost an internal matter for Jersey." *End of citation.*

As Jersey, like the Isle of Man and Guernsey, is not a "dependent and overseas territory" of the United Kingdom, this means that the Island is politically, and by definition legally free to apply the principles of the code and respect the decisions of the Code of Conduct Group. To that extent, Mr Kermode's assertion that Jersey is not part of the EU can be tolerated. However, given the manner in which the initially agreed procedures as to meetings and documentation access have been overridden and, worse, amplified by various politically motivated leakages from ECOFIN, and a complete lack of technical precision in the HLWP report; it is likely that the Island can now content itself with having removed the anti-avoidance provisions which were the object of unsupported criticism from the representatives of certain member states, yet to be identified or for that matter to identify themselves. What remains curious is that one jurisdiction's anti-avoidance rules can be analysed as a member state's "poison" on the basis that they discriminate against residents; already an aspect outside the Code of Conduct political remit.

It has been announced that the EU Commission is facing a Court action by a watchdog body, Corporate Europe Observatory, in relation to its selective 'leakage' of documentation in the trade talks with India concerning the Bi-Lateral Trade Treaty, and it is clear that this executive EU institution is now taking on a political role for which it is structurally ill-suited and outside its legal function and competence. There is no executive control or filtration of lobbyists.

Perhaps it is worthwhile to point out immediately that:

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1. The ECOFIN sub-committee's initial position in 1999 was that zero rate direct taxation was not a problem[15]; and
2. The Deemed Distribution policy currently under review by the Commission is in fact a domestic anti avoidance mechanism destined to stop Jersey residents delocalising their tax base to other jurisdictions, not, as has been mistakenly reported, a form of benefit to non-residents. One Island's anti-avoidance régime is evidently another jurisdiction's poison, which can only be countered by the antidote of correct understanding and comparison with other tax systems, such as the French, within that jurisdictions political purview.
3. None of the Crown Appendages are in a similar financial or legal position in relation to the European Union as Ireland, an EU Member State.
4. Were the Crown Appendages to be forced, politically, and therefore unlawfully to change their tax systems by the United Kingdom to their own economic disadvantage, outside the constitutional position of the Third protocol, thereby surrendering fiscal sovereignty in effect to the United Kingdom; the United Kingdom taxpayer could be called upon to foot the ensuing bill. This has been the case for the Turks & Caicos, a mere associated territory or dependency, with the result that even less capital will come to be managed in the City of London, with a corresponding loss of taxation.

Perhaps the lobbyists concerned should be looking rather to who is benefitting from this discussion and pose the question, is it the United Kingdom? The answer is no, it is France and the less vocal but more influential Germany whose economies are benefitting from the attack on tax information exchange, the savings directive and Zero-ten, not the United Kingdom. The United Kingdom economy benefits from freedom of movement of capital, not from its emasculation by abuse of the fiscal exception to that fundamental freedom to force repatriation of savings.

The position has been changed in that Jersey announced its intention to remove the deemed distribution and attribution rules prior to the ECOFIN meeting of Thursday 17th February, 2011 in order to render Zero-Ten "code compliant", the new quasi-legal buzz word. Obviously the High Level Working Party had not yet "landed", or had insufficient oxygen, and was unable to muster a response to this in time. The ECOFIN meeting was therefore obliged to review a situation with deemed distribution included, which it had no political hesitation in condemning as harmful, again this had to be "political". Given that Jersey had already indicated that it could easily handle the cash-flow implications, the ECOFIN Council were shooting at a target that had already disappeared. Perhaps hurt pride can be soothed by recalling that, as the régime has changed, unless ECOFIN really misbehaves, it is unlikely that its own unconstitutional behaviour will be put before the European Court of Justice as an *abus de pouvoir*. It would be ironic were a

[15] *This position is being reviewed for Ireland, but that is an internal matter to the EU and the Eurozone*

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Union Institution to put HMRC's shallow victory in jeopardy in the VAT *abus de droit* cases, by enabling its administrative antidote, the *abus de pouvoir* procedure to be invoked with equal effect within the Union Law framework against a European institution in the tax field. [16]

It therefore appears that Jersey has succeeded, without the assistance of the United Kingdom, and probably against some bolschiness from labour relics at the Treasury, to maintain Zero-ten as technically compliant, subject to some future anti-avoidance measures being introduced.

The Treaty position on Direct taxation

For the record, the following provisions appear in the Treaty[17]

Article 2

1. When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts.

2. When the Treaties confer on the Union a competence shared with the Member States in a specific area, the Union and the Member States may legislate and adopt legally binding acts in that area. The Member States shall exercise their competence to the extent that the Union has not exercised its competence. The Member States shall again exercise their competence to the extent that the Union has decided to cease exercising its competence.

3. ....

Article 4

1. The Union shall share competence with the Member States where the Treaties confer on it a competence which does not relate to the areas referred to in Articles 3 and 6.

2. Shared competence between the Union and the Member States applies in the following principal areas:

(a) internal market;

(b) social policy, for the aspects defined in this Treaty;

(c) economic, social and territorial cohesion;

(d) agriculture and fisheries, excluding the conservation of marine biological resources;

(e) environment;

(f) consumer protection;

[16] In a letter of 9th March, 2011 addressed to the author, the Commission has admitted

[17] *OJ 30.3.2010 : C 83/47*

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(g) transport;
(h) trans-European networks;
(i) energy
(j) area of freedom, security and justice;
(k) common safety concerns in public health matters, for the aspects defined in this Treaty.

Taxation is not mentioned specifically. Article 4. 2 (c) "economic social and territorial cohesion" would not seem to be the area concerned, as taxation falls outside the scope of the provisions of that section and would therefore be outside an area of shared competence.

To summarise, direct taxation is not a matter of shared competence as it requires unanimous not qualified voting.

Chapter 2 only refers to taxation on goods, i.e. customs duty equivalents.

Article 113 does not legally empower ECOFIN to put its nose into direct taxation.

Article 114 does not apply to fiscal provisions.

Article 115 has been employed by both the Council and the Commission to take initiatives, on a basis agreeable to the Member States, on matters of Direct taxation, provided that they impact on the establishment or functioning of the internal, not the external market.

> *Article 115*
> *(ex Article 94 TEC)*
> *Without prejudice to Article 114, the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.*

The competence of the Council, and therefore by definition ECOFIN, under this article is limited to a Directive, which as has been pointed out to the Commission and the Council

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previously can only be addressed to a Member State and apply within the Internal market, or perhaps in relation to external issues in relation to the Common Customs Tariff or similar issue where the Member States apply a common community provision.

It cannot be employed to address a non-Member State, or one of the Crown Appendages outside the Internal Market.

Neither Jersey, Guernsey nor the Isle of Man is within the scope of the provisions applicable to the United Kingdom Associated or Dependent Territories as defined at Annex II.

Where therefore is the EU "competence" with which the Crown Appendages are being confronted?

There is in fact and legal reality, none. There is no such thing as an "ideal" treaty competence by which an institution can claim and assert a jurisdiction outside its competence. Whilst the Commission is attempting to secure further revenues by creating a common corporate tax base, thereby justifying a further internal resource on a similar basis to VAT, this has always been at best on an absence of worded constitutional or institutional authority, and it has had to rely on economic argument under article 115, as to the correct functioning of the Internal, not any external market to achieve progress in this area. In other words this is a purported n extension of the Council and the Commission's "jurisdiction" whose legal basis is technically questionable, if not false. Fortunately for the European man in the Street, a full scale amendment of the Treaties and an absolute transfer of constitutional competence from the Member States would be necessary to permit that extension.

The argument that the corporate tax base in some manner affects indirectly the functioning of the internal market is an economic one, and is subject to discussion. With the Eurozone there is no doubt that the arguments against depriving Member States of their economic autonomy in relation to corporate taxation are slightly strengthened. However, the gradual erosion of the principle of fiscal and budgetary sovereignty for those States outside the Euro, such as the

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United Kingdom, and therefore outside any Euro fiscal policy in the area of Direct taxation should not go unchallenged.

Even more reason therefore for a Protocol 3 Crown Appendage to retain sovereignty over the basis upon which it gathers its fiscal receipts, the competitiveness of its internal and external economy, and its capacity to issue its own bank notes.

Contrary to certain assertions made recently in the local Jersey press, on the basis of "leaked" confidential papers from the ECOFIN Committee dealing with the political, not the legal, aspects of alleged "unfair" tax competition, the European Union has no legal basis upon which to force an institutional change upon a Crown Appendage[18].

The Member States therefore retain sole Treaty competence for taxation, subject to the provision concerning the Freedom of movement of capital and payments set out at articles 63-65.

> *Article 63*
> *(ex Article 56 TEC)*
> *1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.*
> *2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.*

This is of direct effect, and the Island can rely upon it. A fiscal restriction imposed by a member State, and therefore *a priori* the Union upon transfers in and out of the Union via a third country: Jersey can only be construed as exceptional to this absolute prohibition.

> *Article 64*
> *(ex Article 57 TEC)*
> *1. The provisions of Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the*

[18] *This has been confirmed in the letter from the Commission to Chambers of 9th March, 2011.*

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> *movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets. In respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be 31 December 1999.*
>
> *2. Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other Chapters of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the measures on the movement of capital to or from third countries involving direct investment — including investment in real estate — establishment, the provision of financial services or the admission of securities to capital markets.*
>
> *3. Notwithstanding paragraph 2, only the Council, acting in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries.*

Any step backwards, including a fiscal provision, has to be legislated, not negotiated.

> *Article 65*
>
> *(ex Article 58 TEC)*
>
> *1. The provisions of Article 63 shall be without prejudice to the right of Member States:*
>
> *(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;*
>
> *(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.*
>
> *2. The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with the Treaties.*
>
> *3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63.*

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The ECOFIN sub-committee, and the HWLP, are attempting to obtain by politics that which Member States are not competent to achieve by Treaty, under article 65 (1): in other words legitimising "*arbitrary discrimination or a disguised restriction on the free movement of capital and payments"* in or via a third country.

The EU has no legal, or for that matter political competence whatsoever over the Island's adoption or utilisation of Zero/Ten. Here the distinction between legal competence, by its nature restrictive, and acquisitive political and administrative competence becomes important.

The EU institutions' competence is limited to matters of internal Union taxation[19], and there is no competence under article 115 to for the Council to legislate, as it does not have the necessary power to issue a regulation or a binding decision over the Island. It is outside the scope of its competence. In taxation matters, it can only issue a directive to a Member State under its current Treaty competence[20], as has been shown in the past.

Perhaps the best method of dispatching the opposition to Zero-Ten, from persons who do not pay tax in the Island and who therefore have no democratic standing other than a right to assert an opinion, is to look at the status of the paperwork and documentation upon which ECOFIN and its sub-committee are actually working, and compare these to EU initiatives in relation to taxation in its own Internal market[21].

The basis for this is an ECOFIN Resolution of 1998. This is of no legislative value, and cannot establish a base of competence for anything other than political, not legal, action. Hence the ability of the Sub-Committees created under it to limit publication or circulation of their discussions.

[19] *In matters of direct taxation, Income and Corporation tax are certainly outside the scope of Union competence, and can only be adjusted indirectly, by reference to effect on the Internal market. Until direct taxation is brought into majority voting, and specific Treaty jurisdiction granted over these taxes, the Commission and the Council have only qualified political, not legal power.*
[20] *There is no unwritten Treaty competence available. The Council is a creature, albeit supranational, of a Treaty, and its powers and competence are limited to those expressly given within the scope of that Treaty.*
[21] *Again, I can only refer to publicly available documentation, and not to the confidential working papers, which have been leaked only to lobbyists supporting or encouraging the political position being adopted at ECOFIN.*

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The first and immediate point is that the political Resolution can only address business taxation if it is to remain within its terms. That is the reason why the only reference to shareholder taxation is in effect to parent-subsidiary issues, not where those shareholders are individuals. The deemed distribution rules in Zero-Ten, applicable to individuals therefore fall outside the self-appointed political competence of the Institutions under this resolution.

The preamble to the Resolution, as usual in EU documentary matters, is required to set out its legal status and effect.

The status of the Code of Conduct group is defined by the Conclusions of the Council and the Annex at its meeting of 1st December 1997 on Taxation Policy[22]. There is no Treaty Provision cited as giving legal jurisdiction to the Council or to the Commission in any of the Code of Conduct Committee's documentation. There is an oblique reference, without citing it, to the effect of unfair tax competition on the internal market, perhaps intending that a further Treaty amendment will be necessary to give the Union Institutions greater powers.

This is made abundantly clear in the Annex of the minutes of the Council Meeting, which was already outside strict community competence:

> *"Acknowledging the positive effects of competition and the need to consolidate the competitiveness of the European Union and the Member States at international level, whilst noting that tax competition can also lead to tax measures with harmful effect."*
>
> *"Acknowledging, therefore the need for a code of conduct for* ***business***[23] *taxation designed to curb at harmful tax measures",*
>
> *"Emphasizing that the Code of Conduct is a* ***political***[24] *commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty".*

22 OJ 6.1.98 C 2/2
23 Author's emphasis. No definition of the term business taxation as opposed to personal taxation is given.
24 Author's emphasis.

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In other words, this is an admission that there is **no legal basis** in European Law for the Code of Conduct to be anything except Political[25]. There is no reference to an empowering or legally constitutional article of any of the Treaties. What is more it is limited to business taxation, and should not be concerning itself with the taxation of individuals resident outside the Union.

The United Kingdom, to whom any "competence" would be reserved if it existed, has none "domestically" either, despite the political trumpeting of the left hand of its governing coalition[26].

However, the main key to the issue lies within the following paragraphs of the documentation on the Council's deliberations, to the extent that these are made public.

The Meeting of the ECOFIN Council of 8th June, 2010 on the Code of Conduct (Business Taxation); partially accessible to the Public.

Whilst the Member States are to be commended upon their bond of political understandings, ECOFIN appears to have grasped that the position of the Crown Appendages is outside their normal framework. They are dealt with separately from the Dependent and Associated Territories defined in Annex II which are given specific treatment in the European Treaties. To have done otherwise would have exposed the Council, from whom ECOFIN emanates, to the same degree of embarrassment when the Commission discovered that it had no competence in matters of Taxation to address a Directive to a Crown Appendage. In a way, it is a shame that

[25] *That does not mean that Lobby politics should be tolerated within Institutions supposedly advocating democratic principles: why was the phrase of Thucydides, initially within the Giscard draft for the European Constitution defining democracy removed? "We call it a democracy because power is in the hands of the many, not of a few" .... Recalling Socrates' manner of saving the Delian treasury from sacking by the Alcibiades faction, and the slow rowing of the first trireme sent to sack the Island, overtaken by the second. The parallel is striking. Is the EU seeking to require importation of the third country capital invested via the Island into the City of London into the German or French markets on the false premise that it is being in some manner diverted?*

[26] *Author's opinion: The inability of ennobled United Kingdom politicians to recognise that they have no feodal power over the Island, and its effective small democratic structure is best left to discussion in the Press. The United Kingdom appears incapable of defending its own democratic function in a European context, and is simply deflecting ill-informed criticism onto a smaller jurisdiction. The Bailiwick's institutions work in a disciplined and effective manner, why change them?*

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this was drawn to their attention in a polite and diplomatic manner by the Islands, as the position of the Crown Appendages could have been clarified, if needed, by an action before the European Court of Justice, which would have had to define its lack of Treaty jurisdiction to hear the matter, and would have been required to replace the Council on its proper institutional pedestal.

Paragraph 18 could send shivers down the spine of any constitutional lawyer, were it of any legal significance:

"With respect to Jersey and the Isle of Man, the Group required the Commission Services to prepare an agreed description of these measures, in consultation with the UK."

The Commission is apparently unwilling to allow its papers out, elsewhere than indirectly to a Lobbyist, for fear that its analysis will be analysed and displayed as faulty. On an impartial reading of this, the Papers seem to have been prepared by the Commission and debated without the full agreed reference to and consultation with the Islands. The Island was excluded, in particular, from the Code of Conduct Group meeting of 9th November, 2010 at which the Commission's conclusions were discussed, and the matter referred to the HLWP. The current standard of analysis of the Commission, as "influenced" by its OECD colleagues, or by lobbyists may therefore be below par. It certainly had no scruple in "redrafting" the legislation to fit an as yet undisclosed concept of business taxation rather than as it is, investment income, to suit its own analysis.

The Commission's queries as to differentials of treatment, and here it is the Commission, not the HLWP is based upon an alleged failure to meet three criteria in relation to business taxation:

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

The 0% effective tax rate for Jersey profits was considered to be de jure only available if the Jersey company that realises the profits has non-resident shareholders.

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This is entirely false. The law whether statutory or otherwise states the contrary. The zero-rate applies to companies having shareholders, whether these be resident or non-resident.

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

The Commission was of the opinion that the combination of the 0/10 regime and the deemed distribution and attribution provisions for resident individuals was designed to offer a 0% tax for business profits of foreign investors while ensuring proper taxation of existing domestic business profits and important domestic revenue generators (banks and real estate). Jersey in the view of the Commission had thus protected its domestic tax base against the effects of a 0% of business profits tax and had effectively ringfenced it from the domestic market.

The Commission had misread and miscommunicated the law to the HLWP. The domestic tax base was protected by anti-avoidance measures preventing the use of Jersey companies to shelter undistributed profit from tax.

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

The Commission's view was that the 0% effective tax rate for Jersey companies with non-resident shareholders did not require any substance.

Neither did the application of that rate require any for residents.

These comments are taken from §21 at page 12 of the Chief Minister's report to the States of 17th December, 2010: http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Zero%20Ten%20Corporate%20Tax%20Regime%2020101217.pdf at

Whilst Jersey has been in discussions with the Commission, as mentioned in the Press, these were confidential. The United Kingdom, but not the Islands, was present at the meetings whose

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papers were, apparently, "leaked"[27]. Contrary to the agreement as to procedure reached with the islands, they had not been invited to all the meetings and were excluded from some, as they were also from the technical analyses "leaked" to Lobbyists.[28]

What is also clear is that the Commission was sufficiently insecure in its analysis to need some form of institutionalised comfort from the HLWP, although the HLWP Report was of little technical validity whatsoever.

What is curious is that the main issue of Zero-Ten, that is its equivalence to a method of imputation by a means of total transparency, rather than taxation with credit has been ring-fenced away from paragraphs 29 and 30 of that report, where paragraph 29 holds matters of Inbound profit transfers to the Belgian Presidency and states under paragraph 30 that the question of Outbound transfers cannot be dealt within the Framework of the Code of Conduct. This is being transposed, without being overtly stated, into a question of "competence", whatever that now may be[29]. The following paragraph 31 is not available to the public.

Paragraph 29 should have mentioned Zero-Ten and the Crown Appendages, if it was to retain its internal cohesion and justification. It does not. Jersey does not historically have Double Tax Arrangements enabling its Zero-Ten entities to behave in the manner described by Council by means of withholding tax reductions or exemptions in the State of source. Again the Union, or rather the Commission, is attempting to impose its own policy views and mechanisms upon other fiscal jurisdictions, without accepting that there are other methods, equally if not more valid, of taxing intercompany transfers and shareholders.

27 *The only Code Group meeting at which the Island was invited to be present was that of 23rd September, 2010. The Island was given no further opportunity to update its position in front of the Code of Conduct Group, despite its presence at meetings being a condition precedent of its undertaking to comply with the outcome in 2002. The source of the leaks has yet to be determined. Until the Institutions concerned have managed to conduct their internal policing, this is their responsibility, and they must therefore assume it in an open and democratic manner.*
http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20Zero%20Ten%20Corporate%20Tax%20Regime%2020101217.pdf

28 *The Commission deny being the source of the leaks of their own documentation, and leave this at the door of Ecofin.*

29 *Purely political, one trusts.*

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Zero-Ten is a pragmatic method for a small jurisdiction to manage its tax affairs. Whilst there has been comment passed on what has been falsely categorised as a differential of treatment given to non-residents, this cannot be founded in Law, as the European Treaty expressly authorises this differential under article 65:

> *Article 65*
> *(ex Article 58 TEC)*
> *1. The provisions of Article 63 shall be without prejudice to the right of Member States:*
> *(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;*
> ….

If a Member State is authorised to maintain a differential, it hardly behoves the Commission to behave as if the provision did not exist in relation to one of its Appendages.

It certainly does not justify ECOFIN in rewriting Treaty history in its resolution;

> *When assessing whether such measures are harmful, account should be taken of, inter alia:*
>
> *1. whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents,*
>
> …/…

then applying that "principle" wrongly and out of context, and what is more in contradiction to the principle enunciated as binding on Member States in the Draft Directive on the common system of taxation applicable in the case of parent companies and subsidiaries in different Member States. No advantage is accorded only to non-residents. The zero-rate is applied to all.

What is more the Deemed Distribution policy is in fact an anti-avoidance mechanism, and is of equivalent effect to the régime of taxation of a non-public limited company in an EU jurisdiction; France. The HWLP's assertion that it is not an anti-avoidance provision is no more

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than pedantic sophistry and prevarication, given the contradiction of the assertion made in the preceding paragraph. This begs the question, why are the Member States averse to a separate jurisdiction's anti-avoidance or "revenue protection" mechanisms? It appears that these discriminate against "residents" and thus go against the spirit of business taxation[30]....

Draft Directive on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.[31]

The Preamble to that Draft states:

(2) The objective of this Directive is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company.

(3) The grouping together of companies of different Member States may be necessary in order to create within the Union conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market. Such operations ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States. It is therefore necessary, with respect to such grouping together of companies of different Member States, to provide for tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level.

When taken in comparison to the Institutional position being taken on Zero-Ten, this is express and absolute hypocrisy, double-standards and double dealing. In other words, Lobbyist politics is controlling ECOFIN, not the law.

What is worse, the method available to Member States of integrating Zero-Ten into their domestic fiscal equation is then set out:

*(6) Where a parent company by virtue of its association with its subsidiary receives distributed profits, the State of the parent company must either refrain from taxing such profits, **or tax such profits while authorising the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits**.*

[30] *It remains unlikely that this argument would be accepted in the courts of the member states proposing it, or that the Member State is familiar with English otherwise than as a foreign language.*
[31] *2010/0387 (CNS)*

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The final cherry on the European corporate shareholder's *gateau* follows:

(7) It is furthermore necessary, in order to ensure fiscal neutrality, that the profits which a subsidiary distributes to its parent company be exempt from withholding tax.

Zero-Ten by definition carries no withholding obligation, and what is more no underlying corporate taxation to compensate either by *précomptes* or other artificial credits. Incidentally, Article 7 of the draft enables Member States to continue the practice of re-imbursing the corporate taxation underlying the dividend. This in itself supports the Zero-ten policy. Why should the Island be less free than a Member State to determine its own fiscal policy?

The provisions of the Directive provide for an anti-abuse provision.

2. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.

There can be no fraud[32] or abuse, as the Member State of receipt of dividends will be taxing the amount received, and will have taken measures, such as the French CGI 209B[33] to cover any eventualities. The Zero-Ten domestic arrangement in question is an anti-avoidance provision and should be respected as such.

This taxing provision will be of direct effect; as follows:

Article 4

1. Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the State of the parent company and the State of its permanent establishment shall, except when the subsidiary is liquidated, either:
(a) refrain from taxing such profits; or
(b) tax such profits while authorising the parent company and the permanent establishment to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary, subject to the condition that at each tier a company and its

[32] *Note the differential between the notion of fraud in the common law and fraude within the civil law jurisdictions.*
[33] *In the context of France's territorial system of impôt sur les sociétés.*

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> *lower-tier subsidiary fall within the definitions laid down in Article 2 and meet the requirements provided for in Article 3, up to the limit of the amount of the corresponding tax due.*

The case rests on the Council's own documentation alone. The EU can assimilate Zero-Ten into its overall system without affecting the tax principles regulating the functioning of the internal market.

What is ECOFIN playing at? Politics, or reopening the Congress of Vienna? If it is to do so within its Treaty characteristics, then perhaps it should employ experts, rather than politically motivated individuals in its High Level Working Group and lay down strict sanctions for leakage of confidential documentation with a view to preserving the objectiveness of political debate in a jurisdiction which is linked to the Union.

The Third Protocol to the Act of Accession of the United Kingdom to the Economic Communities of 22nd January, 1972

The answer to that question is in the affirmative: politics. For the reader's benefit the text of the Treaty articles concerning the Island is set out at Annex 1, as it is not available immediately online[34].

The Protocol, apparently simple, is in fact very sophisticated method of assimilating, by exception, a territory, which would otherwise be outside the Union, into certain aspects of the internal market, to the exclusion of others.

I will not address issues concerning Euratom and ECSC here.

[34] *The version used is the 1987 text of Volume II of the Documents concerning the accessions to the European Communities*

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Only one aspect of the Internal Market is specifically addressed: that of the Freedom of movement of goods, and as a consequence the freedom of movement of agricultural goods and the CAP. This inclusion into part of the Internal Market has given rise to a degree of administrative and regulatory understanding between the Island's authorities, those of the United Kingdom and in consequence those of Brussels. It is consistent that only the provisions concerning that part of the now Internal market are introduced by the Protocol into the Island's legal position. In effect, whilst the Competition rules contained in the CAP are specifically mentioned, but it is also clear now that the Island market in goods also can come into the Internal Market for the purposes of goods in relation to the internal EU Competition rules, but as a third territory only in relation to mergers and other similar issues.

Aside the necessary definitions and adaptations of the definition of nationals under the competence of the United Kingdom, this has not changed over time even with the various fundamental EU treaty amendments, saving insofar as Channel Islanders and Manxmen are now European Citizens benefiting from the limited but overriding rights of residence under article 20 et seq of the consolidated Treaty. Further amplification of this right may be expected as article 20's sphere of influence is developed.

The elegantly concise and pragmatic drafting of the Protocol does only what was needed to be done to achieve the limited access required by the Islands from the United Kingdom to the market of goods, and to protect certain European concerns as to the ECSC and Euratom.

The United Kingdom could not commit itself and the Island in the Act of Accession in an area where it had no powers[35]. Hence the exclusion of the appendages from the definition of dependent or associated territories. As it has never had supervision of services, financial services or taxation, it certainly could not commit the Island to the common market in these areas without the Island's constitutional agreement, which has never been given.

[35] *The European Communities were perfectly aware of the constitutional position, dating, in Jersey's case, back to 1066 and to prior to the Constitution of King John of 1204 a.d.*

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Taxation:

The Island is outside the scope of European institutional interference with its direct and indirect taxation jurisdiction, as article 26 (3) (c) of the Act of Accession clearly states.

The Commission, perhaps not having read its text correctly, thought that it would be able to introduce directives to the Channel Islands and the Isle of Man concerning savings and also information exchange, and then had to be reminded that the Directive would find itself holed beneath the waterline between France and the Ecréhos to the Institution's deserved embarrassment. This has led to an effective recognition of the Island's fiscal sovereignty under the EU Treaties, as the provisions of these two internal directives had to be paralleled by internal legislation and regulations in Jersey enabling and permitting the Comptroller of Taxes to adopt them and give independent effect to them.

Here there are two areas of concern.

The Council and the Commission were using serial internal extrapolations from limited competence to justify this unwritten extension of their written Treaty competence, namely:

- The tax exception to the freedom of movement of capital with third countries; and
- The effects of tax avoidance, as they saw it, upon the Internal market.

These issues have been addressed above.

It is therefore clear that the Commission and the Council are aware that their internal law cannot be constitutionally transposed into the Bailiwick without the Bailiwick's agreement as to this exception. In fact, Zero-Ten entirely fulfils any obligation that the Island would have to provide the same par treatment to natural and legal persons of the community, or now Union, under

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article 4[36], were taxation actually to be fully within the competence of the Union Institutions, which it currently is not.

The fact that the Member States are treating the matter and the redefining the concept of corporate and business taxation within a form of extra-legal cabal outside European Institutional competence, and therefore outside the prerogatives of the European Parliament is a matter which should be of more concern to the democratic processes within their own jurisdictions.

What is more, it would be entirely wrong were the Union's institutions to attempt to take a fiscal measure affecting the Islands on the basis of the "safeguard" measures under article 5, as, as is well known, fiscal decisions within the Union can only be taken on a unanimous basis not on the qualified majority basis admitted in the Protocol applying to the market in goods or agricultural goods. Tax is simply outside the arrangements, and therefore outside the scope of article 5, as the VAT régime enjoyed by the Isle of Man with the United Kingdom clearly shows. The United Kingdom "own resources" contribution to the EU budget excepts the Isle of Man's VAT system from being taken into consideration. The Isle of Man chose to introduce its own system of VAT independently, and that has always been maintained outside the United Kingdom VAT budget for Community purposes. Would it not now be curious were the United Kingdom to be required to take the Island's fiscal revenues into consideration in its own future convergence contribution, were income or corporation tax to be included in that Union own resources assessment in the future?

The safeguard measures in article 5 of the Protocol have been admitted to only enable temporary measures of an exceptional, not of a fundamental nature in relation to the internal market in goods and agricultural goods. They certainly do not enable the Commission or the Council to change the arrangements in the Protocol unilaterally, and without democratic consultation.

The Island's manner of implementation of equivalent and enabling provisions to those of the savings directive, and also the information exchange issues, has been clearly that of an

[36] See Annex 1

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independent jurisdiction, taking an international perspective on its position into account, and not as an appendage of the European Union executing an order as to its internal law.

As is clear from the implementation of the Protocol and the Island's respect of its obligations, the Island has implemented Community regulations and similar provision in relation to its obligations and rights under article 1 of the Protocol, with more respect for these than the average Member State, certainly than its main detractor, France.

As to the remaining issues of the Internal Market such as convergence, the Island clearly remains within the scope of its relationship with the United Kingdom, which is one of domestic independence.

The Council Meeting Resolution clearly recognises that the question of the Islands domestic fiscal legislation has had to be placed within the scope of its relationship with the United Kingdom with which it has independence in relation to its internal affairs, including tax. The Council was unable to make any direction or comment to the Channel Islands through the United Kingdom, and rightly abstained from so doing:

The Commission had directed its attention and potential criticism no longer to the actual Zero-ten régime itself, which was initially agreed not be harmful, but merely to the question of whether the deemed distribution system of taxation contains a difference of treatment between residents of the Island, who pay tax on a deemed distribution of profits, similar incidentally to that currently adopted by France in relation to its *sociétés de personnes*, and non-residents, who do not.

For the reasons set out above, it is clear that the Union itself recognises that there is a differential in tax treatment between residents and non-residents within the Union itself. That is the inherent function of the internal fiscal policies adopted by each Member State, the Commission itself is attempting to address this internally, and with little success.

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As it is clear that money has an innate tendency to choose to move through a system with fewer impediments, how come the Commission and the Council are attempting to block off a source of capital coming into London and therefore the EU from outside the Union? At the same time, stating that the competitiveness of the Union's financial markets should not be compromised? Look to France, and Germany its quieter, but equally, if not more directive twin, for the answer.

There is no discrimination against non-residents, under the Jersey Zero-Ten regime. Non-residents have better treatment than that meted out to non-residents within the Union. It is curious that this dual standard is being applied by an institution working in the opposite direction in its own jurisdiction, with Member States who are perfectly capable of enacting draconian measures against their residents to tax this income, without having to give credit for foreign taxation, thereby reducing their tax take. On what rational basis of competence, let alone a Treaty basis is the Union able to argue that because local residents pay tax under an anti-avoidance measure, that that is discriminatory, as against local residents, and therefore an unfair business tax practice within the EU?

The final issue is that, as the deemed distribution rule is an anti avoidance measure relating to the income tax liability of Jersey resident individuals, not corporation tax, it is hard to see how the Commission can uphold a thesis that it is "business" taxation without providing a definition.

Conclusion

Has the Council been given a real idea by the Commission or by the European Parliamentary Lobbyists of how Zero-Ten functions and is it functioning on political prejudice, rather than informed analysis of the actual effect of the deemed distribution issue? The fact that the Islands have had to rejustify a régime which had already been approved by the Commission in 2003 - without the deemed distribution issue -as not being contrary to the notions of fairness, did not dissuade persons bound by a confidentiality rule and undertaking given from ceding to a pressure group with a set of associated "leaks".

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The United Kingdom subsequently approved the Zero-Ten régime with the deemed distribution anti avoidance provision. The United Kingdom cannot now allege that there is any breach of Union law, when the Union has no jurisdiction or competence to pass any. The Council has no jurisdiction to impose its will on a Member State in a matter requiring unanimous voting when the Council has no jurisdiction to act in the first place.

The only suspected "harmful effect" of Zero-ten is a perceived differential of treatment between residents of Jersey, who pay income tax on the deemed amount distributed, and non-residents, who do not pay tax on a deemed distribution, in Jersey. This is no more than an income tax anti-avoidance measure, outside the scope of business and corporation tax and should be treated as such, not transformed into some undisclosed conspiracy to benefit or disadvantage non-resident individuals.

Looked at from a corporate perspective, what the "Lobby" are egging the Commission on to say is that even within the scope of the proposed draft directive on parent subsidiary relations, there has to be a dual standard for offshore jurisdictions. In other words, what is a matter of internal domestic jurisdiction namely whom to tax, is now being subjected to an invented supposedly higher norm, which incidentally is not on the EU's agenda for its own companies.

What no one appears to have grasped within the EU is that the liability in the Island to Income Tax, as transposed historically onto companies, involves taxation of a business activity or trade within the Island. There is no reason why the Island cannot tax foreign companies, if it judges it correct to do so, on trading or business income from a Jersey permanent establishment. That point has not been raised by ECOFIN, which has no jurisdictional or political grounds upon which to criticise. The United Kingdom Treasury has no grounds for complaint as, like the other Member States, it is not required to grant credit for foreign taxes paid in Jersey on distributions of corporate profits: there is no taxation for which unilateral credit is required. This, if anything, is full inbound freedom of movement of capital and payments, without any fiscal impediment

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The Council, through its organ ECOFIN, is in danger of suffering inaccurate and misleading paperwork from the Commission. Given the manner in which the matter is being handled, one could query whether the present Director is attempting to subvert the basis upon which the Crown Appendages are attached to the Union to ensure "protection" of a future Union internal common tax base. It is curious that a jurisdiction which will not join in convergence, such as the United Kingdom, should find itself now being forced to defend an EU convergence "policy" in relation to Corporate taxation and a common tax basis to which it is never going to be subject, for the sole benefit of Germany and France. The United Kingdom, being within an economic model based upon an American capitalist and banking system going global, simply does not share the same economic base and assumptions as those undergirding the Euro, neither does Jersey, a part of the same economic model.

The current proposal is based upon an Eastern European and Germanic thesis which is not a capitalist model with which the United Kingdom economy is familiar. It smacks of a less familiar Marxist economic approach to corporate "taxation", based on allocation by turnover and not profit, which will provide a more stable platform for an extension of European Union Own Resources into Corporate taxation, like VAT. It is not easy to see how deflection of business activity can take place through the Island's Zero-Ten régime in this context, as effectively a third state; that is rather a matter for the Member States themselves.

Why should the Crown Appendages pay further for this, or worse break their word and tax non-residents? Perhaps the Lobby do not understand the substance and meaning of the word "trust", or the concept that the Islands are under an obligation to honour their commitments to the money entrusted to their investment and care? Their assumption that the money in the Channel Islands can only have come from undeclared income is a complete travesty. The French parliament has admitted that it has no idea what, if any, "French" money is actually held in the Islands.

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According to past utterances, the United Kingdom will not necessarily be a party to this convergence base, and, as usual, is side-stepping this issue to the detriment of the Crown Appendages to which it owes a duty to protect under the delegation of the responsibility for their international relationships.

It is therefore essential that the Bailiwick of Jersey and the Isle of Man stand firm on the logic of their domestic system, relying on their unique Treaty and therefore constitutional position, and ensure that the Commission's representatives are correctly informed as to the effect of Zero-Ten, the Island's need to be able to administer its tax affairs in an economic manner, without having to have recourse to the flawed and from its perspective, fiscally and financially obese and now unfashionable EU internal criteria of double taxation with credit[37]. It is curious how, even with the notions of subsidiarity and proportionality in force, the Institutions of the Union appear incapable of enabling or for that matter understanding micro and macro management in smaller economic areas[38]. The Commission should also be made aware of the Island's political will to remain outside any attempts by factions holding influence within the Union to enforce a more totalitarian approach to taxation on its internal affairs.

What is worrying is that Lobby groups are now taking positions as against the European Institutions in a similar manner to those taken before the American Congress and Senate to obtain tax positions which have no basis in a democratic function. This is assisted by the fallacy that the European Parliament is in fact capable of acting as an informed and responsible democratic institution, which remains open to question. It is far too easy for Lobbyists alleging "stakeholdings" and "interest" to spread error as fact within its parliamentary committees, and therefore it remains to be seen whether its attempts to seek jurisdiction outside its geographical and Treaty demographic competence are subject to sufficient safeguards as to representation. Despite the Islands' integration into part of the Union, relating to the freedom of movement of goods, and their authorities' responsibility to ensure par treatment of all EU nationals in areas

[37] *The draft directive cited above is written evidence of this.*
[38] *Their abnegation via the Treaty notion of subsidiarity is evidence of this institutional incapacity.*

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coming within the scope of the Treaty, these have no democratic voices within the European Parliament, and are certainly not treated correctly by British MEPs.

It is clear that once deemed distribution and attribution rules are removed, Zero-Ten is now "compliant", whatever that may "mean"[39]. The Commission have admitted that "the Code of Conduct is based on political commitments. The Code is not a legal instrument." Barring complete pedantry and further obfuscation, there is little hope of ECOFIN salvaging the remnants of an argument to the contrary before their meeting in June.

The HLWP and ECOFIN have shot themselves in all four feet, by assuming that they could force the Island to abdicate its fiscal sovereignty by financial or budgetary means. The argument that the deemed distribution rules discriminated against Island taxpayers, having of course no effect on non-residents, was hardly a serious one. The only *locus standi* that these two august institutions had was that it affected foreigners, not locals. Curious how they were seeking to influence the local political debate to get their way through the Leaks to lobbyists.

The real issue is not Tax: it never has been. It is now one of an attempt to extend EU Institutional legal competence beyond what is permitted by the Treaties, of which the Protocol is and remains the sole "Treaty" source, insofar as the Island is concerned. There is therefore no Union competence, concerning the Island's tax jurisdiction, as the Accession Treaty cannot be modified or extended without the consent of the three jurisdictions concerned. The Commission have admitted this in a letter to the Author of 9th March, 2011.

Is not the issue whether the European Union is attempting, apparently, but not really, under lobbyist pressure to expand the scope of its competence[40], and whether those affected by its extension can retain sufficient independent influence to be able to counter the adverse effects of this expansion? The political issue faced by Europeans now is that the High Level Working Party of the Consilium has managed to convert itself into a quasi-autonomous body, divorced from

39 Talleyrand can grow on you.
40 The term "competence" here includes actual administrative capacity and jurisdiction, not mere political will and "Alcibiades" rhetoric.

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legal logic, responsibility, or for that matter, accountability. Its report is not self-supporting, but circular. That means that there is an undisclosed agenda or principle, outside competence.

That such measures should be proposed without an acceptable and objectively applied definition of business taxation is a sign that the Union Institutions are off the Treaty leash. The English view of a committee is that arguments are sent there to rest in peace. In Europe, it is the opposite; a matter is delegated to a committee to enable an Institution to act outside its legal powers.

Tax is not a question of moral or social principle, it is a matter of state finance, and an exception to the ban on state expropriation, as the European Convention of Human Rights makes perfectly clear. That Convention was implemented to render expropriations of all and sundry in the Second World War, from then on illegal.

That is what has happened here. The result is that the current economic move by Germany and France to extend their capital and industrial base by forced repatriation of savings and capital from other areas within the Union Freedom of movement of capital by means of information exchange and savings directive extension will be used to fund and expand their commercial and industrial presence in Easter Europe, not to honour their commitment to allow capital to flow freely to other European states such as Greece Ireland Portugal and Spain.

The German Landerbanks, undercapitalised under Basle III, and, conveniently, outside mainstream European constitutional supervision, are simply lending money they have "borrowed" via the fiscal exception to Freedom of movement of capital cheaply back to these countries at a usurious rate of interest. The Savings Directive and information exchange are Germanic initiatives. Sound familiar in the context of the so-called German auto-financing of reunification? It certainly is not the economic "efficiency" written into the Economic Union. Follow the working capital movements and the reasons for these European Union fiscal initiatives become clearer. The rest of Europe is now paying for German reunification by refinancing it, and also the consequent German expansion into its previously coveted economic

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hinterland. It will not take long for the Germans and the French to go to a two-level Union in order to leave other European States behind, having bled them of the working capital to which the Treaty entitles them. Whilst Spain may have benefitted from French and German industrial investment in the 1970s and 1980s, the tendency has been to go east since the 1990s.

It is essential that the United Kingdom and the City keep its supremacy as a financial centre with influence in Eastern Europe by resisting these moves and putting unfounded European accusations of financial misfeasance in their real economic and political perspective, that of misrepresentative "gerrymandering".

The recent announcement that Germany is following France's lead in the area of fiscal discipline and a Europe on two levels should come as no surprise. Germany has always got France to take the initiative and then appear to change its mind to agree in due course. The problem is that for the rest of Europe, Germany has repatriated and absorbed more than its treaty share of total European working capital by savings directive manipulation and supposedly ethical tax information disclosure for its own expansion, not for the common European good. The Parliament and Consilium, assisted by the Commission, have chosen the path of effectively reinstating the territories that used to comprise the Holy Roman Empire. Those in the western areas of Europe may not necessarily be invited to join in, on the terms of the Union as its stands.

Fortunately, this subsidised "extension" into an Eastern bloc previously under soviet influence is being achieved without the usual war, at least as yet. It is perhaps inevitable that Germany and France should see the eastern areas of Europe as being areas into which economic expansion is permissible. This is but a continuation of history, or perhaps the Congress of Vienna being rewritten and extended,[41] without the inconvenient notions of independent sovereignty introduced by the mechanism of the Treaty of Westphalia and the Congress itself being respected. The question is whether it is up to the Appendages to subsidise it or not by suffering an unwarranted intrusion into their own affairs, rather than be allowed to continue to provide

[41] A comparison of the economics of the Treaty of Westphalia, the Congress of Vienna and the current position would be interesting, if only to isolate the gerrymandering taking place at present.

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the foreign capital from outside the Union to fund its capital requirements, on a zero-rate system.

The Union's non-lawful prejudices are not functioning to forward its own interests, but rather those of a minority within it. "If it meant so little, then why did you sign it"?

Peter Harris

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Annex 1

Provisions concerning the Bailiwick of Jersey contained in the Act of Accession of the United Kingdom of 22nd January, 1972

Article 25[42]

The following paragraph shall be added after the first paragraph of Article 79 of the ECSC Treaty:

'Notwithstanding the preceding paragraph:

(a) …..

(b) This Treaty shall not apply to the Sovereign Base Areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus.

(c) This Treaty shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Council decision of 22 January 1972 concerning the accession of new Member States to the European Coal and Steel Community.'

Article 26

1.[43] The following shall be substituted for Article 227 (1) of the EEC Treaty:

[42] *Text as amended by Article 14 of the Adaptation Decision.*
[43] *Paragraph (I) as amended by Article 15 (1) of the Adaptation Decision*

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'1. This Treaty shall apply to the Kingdom of Belgium, the Kingdom of Denmark, the Federal Republic of Germany, the French Republic, Ireland, the Italian Republic, the Grand Duchy of Luxembourg, the Kingdom of the Netherlands and the United Kingdom of Great Britain and Northern Ireland.'

2. The following subparagraph shall be added to Article 227 (3) of the EEC Treaty:

'This Treaty shall not apply to those overseas countries and territories having special relations with the United Kingdom of Great Britain and Northern Ireland which are not included in the aforementioned list.'

3.[44] The following paragraph shall be added to Article 227 of the EEC Treaty:

'5. Notwithstanding the preceding paragraphs:

(a) This Treaty shall not apply to the Faroe Islands…………

(b) This Treaty shall not apply to the Sovereign Base Areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus.

(c) This Treaty shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Treaty concerning the accession of new Member States to the European Economic Community and to the European Atomic Energy Community signed on 22 January 1972.'

Article 27[45]

[44] *Paragraph (3) as amended by Article 15 (2) of the Adaptation Decision.*

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The following paragraph shall be added to Article 198 of the Euratom Treaty:

'Notwithstanding the previous paragraphs:

(a) This Treaty shall not apply to the Faroe Islands……

(b) This Treaty shall not apply to the Sovereign Base Areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus.

(c) This Treaty shall not apply to those overseas countries and territories having special relations with the United Kingdom of Great Britain and Northern Ireland which are not listed in Annex IV to the Treaty establishing the European Economic Community.

(d) This Treaty shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Treaty concerning the accession of new Member States to the European Economic Community and to the European Atomic Energy Community signed on 22 January 1972.'

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Protocol No 3 [46]

on the Channel Islands and the Isle of Man

[45] Text as amended by Article 16 of the Adaptation Decision
[46] The Third Protocol to the Act of Accession of the United Kingdom of 22 January 1972

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Article I

1. The Community rules on customs matters and quantitative restrictions, in particular those of the Act of Accession, shall apply to the Channel Islands and the Isle of Man under the same conditions as they apply to the United Kingdom. In particular, customs duties and charges having equivalent effect between those territories and the Community as originally constituted and between those territories and the new Member States shall be progressively reduced in accordance with the timetable laid down in Articles 32 and 36 of the Act of Accession. The Common Customs Tariff and the ECSC unified tariff shall be progressively applied in accordance with the timetable laid down in Articles 39 and 59 of the Act of Accession, and account being taken of Articles 109, 110 and 119 of that Act.

2. In respect of agricultural products and products processed therefrom which are the subject of a special trade regime, the levies and other import measures laid down in Community rules and applicable by the United Kingdom shall be applied to third countries.

Such provisions of Community rules, in particular those of the Act of Accession, as are necessary to allow free movement and observance of normal conditions of competition in trade in these products shall also be applicable.

The Council, acting by a qualified majority on a proposal from the Commission, shall determine the conditions under which the provisions referred to in the preceding subparagraphs shall be applicable to these territories.

Article 2

The rights enjoyed by Channel Islanders or Manxmen in the United Kingdom shall not be affected by the Act of Accession. However, such persons shall not benefit from Community provisions relating to the free movement of persons and services.

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Article 3

The provisions of the Euratom Treaty applicable to persons or undertakings within the meaning of Article 196 of that Treaty shall apply to those persons or undertakings when they are established in the aforementioned territories.

Article 4

The authorities of these territories shall apply the same treatment to all natural and legal persons of the Community.

Article 5

If, during the application of the arrangements defined in this Protocol, difficulties appear on either side in relations between the Community and these territories, the Commission shall without delay propose to the Council such safeguard measures as it believes necessary, specifying their terms and conditions of application.

The Council shall act by a qualified majority within one month.

Article 6[47]

[47] EU EDITORIAL NOTE: *See in this connection the 'Declaration by the Government of the United Kingdom of Great Britain and Northern Ireland on the definition of the term "nationals",' reproduced on p. 103 of this volume.*

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.../...

In this Protocol, Channel Islander or Manxman shall mean any citizen of the United Kingdom and Colonies who holds that citizenship by virtue of the fact that he, a parent or grandparent was born, adopted, naturalized or registered in the island in question; but such a person shall not for this purpose be regarded as a Channel Islander or Manxman if he, a parent or a grandparent was born, adopted, naturalized or registered in the United Kingdom. Nor shall he be so regarded if he has at any time been ordinarily resident in the United Kingdom for five years.

The administrative arrangements necessary to identify these persons will be notified to the Commission.

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Declaration[48]

by the Government of the United Kingdom of Great Britain and Northern Ireland on the
definition of the term 'nationals'

In view of the entry into force of the British Nationality Act 1981, the Government of the United Kingdom of Great Britain and Northern Ireland makes the following Declaration which will replace, as from 1 January 1983, that made at the time of signature of the Treaty of Accession by the United Kingdom to the European Communities:

'As to the United Kingdom of Great Britain and Northern Ireland, the terms "nationals", "nationals of Member States" or "nationals of Member States and overseas countries and territories" wherever used in the Treaty establishing the European Economic Community, the Treaty establishing the European Atomic Energy Community or the Treaty establishing the European Coal and Steel Community or in any of the Community acts deriving from those Treaties, are to be understood to refer to:

[48] *EU EDITORIAL NOTE: This Declaration which appears in the OJ of the EC No C 23 of 28 January 1983 has replaced, from 1 January 1983, that which was made at the time of signature of the Treaty concerning the accession of the United Kingdom of Great Britain and Northern Ireland to the European Communities.*

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14th March, 2011

.../...

(a) British citizens;

(b) persons who are British subjects by virtue of Part IV of the British Nationality Act 1981 and who have the right of abode in the United Kingdom and are therefore exempt from United Kingdom immigration control;

(c) British Dependent Territories citizens who acquire their citizenship from a connection with Gibraltar.'

The reference in Article 6 of the third Protocol to the Act of Accession of 22 January 1972, on the Channel Islands and the Isle of Man, to 'any citizen of the United Kingdom and Colonies' is to be understood as referring to 'any British citizen'.

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