

## **ISLE OF MAN BUDGET 2004**

### **TREASURY MINISTER'S SPEECH**

**17<sup>th</sup> February 2004**

#### **“ On Course to Deliver”**

Mr. President,

In 2002, I had the privilege of standing before this Honourable Court to deliver my first budget speech. The theme of the speech and indeed the budget as a whole, was “The Isle of Man – Open for Business”. I identified that a natural restructuring process was commencing within our economy and I gave notice that the Government would do everything in its power to ensure that businesses on the Island could remain competitive and continue to provide the economic prosperity upon which we all depend.

Last year, I spoke of the need to sustain our success in the face of these changing times, and looked forward to consolidating upon the spectacular gains that we had achieved during the past decade. My priorities were to ensure that we remained competitive within an international marketplace, a marketplace in which new rivals could emerge from anywhere around the globe and impact upon our ability to maintain our current standards of living and the high quality public services to which we are all committed.

However, in so doing, we needed to remember the social needs of all our citizens, especially those who are, for various reasons, unable to directly participate in the benefits that have flowed as a result of our robust economic performance. The introduction of the Personal Credit Allowance delivered a personal commitment on my behalf – a commitment that I was delighted to honour.

2003 has been another extremely busy year for the Isle of Man on the international stage. We have successfully reached agreements with the European Union in respect of the Code of Conduct; we are nearing completion of our Model Agreement over the Savings Directive, which will be based upon the transitional withholding tax measure; we continue to be involved with the OECD and in particular, seeking to achieve that mythical level playing field.

We have received confirmation of our Triple A credit rating from both Standard and Poors and Moody's rating agencies, providing further evidence of the esteem in which our finances are viewed externally.

The report of the IMF was finally received and provided the Island with further cause for satisfaction as our regulatory regime was given a clean bill of health and our reputation as a jurisdiction of the highest standing was confirmed.

In view of the fact that we now comply fully with international standards of regulation, I believe it is important that we do not introduce any further enhancements of our regulatory framework in advance of our competitors.

I am aware of the uncertainties that these external issues have created, but we have emerged with our reputation enhanced and able to see with greater clarity the way ahead. As a result, we can now reinforce the Island as a highly competitive, well regulated jurisdiction, that knows where its future lies and is now positioned to grasp the many opportunities that the future will present.

For 2004, my message is quite simple. We are on course to deliver. While the course we have charted has not been devoid of challenges, we have remained true to our beliefs. We have made significant progress with the implementation of our revised tax strategy and I will announce further progress during this speech. Our predictions in respect of economic changes have proved accurate and again, I will return to this issue later.

As was the case last year, the allocation of funding to individual departments has been agreed following the examination of business priorities by the Council of Ministers. Task Teams, comprising senior officers drawn from all areas of Government, have critically reviewed each other's proposals and challenged areas of uncertainty to ensure such plans are robust. This process continues to evolve and carries a significant weight of responsibility to ensure overall spending targets are not exceeded.

Providing we remain vigilant and alert to the influences, both external and internal, to which we are subjected in our position as an international business centre, I remain confident that we will deliver the objectives that we have set and that the Island's economy will emerge from this transitional phase in an extremely sound condition.

In 2004-05, our economy is set to grow at a rate of 4.5% in real terms, a figure that exceeds the expectations of most other countries. We have a capital programme that will continue to afford work to many, full employment continues in all sectors, our Triple A credit rating reflects our strong finances and as a result of these factors, I am able to make further provision to assist the well-being of many of our citizens, especially those in the lower income brackets.

However, as I have stated in previous speeches, we will never spend more than we earn and we will always differentiate between income that is of a "one-off" nature and that which is recurring annually. In this manner, we will continue to develop the economy on sound foundations and thereby ensure long term stability for our Island and all of its residents.

I turn now to the economic outlook for the forthcoming twelve months and in particular those factors that I believe will impact upon our expenditure, taxation and other plans.

Despite the growth that we have witnessed in our own economy, the world economy has been in a decline that commenced in 2000 and which was deepened by the events of September 11th 2001 and their aftermath. We have seen some slowdown in our own growth rates in the last couple of years in comparison with the unsustainable increases of the late nineties. To a large extent this has been an outcome of the global recession, so any global upturn should affect us positively in the years ahead.

Growth in the Isle of Man in 2001-02 was 5.4% in real terms, similar to the previous year. I am forecasting annual real term growth to be 3.5% in the current year and 4.5% in 2004-05, increasing thereafter to 5.5%. While these rates of economic growth may seem modest to those with short memories, they still represent an excellent economic performance in comparison to longer term statistics. They will enable us to maintain full employment and would represent an extremely sound economic performance.

However, it is essential to remember that in the current climate of changes to our taxation regime, increases in future economic growth will not necessarily directly result in increases to Government revenues. However, the creation of economic wealth by those who offer employment will provide a greater value to Government than short-term direct tax receipts. I cannot stress too strongly how fundamental these changes remain to our long term goal and I will return to the issue of our taxation strategy later in this speech.

As economic recovery gathers momentum it is often the case that inflationary pressures rise. Inflation in the Island has fortunately not been a major problem in recent years, as annual price inflation has been at or below 4 % for the past 11 years. Latest estimates of inflation are that it has averaged approximately 3.1% over the past 12 months. I am forecasting RPI inflation generally to remain in the region of 3 % over the next three years, although rising interest rates (and hence mortgage and other loan repayments) may put this under pressure during the course of the next year.

I would hope that such benign consumer price inflation will be taken on board in wage negotiations for it is critical that we retain the competitiveness of our economy. It is of some concern that average earnings on the Island increased at a rate well in excess of inflation in 2003 and significantly higher than the rate of the increase in our economic output.

I have also noted with concern the job losses, principally within the finance sector, which have been announced within the past 12 months. Whilst unemployment has risen, it has not increased substantially, as many recent arrivals have elected to return to their previous domiciles, rather than attempt to seek alternative employment on the Island. This factor, along with the existing number of job vacancies has ensured that the unemployment rate remains at its current level of 1 %, out of a total workforce of well in excess of 40,000. Government is committed to seeking to maintain full employment, and

this objective is a key driver in formulating our future strategies to develop and to diversify the economy.

The ongoing development of the economy is the subject matter of the review of the Island's Economic Strategy currently being discussed within Government. The interim report on the review was received by Tynwald in October 2003 and it is hoped that a final report will be before this Court in June.

Essentially, the review is concentrating on the means by which the Island can continue to develop, generate wealth and thereby reap the benefits of economic growth whilst at the same time minimising the downsides to expansion. It focuses on development in areas that produce greater output per head of the labour force and of a kind which puts less additional pressure on the labour market. It also considers the means by which we can sustain our development with less reliance on imported labour. This means that the Island should face reduced pressure to be continually investing in new housing, new schools and other elements of the infrastructure.

By placing an increasing emphasis on the training of our indigenous population, it will be possible to ensure that they are well placed to take advantage of the increased number of well paid jobs that a more highly developed economy is able to provide.

We have heard a great deal about the need to achieve a level playing field, in economic terms, with our competitors. However, we must always remember that if a true level playing field is ever achieved, the successful jurisdictions will be those with the highest possible levels of professionalism, innovation and skills base.

The quality of our workforce is the key to our future success. The need for improved training and retraining is fundamental to our economic strategy.

Training courses that can now be offered to Manx students through facilities such as the Isle of Man College and the International Business School are growing, both in terms of diversity and academic significance and I would urge both employers and employees to maximise their use of the cost effective training opportunities afforded by these institutions.

Recent initiatives within the Department of Trade and Industry have been consistent with our economic objectives and I am greatly heartened by the encouraging news that is emanating from this Department. I am advised that there is currently a potential for up to 150 new jobs in the manufacturing sector that have arisen as a result of enquiries generated since the modified taxation strategy was announced.

Significant additional funds are being made available to the DTI to further key initiatives aimed at delivering future economic success and providing our people with employment opportunities. £250,000 is to be spent in developing a Vocational Training Strategy and further funds have been set aside to support the DTI's Business Support Scheme that assists small businesses with IT, marketing and other key business requirements.

It has been my view for some time that the DTI should be extending its activities to include the training requirements of the finance sector and I am pleased to announce that the DTI will be commissioning and funding new training programmes tailored to assist in key areas such as Financial Services and management development, in addition to the range of traditional occupations that the DTI currently has within its remit.

The small business Start Up Scheme has so far supported over 100 businesses and I am pleased to report that the current Treasury receipts generated as a result of this expenditure now exceed the one-off support originally provided by the DTI.

Our policy of diversification continues to bear fruit and alongside the highly respected shipping register that has grown substantially during the past few years, funds have been made available to the DTI to produce a detailed evaluation of the merits of establishing an aircraft register. I have alluded to this matter in previous speeches and am more than pleased to see progress being achieved.

It is our belief that the trend for some categories of clerical and similar jobs to migrate to less well-developed economies will continue over time and that the Island's economic progress will accelerate such a process. I am acutely aware of the potential hardships created by the loss of employment, and I wish to do all that is possible to ensure that short term job losses are not necessarily detrimental to the longer term aspirations of our citizens.

It is my wish that steps continue to be taken to ensure that the new jobs that are being created can be filled by today's students or by the re-training of the existing workforce, thereby maximising employment prospects for current and future generations of Manx people.

The Budget, alongside the Government Plan, is consistent with the objectives of this evolving economic strategy. I look forward to the strategy being accepted by this Honourable Court upon its return later this year and I will continue to use future Budgets to further address and progress the various elements of the issues raised.

I turn now to issues relating to public expenditure.

Honourable Members will recall that I have historically criticised the capital programme as being too large and failing to deliver the planned levels of work. Therefore, it gives me a great deal of satisfaction to announce that the percentage of our Capital Programme actually spent in 2003-4 has been better than in previous years, despite the large carry forwards at the end of 2002-3 and I congratulate those who have contributed to this improvement. Our current forecast is for Capital Spending for the current year to be in excess of £100 million for the first time in our history, compared to an original budget of £104 million, a probable delivery of 97% of the estimated spend.

However, this statistic tends to hide some less palatable features of the capital programme - namely that prior to coming before this Honourable Court for formal approval, too many projects continue to exceed their original estimates, either in terms of capital cost or ongoing revenue consequences.

The need for robust and detailed business cases in support of capital expenditure has never been greater and I will be taking further steps to ensure that Treasury officers challenge all new and ongoing capital projects, prior to their inclusion within the capital programme, to ensure that they remain focussed on delivering the maximum benefit at the optimum cost.

Honourable Members will be aware that we have published the next three years' Capital Expenditure, in order to link the Capital Programme to the three-year business planning cycle. While items of new Capital Expenditure for years four and five have been identified, these will not progress into the three-year programme until the appropriate business cases have been provided. In this way, it is hoped that increased discipline will be placed on Departments to properly plan and develop capital items, thereby helping to ensure that such schemes do not result in a requirement for additional unplanned capital funding or increased annual revenue budgets.

Although we are able to afford a Capital Programme of some £98 million in 2004-05 without recourse to external borrowing, it remains my opinion that this figure will need to reduce in future years, although this will be balanced against our need to maintain the viability of the construction industry.

Assistance to the construction industry is contained within Government's substantial commitment to provide new housing for our residents. Such schemes include the continuation of the schemes at Red Gap and Westmoreland Road and refurbishment of the Janet's Corner and Pulrose Estates and will account for some £39 million in total. The redevelopment of the Lezayre Housing Estate at a total cost of £27.3 million and the investment in public housing at Jurby are further examples of Government's commitment to the housing issue.

For those who continue to experience difficulties in securing affordable housing, the continuation of the House Purchase Assistance Scheme will provide opportunities that would otherwise not be possible. I would like to congratulate the Minister for Local Government and the Environment for her achievements in this sector and look forward to her comments on this topic in due course.

Within Education there are numerous schemes within the capital programme that will significantly enhance both the capacity and quality of our primary and secondary

educational facilities. Over the next five years some £49 million has been identified as proposed expenditure on capital schemes.

We are currently experiencing a significant peak in the numbers of students passing through our secondary schools and I am aware of the tremendous efforts made by the Department of Education and its teaching staff to cater for this situation.

The long overdue replacement for the Victoria Road Prison moves ever nearer, and it is intended that construction works will commence at Jurby in the near future, at a cost of over £35 million. Other infrastructure developments at Jurby have also moved forward during the past year and I will look forward to the continuing stimulation of economic activity in this area.

I now turn to matters relating to Revenue Expenditure.

As in previous years, it has been Treasury policy not to commit one-off receipts to ongoing revenue expenditure, and I am therefore in the fortunate position to report a probable surplus of £27.7million for 2003-4, and an estimated surplus of £10.6million in 2004-05.

This larger than expected surplus in the current year arose predominantly as a result of higher than anticipated indirect taxation receipts arising from the Decennial Test and the revenues raised by a new team of Customs and Excise officers appointed as a result of my initiative to ensure that all taxation receipts due to Treasury were collected.

This latter exercise produced in excess of £6 million of additional receipts, largely as a result of the increased scrutiny of those non-resident businesses who undertake work in the construction industry on the Isle of Man. The increase in the importance of these activities has been fuelled by the availability of the 5% rate of VAT on building works. On that subject I am more than pleased that this reduced rate trial period for labour intensive services has been extended for a further two years, to December 2005.

In 2004-05 it is estimated that net revenue expenditure will rise to **£448.3** million, an increase of **£30.7** million or **7.3%** in comparison to the current year's estimate. It is a sobering thought that this increase, although still substantial, is the lowest in percentage terms since 1997-98, thereby illustrating the huge investment in public services that we have made in recent times!

Of this significant amount, over £21 million is required simply to maintain public services on a par with the previous year. On top of this sum, I have added an additional £9 million of "new" money to enable further enhancements to public services and other Government expenditure to take place.

It remains this Government's policy that any increase in net revenue expenditure should not exceed forecasts of economic growth, and the estimates for 2005-6 have been adjusted to ensure that net spending remains within this overall control. However, as I stated earlier, we have to ensure that increases in expenditure do not exceed additional income, as it is quite feasible that increases in revenue arising from such growth factors may take some time to accrue.

My determination to reduce the levels of year on year increases in annual revenue expenditure is reflected in the estimates for future years. Spending increases are planned to be **6%** in 2005-6 and **5%** in 2006-7, the lowest for a decade, clearly showing our resolve to maintain public expenditure at affordable levels.

Keeping public spending under control is a constant challenge, and with large parts of any annual increase in spending taken up by pay awards, inflationary increases to benefits, and repayment of loan charges, there is often relatively little left to award in additional spending. Going forward we must become even better at prioritising and re-prioritising competing demands from and within Departments, if we are to make the best use of the resources we are given. To a large extent, this may involve Departments looking at additional ways of generating revenue.

The need to control rises in public expenditure and to spend only such amounts as are justified and affordable remains a key issue. The ongoing development of the Corporate Planning Process will help myself and my Ministerial colleagues to have confidence that Value for Money is being optimized from the public purse. This remains a vital requirement and I believe that there is still much that can be achieved by ongoing reviews of all areas of expenditure, especially with regard to the procurement of goods and services. To this end, I have requested my Treasury colleague, Mr Adrian Earnshaw, who chairs the "Value for Money Committee" to focus his efforts on this matter during the forthcoming year.

Having said this, I am still able to budget for a surplus of £10 million in 2004-05, after directing an additional £30.67m for new revenue spending in 2004-05, such money including an extra £6.1 million for Education, an increase of 7.9%, and an extra £9.75 million for the Department of Health and Social Security, an increase of 6%. Government will limit its staffing growth to a total of **56** new posts in 2004-05, **30** of which will be in the above Departments.

In 2004-05, it is estimated that Government will spend over £90 million in supporting pension payments, that is more than £1,000 for every man woman and child on the Island. The State Retirement Pension will increase by £2.15 per week in line with the United Kingdom, thereby increasing the payment from £77.45 per week to £79.60 for a single pensioner.

In addition, the Pension Supplement will increase by £1.08 to £39.80 per week for those with the necessary contribution record. A Pensioner couple, with the wife qualifying on

her husband's contributions, will now receive £190.88 including supplements, £63.63 per week more than their UK counterparts.

I am also proposing further above inflation increases in Overseas Aid. Following last year's 11% increase, the amount available for 2004-05 will be raised to £650,000, an increase of 30%, or £150,000 over the current year's budget. As our society become more affluent, it is important that as a Government we ensure that we share this prosperity with those less fortunate than ourselves. I am aware of the significant fund-raising that takes place on the Isle of Man for a host of worthy causes, both local and overseas, and I intend to ensure that Government contributions to such causes reflect the generosity of the Manx people.

Last year, I reduced the rate of interest on Agricultural and other Government loans from 7% to 6% and promised to look again at this issue in twelve month's time. Recent increases in base rates have compromised my options to some extent, but I am pleased to announce that I can provide ongoing assistance to the farming and fishing industries by a further 1% reduction in these rates, to a new rate of 5%.

I alluded earlier to the efforts of the taxation teams in which Treasury has invested resources to achieve a significant return. This principle also applies to the Media Development Fund, which continues to generate substantial benefits for the Island. In the current financial year, a further 21,000 bed-nights have been derived from the film business, as part of an estimated local spend of some £12.6 million.

Last week, the UK Inland Revenue announced changes to its legislation in relation to film financing that permitted trading losses incurred within partnerships to attract tax losses. While it is likely that there will be some short-term reaction to this change, we believe that the stability and expertise offered by the Isle of Man will lead to enhanced opportunities for our film industry in the future and that our estimates for 2004-05 will not be adversely effected.

Again, on behalf of Government, I congratulate all those involved in this continuing success and I anticipate that the Chairman of the Isle of Man Film Commission may wish to add further particulars later in this debate.

In order to ensure that we continue in our quest to complement those businesses who may have matured in terms of profitability and employment prospects with the next generation of entrepreneurs, we must invest more heavily in marketing related activities and I welcome the recent private sector led initiative to review ways in which the branding of the Isle of Man might be strengthened.

In consultations with our local industry, one fundamental message continues to emerge, namely the ability to access markets. I have taken on board this message and, during the processes that I have just outlined, access to markets will be a key driver of our thinking and actions.

Although the taxation strategy provides a strong competitive position for the Island, it is essential that the opportunities for economic and business development that it creates are actually delivered. Therefore, it is necessary to ensure that a range of associated issues are considered within the wider context of the Economic Strategy and addressed quickly and with determination.

These include appropriate support for negotiation of the many forthcoming bilateral agreements arising out of the European Union Savings Directive and the OECD based Tax Information Exchange Agreements and additional marketing of the Island and the business opportunities that we are able to present.

I am also conscious of the views expressed from a number of quarters of the need for a thorough review of the Island's Company Law to enhance our competitiveness whilst maintaining our hard won reputation as a high quality, well-regulated jurisdiction.

I accept the need for this to be addressed without delay and to this end I propose taking direct responsibility for this review. I have established a high level steering group consisting of the Attorney General, the Chief Executive of the Financial Supervision Commission and the Chief Financial Officer to assist me in this task.

There is a significant commercial advantage to be gained from a speedy and meaningful development of strategies to address these specific and time sensitive issues. To enable such activities to take place I am proposing that for the next three years the interest earned by the Tax Strategy Requirement Reserve be utilised specifically to ensure that these essential activities can be undertaken by Government.

I believe that it is vital that we that we maximise every opportunity to promote and develop the Island's business environment in the forthcoming years and I further believe that this is an appropriate means by which we can achieve this objective.

Finally, I would refer Honourable Members to the comprehensive Business Plans that have been circulated. They outline, in some detail, the individual spending plans of Departments, and their priorities over the next few years. Soon, we will begin the parameter setting process for 2005-6 as part of the Corporate Planning Process that has become a truly year-round procedure and has allowed us to link financial information with effective service delivery.

As I have previously stated, the majority of our projected surplus of £28 million for 2003-04 arose from "one-off" receipts that by their nature cannot be counted upon to reoccur. Therefore, as has been Government's policy for some time, I intend to transfer a significant proportion of the surplus to various reserve accounts to be used for "one-off" expenditure.

Twelve months ago, I estimated that transfers of £1 million would be made to the E-Commerce Fund and the Public Service Employees' Pension Reserve. At that time, some comments arose as a result of what was perceived to be a relatively small transfer to the E-commerce Fund, in view of Government's aspirations in the world of e-business.

In fact, at that time, a healthy balance was still available within this Fund, and initiatives continued during the year, including the continuation of funding for the Department of Education's ICT strategy and the upgrading of computer equipment throughout Government. As a consequence, I am proposing to transfer a further £5 million from the probable 2003-04 surplus to replenish this Fund and in so doing maintain Government's commitment to E-Commerce opportunities.

In addition, I am including a further transfer of £1 million to both the E-Commerce/ICT Fund and the Public Service Employees' Pension Reserve in the estimates for 2004-05.

The purchase of strategic land and property for Government remains a key driver, especially in the light of the ongoing demand for housing. Therefore, I propose to transfer £5 million from the probable surplus in the current year to the Land and Property Acquisition Reserve, with a further £1 million in 2004-05. This will continue to enable Government to more swiftly acquire such property as is considered essential to our long-term requirements.

Furthermore, within the capital programme, Executive Government contains over £3.8 million in 2004-05 for the planned acquisition of land by Departments.

Last year, Members will recall my colleague, the Minister for Transport, seeking approval for initial funding in respect of the Capacity Contribution Grant Scheme, that provides assistance to airlines in exchange for additional capacity being provided on certain routes at reduced fares that are affordable to both local residents, business travellers and other visitors alike. This scheme has been monitored very closely by officers of the Department of Transport, Treasury and Tourism and Leisure, and it is believed that the pilot scheme has been a success, with benefits accruing to the Airport, to Tourism and to Treasury.

Therefore, the Minister will shortly be advising Members of his wish to extend the scope of the initial trial and Treasury is pleased to be supportive of this position. In anticipation of a requirement for further funding for this Scheme, pending this Honourable Court's agreement to the proposal, I propose to transfer £2 million in the current year to the General Development Reserve, for such a purpose.

This scheme is a further example of the need for Government to be working in a cross-Departmental fashion, in order to generate benefits for the Isle of Man as a whole. I welcome the increasing signs that this type of co-operation is becoming more prevalent within Government and wish to assure Members that Treasury will work positively with any Department that comes forward with this type of opportunity.

Finally, in relation to the issue of transfers to Reserves, I intend to transfer £10 million to the Taxation Strategy Requirement Reserve in the current year and a further £5 million in 2004-05. This will create a principal balance of £32 million for this account.

I envisage that the life span of this Reserve will be relatively short, as I intend to return the funds to Revenue over the next two or three years, as existing direct taxation receipts reduce as the new economic and taxation strategies mature.

I will deal with the issues of the taxation strategy in a short while, but as previously advised today, I intend to use the interest earned on monies held within this Reserve to assist in the generation of new business opportunities for the Island.

I am not proposing to transfer additional funds to the Reserve Fund in 2003-04, or indeed 2004-05, although we will continue to retain some £8.4 million of interest generated in this account for both 2003-04 and 2004-05.

As at the 31<sup>st</sup> December 2003, the market value of our Reserve Fund investments stood at £236 million compared to a book value of £230 million. The market value is equivalent to 70% of the target level of one half of Government's annual gross revenue funded expenditure.

I am indebted to both my Treasury colleagues, Mr Donald Gelling MLC and latterly Mr Adrian Earnshaw MHK, for their Chairmanship of the Investment Management Committee that has overseen a welcome increase in the value of our reserves as the world stock markets have recovered from their downturns of recent years.

Mr President, I now turn to issues in respect of Taxation.

Having successfully promoted a strategy to overcome the latest hurdle of the EU in the form of the Code of Conduct, the past year has been one dominated by building upon our modified Taxation Strategy.

The joint announcement of the Isle of Man and the Channel Islands that, in respect of the Savings Directive, we would be adopting the Withholding Tax route came after long consultation with our financial community. I believe it has been broadly welcomed as the right decision.

Of course, we remain aware of the potential threats posed by the European Union, the OECD and other such bodies, but it is my hope and belief that a period of consolidation will now be called for, while we assess the impact of these most recent changes on our economy, and negotiate agreements that will improve our commercial opportunities.

In looking at Taxation this year I have been concerned not only by the need to build on the steps already taken towards the delivery of the Taxation Strategy, but also to continue

to assist those on low incomes, while maintaining the tax base required to deliver the ever increasing quality of public services that we have come to expect on the Island.

Therefore, let me turn first to Individuals.

Last year, I honoured my pledge to introduce the Personal Allowance Credit, paying up to £200 to those whose Gross Income was between £6,000 and £8,000 per annum. I am pleased to report that approaching six thousand payments have already been made and welcomed by those recipients on low incomes.

It is estimated that a further two thousand have still to be made, with a total cost of all payments of some £1.5 million. As promised last year, my officers are currently carrying out a review of the credit scheme to determine whether it is getting to the people who most need it. If amendments are required I shall not hesitate in bringing forward the improvements and shall not necessarily wait until next year's budget to do so.

Last year, I did not feel it appropriate to increase Personal Allowances. However, for 2004-05 I have decided to increase the Personal Allowance by 2.8% to £8,225 per person, and £16,450 for a married couple. There will also be corresponding percentage increases in the nursing expense and blind and disabled allowances.

Furthermore, and in keeping with my commitment to those on low incomes, I shall be extending the increase in allowances to the Personal Allowance Credit. The range of the Personal Allowance credit will go up from £2,000 to £2,225, an increase of over 11%, with the maximum payment rising to £222.50. In this way, the benefit of the increase in Personal Allowances will be spread over those both within and outside the tax system.

I have decided that the Basic and Higher rate of tax for individuals will remain at 10% and 18% respectively, and that the threshold will remain at £10,000 per person. In announcing these rates, I am aware that there have been calls by some Members to increase the higher rate to 20%.

In response, I can only say that I believe such a move at this time would harm our competitiveness, and send the wrong signals to potential investors in the Island. The Draft Economic Strategy clearly indicates that the future is in attracting high value employment. I therefore remain opposed to such a move at this time.

In terms of the other reliefs available, I am proposing to increase the maximum amount of relief available for charitable donations by 10%, from £5,000 to £5,500 per annum. This relief is available to those on this Island who give so generously in the support of others and I am pleased to be able to support them in this manner. I also propose to increase the level of relief available in respect of Educational Covenants by 10% to £5,500 per annum.

There have been calls from elected representatives both in this Honourable Court and

elsewhere, for a review of our system of relief for Mortgage and Loan interest. Like many areas of the United Kingdom, Ireland and the Channel Islands, the Isle of Man has seen large increases in property prices over the last few years, in part fuelled by low interest rates.

These have a significant cost to householders, who have been taking on more debt, which has the risk of becoming inflationary to businesses, who may end up having to meet the additional expenditure through upward pressure on wages.

The recent slow-down in the pace of increase is to me a welcome sign that the market may be cooling. It remains an option for the Treasury to limit the level or amount of relief available, in order to suppress this demand if necessary. However, for the current year I have decided not to make any precipitate changes.

Instead, I have asked the Economic Adviser to include this issue in the overall review that is being carried out within the Economic Strategy to determine whether such changes are in the best economic interest of the Island. However, in view of the current trend of rising interest rates my message to householders is blunt - do not take on more debt than you can afford to repay and be conservative in your personal budget calculations.

In relation to benefit in kind charges, the cost of fuel and cars has remained reasonably constant and there will be no changes for this year to the benefit in kind limits. One small change I have made is to the extra statutory concession for employees disabled at work. In future, it will no longer be a requirement that the pension falling within the concession has to be arising from a discernible physical injury or illness.

I turn now to our proposals for Businesses.

The Taxation Strategy, built around a zero rate of Corporate Tax on all trading income, other than for a 10% rate on defined activities, is still on target to be completed by 2006. We may still be in the transitional phase but I believe the changes I am making this year will show that the Government remains well and truly committed to the strategy.

Last year I was able to achieve a 10% rate for most financial institutions and trading companies, but not for all. There were a significant number who did not benefit due to their non-resident status but who nonetheless provide meaningful employment and contribute significant tax revenue. It is important to safeguard their competitiveness in a market that is increasingly looking at the business rationale for subsidiary and branch operations in more than one offshore location.

I therefore propose that from 6<sup>th</sup> April 2004, all trading income is now to be taxed at a maximum of 10%. This will be achieved by reducing the tax rate for trading operations being carried on through a branch or non-resident subsidiary from 18% to 10%. An amending provision will be introduced shortly by way of a Temporary Taxation Order.

This will bring non-resident subsidiaries into line with our resident operations and mean that we have achieved a 10% rate of tax on all trading income across the spectrum of business activity that can be carried out by companies on the Island.

It also means that we have delivered our taxation strategy in relation to all our Banking industry two years ahead schedule giving them clarity and certainty for the future.

We are now well over halfway to achieving our ultimate goal and this leaves us the next two Budgets to move from 10% to zero % for those trading activities that have still to move further down the taxation scale. In so doing, we will have created one of the most competitive jurisdictions for businesses to be located around the globe.

But before this final step to zero rate can be undertaken it would be imprudent of me if I did not first introduce some legislative changes that will safeguard our tax base against undesirable tax avoidance. This will be achieved both by the Income Tax Bill currently being considered in another place, and in a further Income Tax Bill that will be introduced later this year.

That further Bill will contain measures relevant to company distributions and undistributed profits. It will also provide for a basic fee or charge on all companies, mitigated by any tax liability, as well as addressing the issue of speculative gains on property transactions.

Some of these measures will not be well received by the minority in our community who seek to go beyond the bounds of what is acceptable. This applies equally to the more sophisticated tax planning as it does to those who fail to make payments or submit tax returns within statutory deadlines.

The combined effect of all these measures will enable the final steps to be achieved in delivering the tax strategy. Until then I propose to leave the income tax rate at 18% on the Investment Income of all Companies where it does not fall to be treated as part of the trading receipts.

Because we are in a transitional phase it can be difficult for our business community and our international audience to see the “wood for the trees”. Achieving a 10% rate across all trading activities is a major step forward but there is still the question of how the transition for the exempt entities will take place. I have therefore asked the Assessor in conjunction with the Economic Adviser to publish before the summer recess a document that sets out the potential timing and cost of the final transitional phase.

In the meantime, I intend to extend the existing zero-rate to new opportunities as and when they arise. A small but exceedingly promising area is Space and Satellite Technology. This will encompass the manufacture, operation, sale or other activities provided in respect of launch vehicles, satellites or similar assets, including those educational and other training activities that are directly associated with the industry.

A two-day course for representatives from the Island's business community and other interested parties will be given by the International Space University from Strasbourg at the International Business School in May 2004 and will provide an opportunity to impart detailed knowledge of the space industry and the business opportunities it affords the Island's economy.

Companies involved in this high value added category, will from 6 April 2004 be included in the growing number of activities that already benefit from the zero rate band of tax.

I am extremely hopeful that high technology businesses will look to the Isle of Man as their preferred location, and know that the Treasury and the Department of Trade and Industry are working to further develop relations with several multi-national companies. One such company that provides a range of global communication services via its network of satellites has already established a base on the Island. Such developments fit perfectly within our economic plans and are made possible by the new taxation strategy.

Despite the falling rate of tax, capital allowances still provide a strong incentive to increased investment. The Commercial Buildings Allowances introduced for Ramsey and Port St Mary are due to expire on 5<sup>th</sup> April 2004.

I propose extending the time limit by one year to bring them into line with Peel, so that they all will be available until 5<sup>th</sup> April 2005 in respect of planning applications and until 5<sup>th</sup> April 2007 for any constructions. During the course of the year the interest shown in these incentives will be reviewed and a decision taken as to their effectiveness in attracting the desired development.

One emotive area that still needs to be addressed is that of adequate and affordable child care facilities. I am aware that this has been referred to in the recently published Review of Economic Strategy and that the economic argument strongly favours addressing the supply side rather than increasing the demand side through tax relief.

Therefore, as an interim measure, I have asked the Assessor to bring forward measures that will provide an incentive to the provision of further places through the introduction of relief for capital expenditure on nursery premises, perhaps similar to the commercial buildings allowance. This will require a period of consultation with interested parties but I expect to see proposals before this Honourable Court by October of this year. This will provide a clear incentive to increase the supply of such facilities and give more parents who so choose, the ability to return to work.

I would remind employers of the exemption from a benefit in kind charge of registered nursery or creche facilities either provided or paid for by an employer at the employers' expense where the facilities are necessary to enable an employee to attend at the place of employment to perform the duties of the employment. This concession has been in force since 1990.

As already announced, the basic fee for exempt companies, international limited liability companies and international limited partnerships will be increased from £430 to £450, effective from 6<sup>th</sup> April 2004.

Finally on the business front, and in advance of the company law review, steps are underway to update the current audit exemption limits. Differences of opinion on this subject within the profession have in the past made it difficult to know just where to pitch the new limits. However, I am pleased to note that there is now more common ground as to the way forward. Therefore, I am optimistic about being able to issue an early paper setting out suggested changes and inviting comment in time for an amended Order before the summer recess.

Mr President,

This year's Budget is the second that has taken place within the auspices of the Corporate Planning Process. This results in the Budget forming a part of a bigger picture for the Isle of Man and provides a stronger link to Government policy than the previous process permitted.

However, I again reiterate that while issues of Departmental spending and prioritisation of resources are now more firmly in the control of the Council of Ministers, the general thrust of economic and taxation strategies remains very much a focus for Treasury.

I said last year that the Island was at a crossroads after the heady days of the start of the new millennium. Significant decisions were required and these have been made. We have embarked upon a new journey, one that requires a new approach to economic and taxation strategies.

As the Island continues to compete upon a world stage, economic issues and taxation strategies can no longer be viewed in isolation. Increasingly, economic factors will influence our decision making process as direct taxation becomes a less crucial item on the budget agenda and we have to respond to the implications of the growth in our reliance upon indirect taxation receipts.

It is the economic benefits relating to key decisions that will influence our decisions. The type of industry that we wish to attract; the training that will be necessary for the indigenous workforce; the manner in which Government can assist in attracting the most appropriate organisations; the optimum size of the Island's population; the realisation that not all types of employment will necessarily be beneficial to our Island – these are the sort of economic decisions that we will be called upon to make.

Fortunately, I am able to stand before this Honourable Court today and to share with you and those who are listening further confirmation that we are delivering upon the commitments that have been made in previous budgets.

We are providing business with confidence and clarity; we are maintaining full employment through economic growth; we are further diversifying the economy as a result of our determination and focus on delivery and we are clearly differentiating ourselves from our competitors.

In addition, I believe that a key factor in our success has been Government's ability to listen to the views of business. Within the insurance sector, the introduction of the Protected Cell Companies Act 2004 and the Insurance (Amendment) Act 2004 relating to the abolition of insurable interest for contracts of life assurance, have arisen as a result of extensive dialogue with the industry and demonstrates the ability and readiness of the Island to provide a modern and forward-thinking environment for business and its customers.

Similarly, amendments to certain aspects of legislation applicable to the Fund Management Industry were undertaken after a lengthy period of consultation and the feedback we have received from the industry has been most positive, with significant increases in assets being reported by several large companies. Initiatives are ongoing to attract additional business, often in conjunction with Isle of Man Finance, the Treasury's Financial Services Division.

At the same time, we are listening to the needs of our citizens, we are assisting those who are less fortunate than others; we are continually investing in the Island's infrastructure and providing standards of public services that two decades ago could only be dreamed about.

Good fortune has historically played a part in our Island's fortunes, as tourism was succeeded by the finance sector and we were able to move forward throughout the second half of the last century. Now, we face a new challenge as we progress through another transitional period in our Island's economic history.

However, I know we are well-placed to ensure that not only is our recently enhanced prosperity preserved, but that we can move forward to take advantage of the new opportunities that are now arising. In so doing, we will seek to ensure that the levels of education, health, social services, utility services, policing and environmental benefits are maintained. This will be done by the creation of economic wealth within the private sector, which in addition to providing full employment, ultimately funds the public sector jobs and services that Government provides.

This is a three-pronged Budget. It supports jobs, improves public services and benefits, and maintains business confidence. We remain on course to deliver the zero tax rate and are laying the foundations for a new era in the economic development of the Isle of Man,

providing we retain the fundamentals of our financial strategies, that we only spend what we earn, pay ourselves only that which we can afford and embrace the principles of quality as opposed to quantity, we shall deliver!

This Budget, which I believe will be very positive for our Island, has been achieved by the hard work and co-operation of my fellow Ministers, Tynwald Members and especially my Treasury officers who have worked long hours over the last few months to deliver the Budget. To all concerned I offer my sincere thanks.

In particular, I would like to thank Mr Donald Gelling MLC and Mr Adrian Earnshaw MHK for their commitment and support in Treasury throughout what has been a challenging year for me personally.

Finally, and with a significant degree of sadness, I would like to thank one more individual. For Ian Kelly, our Assessor of Income Tax, this will be his final budget prior to his retirement in November.

Without question, his outstanding abilities, not only in developing our taxation strategy, but more especially his performance as our lead negotiator at many of our international meetings has helped to steer the Island through potentially extremely stormy waters, to the position we have achieved today.

Ian has earned great respect for himself and his country both on and off the Island and without his efforts and skill our Budget today could have looked very different. The Isle of Man owes Ian a debt of gratitude and I would like to add my personal thanks to him for his help and support during this challenging period.

Mr President, I commend the Budget to Honourable Members.

**Hon. A. R. Bell, M.H.K.,  
Minister for the Treasury  
17<sup>th</sup> February 2004**