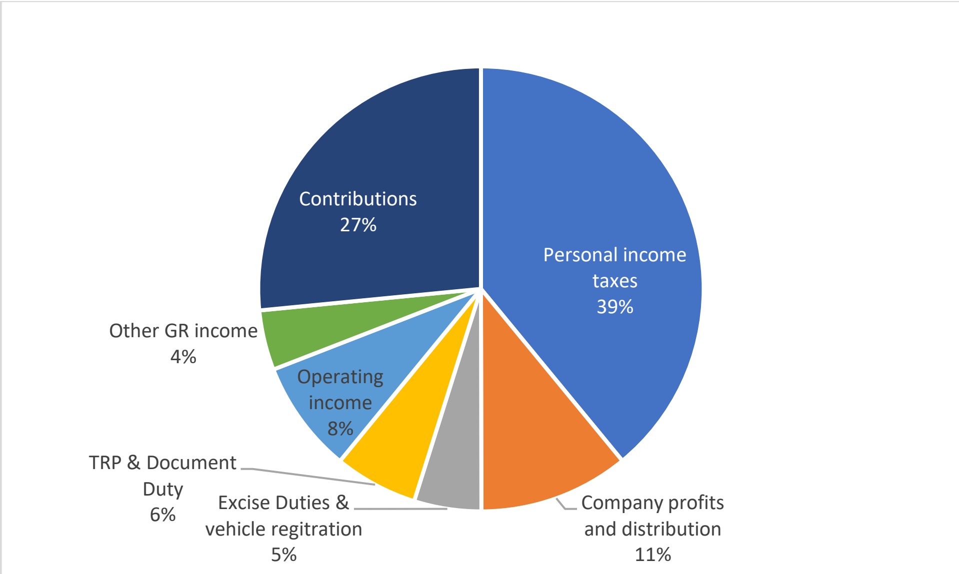
Why not just increase income tax?

A brief comparison of the progressive model against an income only based alternative

Guernsey's tax base is already very focused on taxes on income, which account for about 2/3rds of government revenues, including both social security and personal income tax.

Sources of States' Revenue (2023)

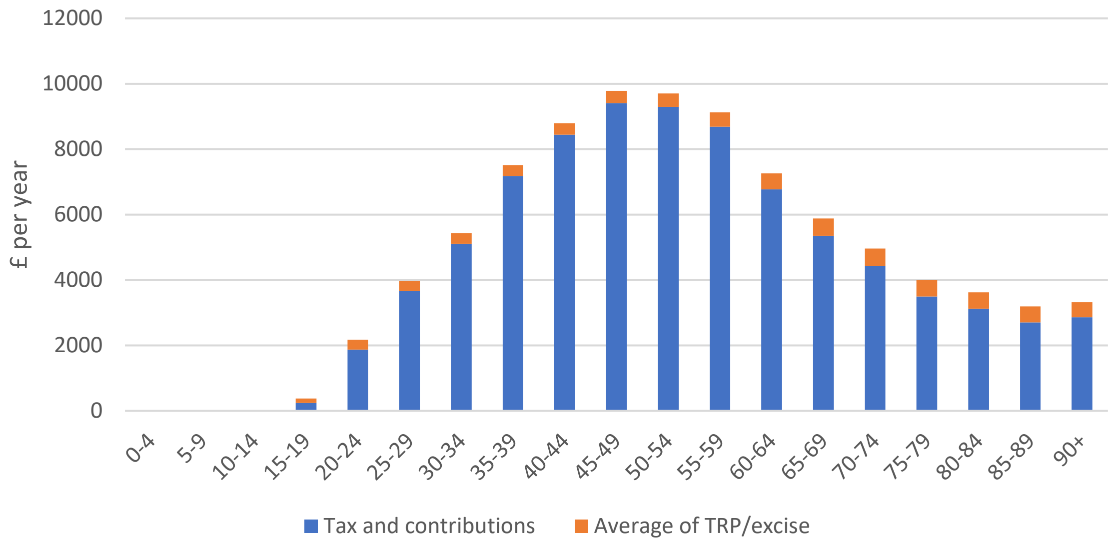


Income varies significantly throughout people's lifetime, generally beginning to earn sufficient income to pay tax in their early twenties and, on average, peaking in their mid-40s and 50s. Beyond about 55 average income generally starts to decline – this may be because they may have paid off their mortgage or inherited wealth so they can afford to work less.

Once people retire, they generally have less income but also less housing expenses (unless they are in the minority of pensioners in privately rented accommodation). They also frequently have capital resources, such as the lump sum from a pension which don't attract income tax.

This means that the revenues generated in Guernsey are focused on a relatively narrow portion of the population of middle age and of middle to high income. If we continue to raise revenues in the same way, we intensify the focus of taxes on this group, gaining the most additional revenue from those who are already contributing the most.

Estimated average annual tax paid by age group



This also makes us particularly vulnerable to shocks which might impact our labour market, since if we lose employment, we also lose a large proportion of the tax revenue we generate.

Consumption also varies through people's lives but not as much as income. While for many people what they spend and what they earn are similar, for others they are not. By adding a form of consumption tax to the tax base we spread the load and we can gain a greater contribution from those who support their spending with accumulated wealth – for example where people have retired early and have a generous lump-sum, or where they have inherited wealth or sold an asset. It also collects a contribution from visitors to Guernsey who currently make very little contribution to the tax base.

Spreading the load differently not only means we are not focussing all revenue raising on the same group of people, but also makes Guernsey's revenues more resilient to things like demographic change and economic shocks, since consumption taxes and income taxes often behave differently in response to economic stress.

The analysis below compares the package of measures presented in the Funding & Investment Plan, with an alternative solution which raises approximately the same amount of income but using only increases in income tax and social security rates.

The progressive package includes:

- A £600 increase in the personal tax allowance;
- The introduction of a 15% rate of tax on income up to £30,000;
- The increase in the allowance available on social security contributions for employed and self-employed people to the same level as the income tax allowance;
- A 1.5% increase in the rate of contributions charged for employees above the 2023 rate, a 2.9% increase in the contribution rate for self-employed (which includes a contribution as their own employer) and a 0.4% increase in the rate for pensioners;
- A 1.2% increase in the employer contribution rate and a 2% rate on employer contributions for employee earnings between £168k and £250k;
- A 5% GST on the majority of goods and services excluding rents and mortgages (or 6% if food is zero rated);

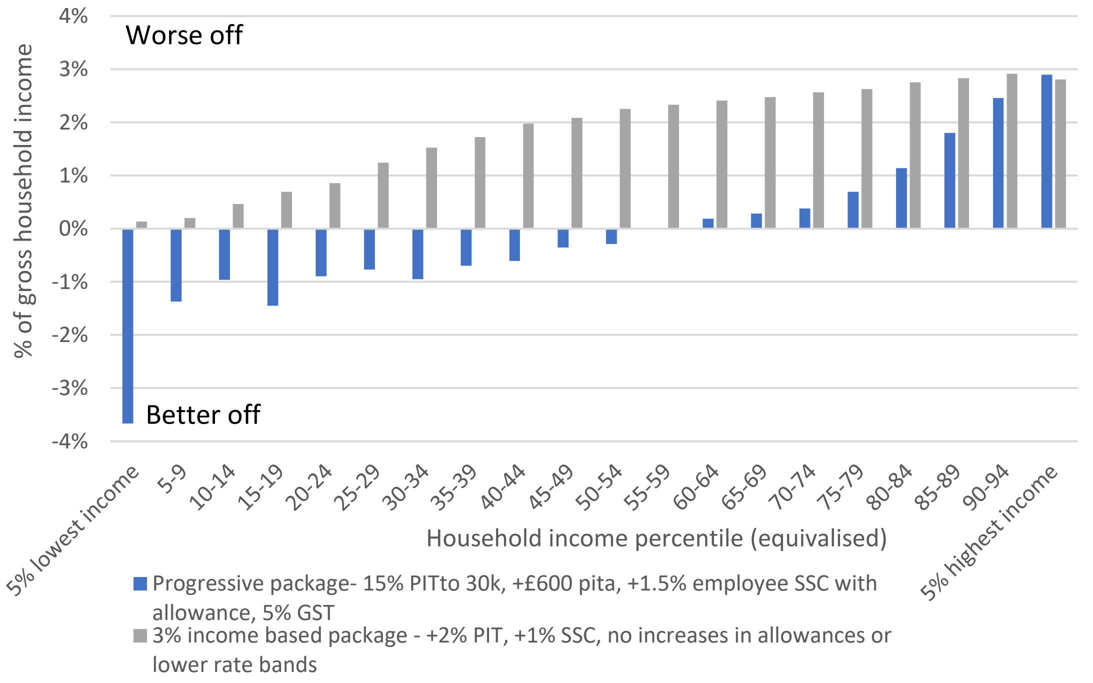
- An increase to pensions and benefits to allow for a 3.4% impact on inflation;
- A cost support scheme to help low-income families not on income support;
- Estimates revenues from an International services entities scheme which applies fixed fees for zero-rated finance sector activities of about £8m; and
- Estimates of about £7m of revenue from tourist spend.
- **This package raises about £56m after netting off costs.**

The equivalent 3% income-based package includes:

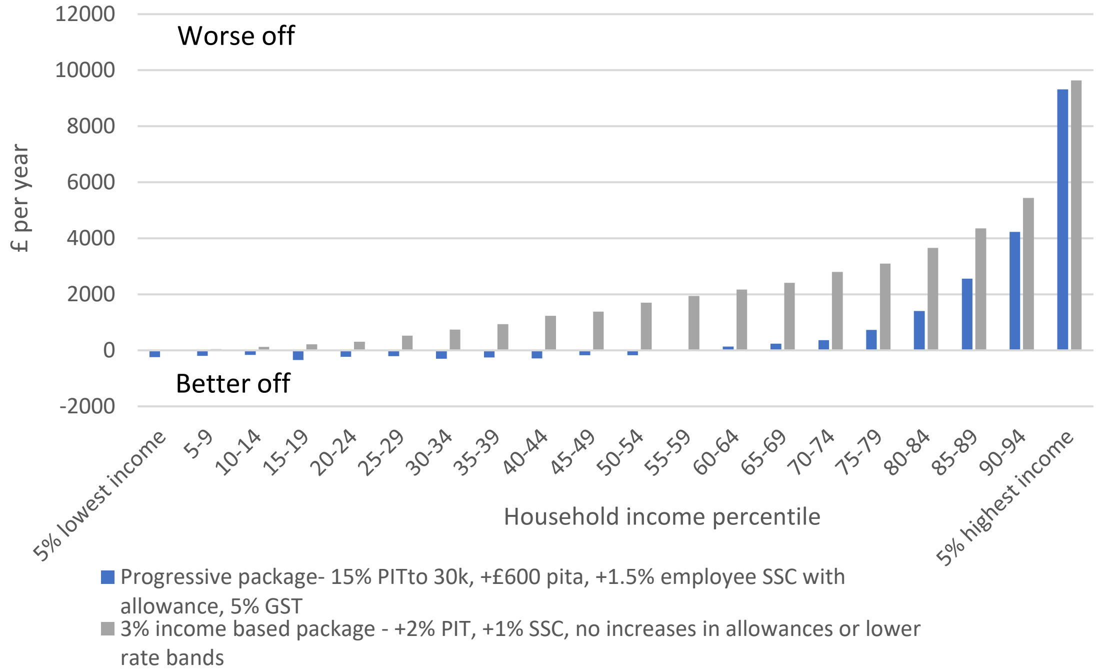
- A 2% increase in income tax;
- A 1% increase in employee social security contributions, a 1.8% increase in the contribution rate for self employed and a 0.2% increase in the contribution rate for pensioners;
- A 0.8% increase in the employer contribution rate (as agreed in principle Oct 2021);
- No increase in allowances on either personal income tax or social security contributions;
- No lower rate tax band; and
- No adjustments to pensions and benefits.
- **This package raises about £60m.**

In the absence of the estimated £15m of income generated from the GST ISE scheme and GST on visitor spend, this model has a heavier burden on local households. In addition, without the measures that might reduce the income tax and social security liability for low- and middle-income households, a model which focuses only on income-based tax measures is substantially worse for most people.

Estimated average impact on household net contribution as % of gross household income (vs 2021)



Estimated average impact on household net contribution in £ per year (vs 2021)



The progressive package will reduce the dependence on Income Tax and Social Security Contributions from 66% of the total tax to around 58%. By contrast, the income-based package will continue to have a contribution of around 66% from personal taxes on income. Such a package therefore does not diversify the tax base or reduce the impact to States' revenues to labour market shocks.

Estimated distribution of tax revenues (inclusive of other F&IP measures - £10m annual vehicle taxes £15m corporate tax)