

## **2012 Budget Speech**

### **Striking a fair balance**

#### **Introduction**

Madam President,

I realise that many members of this Honourable Court will have been unsettled in the run up to this year's budget, and will be looking to me today not only to make clear our current financial position, but to give an indication as to how we will go about the difficult journey that we have to make. As Chairman Mao said "A journey of a thousand miles begins with a single step". A good start was made three years ago, but this is another confident and positive step.

Nobody enjoys having to raise taxes or reduce services, but at the outset I must emphasise that we are facing a reduction in our income of such magnitude, around £75 million next year, and it must be dealt with. We cannot act like Mr Micawber and just hope that something will turn up!

This is a journey that the Council of Ministers and Treasury have embarked upon together. There will be many changes ahead, but at each stage the challenge for us, as politicians is to ensure that the changes we propose promote fairness and equity in our community, and ensure that we target our limited resources where they will do the most benefit. This is the theme running through this budget and has been at the forefront of my deliberations.

We must also ensure we grow the economy, as lack of growth will slow our return to a balanced budget.

So my objectives today are twofold -

Firstly to clearly set out where we are as a nation financially. I must deliver clarity to maintain confidence within the business community who need to plan with certainty. It is they who will deliver the employment which we will need to provide good quality opportunities to our young people.

And secondly to indicate how we will move back to a balanced budget within the next few years. We have no option as our reserves are finite.

Of course we are not alone in experiencing difficult financial times. The countries of Europe appear paralysed between the conflicting desire to reduce deficits and avoid recession. We are fortunate that our economy is still growing, and that we have the financial strength to withstand a short term deficit without the need to borrow externally. This is the legacy of a succession of cautious, Treasury Ministers who I thank for giving me the resources that will ensure we can manage our way out of our current difficulties. I do have a firm foundation upon which to build and I would especially like to thank my predecessors, the Chief Minister, Mr Bell and his successor, Mrs Craine for their professional and measured approach.

The first objective for the new Council of Ministers was to determine the size of the deficit, and to agree a timescale for its removal. To do this needed a careful

consideration of the current economic position coupled with the need to protect reserves. After doing this the Council of Ministers has determined that a four year period of rebalancing, finishing in 2015-16 would strike the right balance.

Treasury have updated the Rebalancing strategy based on this timescale. This will involve a period of reliance on reserves, but this is an absolute necessity if we are to maintain employment, confidence and growth. In Ireland budget cuts resulted in a 14% contraction in the economy and a quadrupling in the rate of unemployment. Excessive cuts result in a downward spiral leading to further reductions in income to Government and further spending reductions. In light of this I have considered with Council how and when the current deficit can be removed. This can only be done by reducing our spending, Revenue or Capital, or by increasing our revenue.

This Government does not have a tax and spend policy. We must be as efficient as possible and also consider our competitive position. Value for the taxpayer's money must be paramount. Over the past three years we have reduced Government spending in real terms by around £70 million, of which £28 million was found last year. It is not appreciated how much has been achieved already, and I would speculate that this is because of the professional manner in which the reductions have been managed. Recognising the pressure on personal budgets, I have actively tried to limit the increase in Government charges to those required to keep pace with inflation.

But much of the important work on determining the future scope of Government remains to be done. And to do this we will be undertaking a medium term spending review this summer to agree the difficult decisions that will need to be made. This will involve setting budgets for each Department for the next three years. Thus for the first time we will be planning in detail for the life of this Government. This will bring clear direction.

But in taking difficult decisions we need to consider the wider world and its impact on us. So I will now turn to looking at the position of the Economy, both here and abroad.

## **ECONOMIC OUTLOOK**

During the last three months I have undertaken extensive meetings with many of the business leaders and business organisations on the Island. I do appreciate the time which they have given me and the open discussions which I have had. Whilst there are some difficult areas the overall mood is one of subdued confidence. The Island's economy has been under pressure from the financial crisis in our major markets and this pressure will intensify in the immediate term as economic uncertainty remains on the back of the situation in the euro zone. In the UK there are fears that the economy is slipping back into recession and this would inevitably impact upon the Island as the bulk of our trade is with our near neighbour.

We have to acknowledge that rebalancing of our own finances may dampen local economic prospects. Reductions in public spending, increased deductions from pay packets and, in some cases, the loss of employment, will all mean less spending and income generation than we would ordinarily expect. Like Treasury Ministers everywhere, I am looking to devise a Budget that addresses issues of public finances but seeks to minimise the damage to the economy and economic confidence. I

believe the measures I present today meet the need for a balance between these dual objectives.

Fortunately, we have an economy that to date has shown extraordinary resilience and stability, living up to the Island's motto "wheresoever you throw me, I will stand".

Government has played a part in this by maintaining economic and political stability. I would like at this point to thank the real key players – the businesses, large and small, international and local, who have striven to secure and improve their positions and in doing so have been able to retain, and even expand, their workforces. They are operating in the toughest environment for several decades and I can only praise their collective performance. I hope they find this Budget supportive of their efforts.

The Isle of Man has always adapted to a changing market environment by seeking out and developing new areas of business and economic activities. Recent evidence of this being the development of sectors as different as aircraft registration, clean-tech and e-gaming. While the financial services sector still produces a third of our national income, over the last two or three years it has been the 'new' sectors that have provided most of the growth in the economy. As a result we have moved to a more diversified, balanced economy.

Growth - last officially recorded in 2010 at 2.1% and believed to have been sustained since - may not have matched the 6% averaged over the previous ten years but in the difficult economic circumstances we find ourselves in it is nevertheless an achievement few countries in the western world have been able to match. Similarly few can point to an unemployment rate as low as 2½%. However within this figure there is a higher level than I would wish of unemployed young people, but this is still less than half the equivalent figure in the UK and one fifth of that in Spain. Recent measures taken by the Government are assisting young people to enter the workplace and the measures which I will announce later will give a further impetus.

I do acknowledge that household incomes are being squeezed. Few have received salary increases of any significance in recent years, and for those living off their savings interest rates have fallen, while increased taxes, direct and indirect, have served to reduce disposable income for many. Rising prices have put further strains on households. So it is good to see the Island's inflation now in decline. From a peak of 6.8% in August 2011 the annual rate of inflation as measured by the RPI has fallen five consecutive months to stand now at 4% and we can expect further falls over the course of the year - one beneficial outcome at least of slower global growth.

One of the ways that the slowing world economy affects us is in the development of our international relationships.

## **INTERNATIONAL OUTLOOK**

We are all aware both in this Honourable Court and in the Manx community as a whole that the global recession, which has affected so many countries, has not yet gone away. Indeed, it is likely that in a number of European countries it may yet come roaring back with a vengeance. This fact, and the underlying fiscal problems which it leads to, means that countries are becoming more protective of their

revenues and increasingly alert to any threats which they perceive as affecting those revenues.

I have never known a period when tax is being mentioned so frequently in the media, and it is inevitable that the tax arrangements of well known individuals and businesses have come under close scrutiny, if not attack. The phrase 'tax haven' is once again being used frequently, and tax havens are described as being part of an international problem which assists in objectionable tax planning, facilitates the flow of various kinds of criminal money and then helps to hide everything away from view.

Honourable Members may expect me to dismiss such comments as either being ill-informed, or as not applying to the Island in view of the quality of our regulatory systems and international co-operation. Both of those responses are true: but that does not stop the attacks. We continue to suffer from negative labelling, and it must be in our national interest to robustly refute these misconceptions.

It is also important that we should be aware of impending developments in the standards applied in the world of international taxation. It would be naïve in the extreme to assume that anything stands still, and this is certainly the case in the world of tax. I expect to see in the coming years new approaches to information exchange, new forms of international agreement, additional requirements regarding the ownership of business and investment structures and further pressure for greater transparency.

We do not need fear these developments, Madam President, but we need to be fully aware that they are coming -, to continue to participate - to influence the outcome wherever we are able to - and to accept that if there are 'rules of the game' which apply to the global marketplace then we will have to follow them.

All of these things mean evolution. Evolution of Government's approach to the international arena will mean even more engagement, more pressure on our stretched civil service and political resources and to some extent will involve more cost. I expect that our economy as a whole will need to evolve in order to thrive in a changing world, and this means Government's strategic leadership and engagement with our private sector is even more vital. I also see the need for individual businesses to evolve in order that they fully respond to new standards and regulations.

Honourable Members, you may feel that my comments indicate that an enormous amount of hard work will be needed, and you would be right. However, if we are to manage and bequeath a country and economy to our children which continues to thrive and to give them opportunities for careers and good livelihoods then we must take on that hard work with enthusiasm and commitment .

Evolution in the world of taxation in many ways mirrors that of changes faced daily by our local businesses. It is to these that I will now turn.

## **LOCAL BUSINESS PERFORMANCE**

Madam President

Government has diversification as one of the key elements of its economic strategy, and as I mentioned earlier, the relatively new industries such as e-gaming, aerospace engineering, hi-tech manufacturing, shipping, aviation and clean-tech are all thriving, with the e-gaming sector registering annual growth of more than 40%.

Local VAT registrations in December 2011 were at a three year high, at around 7,900. There are many signs then that our local economy is continuing to grow.

Our financial services industry continues to cope admirably with the fall out of the banking crises, which have in more recent times become sovereign debt concerns. The industry has continued to weather the international storm, with most financial sub-sectors at least holding their own in terms of employment and asset base. The Government is backing initiatives to assist our industry tap into new overseas markets in China and the Middle East and to spearhead initiatives with potential to develop new lines of business and economic opportunity. The Financial Services Partnership between the Department of Economic Development and the Chamber of Commerce formed in September last year will play a key role in determining the success of sector initiatives.

Banking deposits have remained relatively stable, over what has been a turbulent period generally, and these funds continue to provide invaluable liquidity to the UK Banking sector and hence UK industry, to the immediate benefit of the UK economy but ultimately to us all.

2011 has been a particularly good year for e-Business. The e-business sector as a whole, incorporating e-gaming, now accounts for 12.9% of the Island's GDP and is the joint largest sector of the economy based on GDP contribution.

Manx e-Gaming Association statistics show that the wider e-Gaming industry contributed a total spend in the economy of £153m in 2010, with estimated total tax revenue generation of £15.2m. It is believed that 2011 will show a further increase in its local spend to around £165m.

The Isle of Man continues to develop as a global centre for space commerce, covering satellite filings, legal, leasing, financial services and manufacturing. The Island is ranked as a leading world player, with specific focus on the strength of the Public Private Partnership between ManSat and the Isle of Man Government in orbital filing and space marketing, and on the strength and innovative approach of the Isle of Man finance industry.

Manufacturing continues to make a valuable contribution to the Manx economy. The sector has indicated to Government that it could grow by over 300 employees through to 2015. The growth is forecast mainly by the aerospace engineering businesses which are seeing strong aircraft build rates over this period. The Isle of Man Aerospace Cluster is now accepted as a fundamental part of the UK supply chain. This has helped align Isle of Man engineering businesses with some of the biggest names in the aerospace sector such as Rolls Royce and Airbus. It has provided links into UK backed aerospace initiatives, intelligence on new programmes and supply chain opportunities.

Prospects are for a high demand for new skills in manufacturing and therefore many new job opportunities for the Island's population. Government (through the

Department of Economic Development and the Department of Education and Children) is currently examining the training provision for engineering apprenticeships and skills to see how this can be substantially increased to meet the needs of the sector in the future. College engineering apprenticeship courses are presently over-subscribed and enquiries directly to companies for apprentices are at recent highs.

Increasing energy costs have been a great concern to the manufacturing sector and prompted the decision to withhold electricity tariff increases. I hope this has been a further boost to the industry.

Tourism continues to play a key part in the local economy. The TT attracted increased numbers of visitors in 2011 and early signs are of further increases this year. Expansion of worldwide take up of TT television programming is raising awareness not just of the Festival but also of the Isle of Man generally. The excellent film, *Closer to the Edge*, has undoubtedly brought the TT to a much wider audience - a very positive achievement from our local film industry. Similarly we are delighted to have another of our local productions nominated at the Oscars. The animated film production of *Chico and Rita* is further testament of our ability to diversify and encourage a new skill set to develop in the Island. The TT remains the Isle of Man's most recognised brand and the Department of Economic Development will continue to capitalise on this.

The strengths of our key traditional industries and the energy and vigour of our newer sectors together provide for optimism for the future of our economy. In the immediate term the employment and incomes they generate will help sustain the fortunes of the domestic sectors such as retailing and construction which are currently suffering from constrained discretionary personal spending.

## **FINANCIAL PERFORMANCE**

I will now turn to look at the current year's financial outturn.

Whilst our VAT income for 2011-12 was some £30 million less than budgeted for, due to the new revenue sharing arrangement concluded last year, one-off revisions to previous years resulted in £54 million more being received. Indirect tax receipts are therefore £24 million above budget. Income Tax receipts are around £9 million below budget, due to lower investment income and self employed income receipts. As a result, total income for the year will be some fifteen million pounds above budget.

Net expenditure in 2011-12 has been close to that budgeted, and is expected to be around £1 million above plan, at £534 million. The Department of Social Care is likely to overspend the original budget by around £1.5 million, of which £0.5 million relates to a supplementary vote approved by Tynwald last summer.

The overall impact is that our surplus will be £14 million ahead of budget, and £16 million in cash terms.

A year ago we projected a surplus, £1.7m for 2010-11. In actual fact the surplus finally came in at £9.6 million, some £ 8 million higher.

As a result of these two surpluses I am able to announce two transfers to reserves. £15 million will be added to Government's Capital Fund. I shall return to the Capital Programme later. £5 million will be added to the Housing Reserve Fund, which will provide a further boost to our construction industry.

I will now turn to the position of the other Reserve Funds.

## **RESERVES**

Before I go into detailed consideration of the reserves, I should make some general comments. Firstly, and most obviously we are extremely fortunate to have reserves in excess of one thousand million pounds, built up over decades by the cautious fiscal policies adopted. It is not my intention to spend this inheritance in a rash manner, but to use it to ensure a managed transition to a lower level of Government spending.

Secondly, a number of our reserves are coming under pressure as we have been unable to top them up in recent years. This has forced a growing sense of financial responsibility on those prioritising what are in many cases reducing balances. I have to be honest and say that it is unlikely that many of the current funds will be replenished over the lifetime of this Parliament, and that those responsible for the management of many of our reserve funds will need to plan on that basis.

Finally, I would like to place on record my thanks to Mr Braidwood for the management of the Investment Committee of Treasury, for continuing to oversee the management of our funds in a most professional manner during what remain exceptionally difficult circumstances globally.

Now I would like to turn to the Reserve Fund itself. I will transfer £4 million from here into the Legal Costs Reserve. This is a necessary but undesirable result of the significant resources currently being deployed in respect of both the criminal justice system and legal aid. We are aware of these problems and have recently concluded a significant external review that must now be implemented to better manage the costs in this area.

The Public Sector Employees Pension Reserve was set up to deal with Government's emerging employee pension liability and has more than tripled in size to over £200 million under the former Treasury Minister: now Chief Minister. Dealing with the emerging pensions liability for our employees was, in my view, the key achievement of the last administration. We simply would not have been able to offer the package now being implemented without this fund, but we did need to reduce the overall cost for our pensions to remain affordable in longer term.

I am pleased that the new unified scheme will be in place in April 2012, and we have assumed over a million pounds of additional income as a result of increasing employee contributions. These contributions will help manage the increasing costs of paying pensions, and for new starters lower pension benefits will be offered. We have forecast the cost of the new scheme to 2030, at which time we will be able to start increasing the balance on the Pensions Reserve again, and at the current time the value of the reserve is well ahead of those projections.

The Media Development Fund continues to facilitate investment in film and, as previously announced, we are reviewing the future of this fund and will revert to Tynwald in the near future with finalised proposals.

The Commonwealth Youth Games Fund will be closed, following the successful hosting of the games in September 2011.

Finally Madam President I am sure you will have noticed that this Budget makes provision for the establishment of a Depositors Compensation Scheme Fund. It was my intention to seek Tynwald approval for the creation of this fund at this sitting, however I have noted the comments of a number of Honourable Members who have indicated that they would prefer a dedicated debate on this matter later this year and as a result I shall not be moving this item later today.

## **FUTURE BUDGETS**

I will now turn to our budget for the coming year. Before doing this I would like to set out our thinking, both for this year, and the years ahead. We have decided on a four year programme of which this is the first. In the first year we have delivered £12 million of savings and have reduced overall spending by £19 million (in cash terms) compared to our plans of just a year ago.

Similar savings will be required in years 2 and 3 with a smaller final amount to be found in the fourth year.

Controlling the cost of staffing will be a key aspect of any rebalancing, as around a third of all our costs are staff related. The Chief Minister has indicated that a 10% reduction in the cost of staffing, in real terms over the next four years is planned, which in reality means keeping the overall cost of salaries at around £300 million over this period. The choice between jobs and pay rises is I accept a difficult one for unions to accept but it will have to be the reality for now. Since April 2010 the actual number of public sector jobs has reduced by 266 and without cooperation on pay this will accelerate. We cannot protect jobs on our own.

In finding savings the Council of Ministers has considered the implications of reducing budgets on each Department. This has resulted in some important changes. For instance, we have not significantly reduced budgets within Economic Development, whose key challenge is to create the wealth that we all rely on. We have funded increases to Health and Social Care, but with different impacts. In Health, the 3% rise will just cover the growing cost of drugs and treatment overseas.

In Social Care, despite the provision of an additional £12 million on benefits, difficult decisions have had to be taken. For instance, at a time when those in work are receiving low if any pay rises, can we afford to increase the benefits of those out of work by more than 5%? Council concluded that we could not, and so a number of benefits have been uprated by average earnings instead which we feel is fairer.

The problems in the benefit system are both cultural and historic. Cultural as despite maintaining near full employment we have found growth in excess of 10% in the cost of Income Support during the last year, for example. This is put down to social pressures, but when does a safety net become a comfort blanket that is too easy to fall into and hard to get out of? These are difficult questions to ask, but we need to

be fair to both those in work, and those who are genuinely in need. It was interesting to note that when the supplement for long term unemployed was removed, some two years ago, the number of those unemployed for longer than one year declined by 10%.

I fully support the Chief Minister's review of the benefit system. In case Honourable Members think I am just focussed on saving money from the less well off, let me say that it is my view that it cannot be acceptable for the state to pay universal benefits to those people who are well off, however we define that. There is an argument that the State Pension is paid for through your working life, and is funded through the National Insurance system, and I support this. But payments such as Child Benefit involve paying large sums, in some instances, to high earners. Figures indicate that around one quarter of families with Child Benefit earn more than £70,000 per annum, costing around £ 3 million a year.

The Minister for Social Care and I have concluded that this must change. We are not going to be rushed into a policy announcement without working through the complexity of how any restriction will be implemented, as has been seen on the adjacent isle.

For 2012 then, we will reduce the level of Child Benefit for second and subsequent children to the same levels as paid in the United Kingdom. This will save around £2.5 million per annum. There will be compensating increases for those on the lowest incomes to Employed Persons Allowance.

The Minister of Social Care and I have also revisited the longstanding commitment to implement free Nursing Care on the Isle of Man. As a result we shall increase the current £60 per week contribution to £100 per week, bringing it broadly in line with payments in England and Wales.

Even after these changes we will still be spending more, after inflation, on benefits next year than we were three years ago. This indicates both the continued high level of support they provide, but also the challenges we face in managing these costs.

There must also be a strategic review of the provision of Housing. When nearly 10% of our public sector tenants are amongst the top 25% of earners and over 1,000 people wait for a place and probably rent privately, can anyone in this Honourable Court defend this as fair? We need to look at the overall problem. I do not have all the answers Honourable Members but I do think the questions need to be asked.

Let me move on to Education. The Minister for Education has a difficult job to do, as his Department strives to live within its means. I know this because I have recently been the Minister for Education I therefore support the creation of a working group by the Council of Ministers which will seek to find a better way to target resources in nursery education on those who most need the support. Another area we need to review is the growing cost of University tuition.

My Honourable colleague, the Minister for Education, will be bringing forward his proposals for Student Awards in the near future and I will do my best to protect the present level of support, but with the increased financial costs levied upon us by the UK it may well be that the time will come when we have no alternative to seeking a contribution from the students.

I want to reiterate that we are not looking to cut the overall level of support given to our young people, but, when times are tight, we cannot afford the additional several million pounds that would be required to continue the current system for the next five years.

I could of course mention every Department here but let me finish with Home Affairs, and of course the Treasury. Home Affairs budgets have been reduced, and will be challenging to achieve. There are strategic issues with the whole of the criminal justice system from the police onwards that we cannot ignore in considering this area. An external review, within the Transforming Government programme has clearly spelt out the problems and the excessive costs being incurred. The Minister of Home Affairs is well placed to deal with this and has been tasked by the Chief Minister in submitting his proposals within six months. With the low levels of crime we enjoy, we should not be incurring the millions of pounds of expense that we are, on delivering effective justice.

Treasury's budget has reduced. Last April we brought together around one hundred finance staff from across Government, with a combined budget of around £2.5 million. We targeted the team to deliver a 20% saving, £500,000 in the cost of processing invoices, payroll and other financial functions. Within a year we have surpassed those savings, losing posts through natural wastage and delivering a more effective service. Similar changes are taking place in personnel, in procurement, and in estate management.

Government can and will become more efficient at delivering its services as a proper contribution to the rebalancing of public finances, and I look forward to further successes in the near future.

## **CAPITAL SPENDING AND CAPITAL PROGRAMME**

I will now report on our plans for the Capital Programme. The current level of activity in the construction industry does give me cause for concern, but Government cannot deliver all the demand necessary to maintain a vibrant sector. Recognising our impact on this sector our Programme next year is for £83 million of spending, some £7 million more than we are projecting to achieve in 2011-12. We estimate that £55 million of construction related schemes will take place including continued investment into public Housing, extensions to schools and colleges and smaller scale maintenance and improvements. However I do recognise the wider difficulties facing the housing market which is a key part of the construction sector. Working with my colleague, the Minister for Social Care, we are considering ways in which Government may support activity and the wider market.

In the coming year one of our most significant capital projects of recent times, the new St Ninian's Lower school will be opened. We will also be switching much of the Island over to Natural Gas. These are the capital expenditures that improve quality of life or save money. Our focus going forward has to be to ensure that Capital Spending does not get spent on grandiose schemes or pet projects. We need to invest in maintaining what we have, not creating new liabilities for the future.

I will now turn to taxation.

## TAXATION

I know that this Honourable Court recognises that we are faced with many difficult fiscal questions – not only this year - but going forward for a number of years. I will say again that control of public expenditure, economic development and growth and a careful use of reserves are in my view the best way for us to move back to having a properly balanced budget. There may be some among us here and perhaps members of our community, who feel that 'tax and spend' is an appropriate policy: but I do not agree with them. If we are to show fairness, then it cannot be right that the people and businesses of the Isle of Man should be obliged to pay ever more so that government can continue as if nothing has changed.

I will propose measures which result in some people paying more tax, but there are no new taxes in this budget. While a limited amount of additional revenue is certainly useful to us, I am also driven by fairness and I would add that simplifying the tax system will have the medium-term benefits of making it easier for all of us to deal with the Income Tax Division, of allowing Government to reduce the cost of administration and ultimately I feel that we can aspire to a situation where many people no longer need to complete a tax return at all.

In other cases, we will change the way that tax returns are handled. For example, from this April our larger employers will be obliged to conduct their business with the Income Tax Division and submit their returns using Online Tax Services; and that approach will be extended to more employers in future years.

As a final introductory comment, Madam President, I want to say that we have had public tax strategies in the past, and these have been very useful for signalling the direction that Treasury is moving in. I will commit today to publishing a new tax strategy before the end of this year which, if supported by Tynwald, will indicate the areas of the taxation system which I would like to update while I am Treasury Minister. One issue which I can say here and now will be in the new strategy is seeking to find an appropriate method to oblige major retailers, to make more of a wider contribution to our society. It cannot be right that the taxpayer has to provide the infrastructure to support their operations, but does not receive any direct compensatory benefit. I will not prejudge which method will be settled on, and I accept that we will need to discuss matters with the businesses which will be affected, but I can assure this Court that the issue is one of my personal priorities.

### Taxation for individuals

I will firstly cover the taxation of individuals. I propose that there will be no changes in the personal allowance, the rates of tax or in what is known as the 10% tax band. This means that the tax-free personal allowance will remain at £9,300, 10% tax is paid on the next £10,500 of income and 20% tax is paid on income above the level of £19,800. These allowances and levels can be double for jointly assessed married couples or civil partners.

I intend to raise the maximum income tax liability, which is commonly called the 'tax cap', to £120,000 and £240,000 for jointly assessed couples from 6 April 2012: an increase of over 4% which it is estimated will result in £375,000 of additional taxation revenue.

Madam President, a consultation was carried out last year on the future of the personal allowance credit system, and a response document setting out the public's comments was published in December. The Chief Minister announced last month that we must carry out a thorough review of our national insurance and benefits system. In view of this, I have therefore decided not to make any fundamental change to personal allowance credits this year, and will ensure that a definitive view on the future of the system comes out of the benefits review.

However, I do feel that the rising cost of the system must be halted, and so I am proposing that the amount of the personal allowance credit should be reduced from £700 to £500. In inflation adjusted terms the payment will still be more than the equivalent of £200 when the scheme was introduced. I am also mindful of the distorting effect when compared with those earning the minimum wage. The reduced amount will still be payable to all eligible people whose income in the 2011/12 tax year is less than the £9,300 personal allowance level. In effect it is paid to those who do not pay income tax.

The personal allowance credit system continues to provide financial support to the less well-off in our community. Credits are paid to over 11,000 people each year and even with the change which I have announced just now, the total amount provided to those on low incomes through this system will still be in excess of £5.5 million.

I intend, Honourable Members, to abolish a tax relief this year, but in a way which aims to be revenue-neutral. The relief for maintenance payments is currently based on the principle that the payer gets relief and the recipient is taxed on the amount received. It could be argued by some that the relief provides a benefit for family breakdown: although others may say that it encourages those required to pay maintenance to do so.

This relief is difficult to administer, and obliges couples who have split up to become involved in what are sometimes complicated dealings with the Income Tax Division. My proposal is therefore a straightforward simplification: that we should abolish the relief but also at the same time exempt maintenance from being treated as taxable income in the hands of the recipient. This change will adversely affect some 982 people who currently pay maintenance.

The biggest change which I will propose in individual taxation this year is to remove tax relief at the higher 20% rate from all remaining reliefs and deductions with the exception of pension contributions. This means that all taxpayers will receive the same treatment and be given relief at the 10% rate, and I consider that it will therefore be a fairer system as a result.

The areas covered by this change are:

- interest paid on mortgages and loans;
- charitable donations and deeds of covenant;
- private medical insurance;
- nursing expenses; and

- educational deeds of covenant entered into on or before 5 April 2011.

It may be felt that this was not the time to reduce tax relief to 10% on mortgage interest paid, but with the current low level of interest rates, which are forecast to continue for the medium term, I feel that it is a sensible approach. I am also aware that this tax relief is now unusual in European terms as is allowing relief on any interest paid, which may include finance for a new car or a holiday.

The Income Tax Division has been carrying out an initiative with all Government Departments to examine the conditions under which services are provided by external agencies and contractors, and has found a number of areas of concern which may mean that the correct amount of tax and national insurance contributions due to the Isle of Man are not being received.

The Assessor already has powers under the Income Tax Acts to direct that any payment made which is attributable to labour or service is remuneration and that the person who the Assessor considers ought to be the employee, shall be the employee. This power has been used infrequently, but so that we increase the fairness for those who are contributing through taxes and national insurance, I have asked the Assessor to consider using this power more often: and in particular where in his opinion someone would be in an employment relationship but for the insertion of a company.

Madam President, I would also like to state that although not included within our Order Paper today, I intend to introduce a legislative change which will make it clearer when income is to be treated as deriving from employment.

#### National Insurance

Honourable Members will know that at present, and by virtue of a reciprocal agreement, large parts of our national insurance system mirror the UK system, and we are obliged to follow certain changes each year which the UK has brought in. We do, however, have some flexibility, and I want to exercise that flexibility this year so as to maintain the Island's competitiveness and to introduce a significant new policy aimed at encouraging employment.

Madam President, for the sake of brevity, I will not go through what might be called the routine changes in national insurance rates and thresholds in detail, and would guide Honourable Members to their budget packs where the details are set out. I should say, however, that I have decided that we will hold our principal rates of national insurance contributions for employees, employers and the self-employed at levels 1% below those in the UK.

I intend to introduce a completely new scheme in order to boost employment and economic growth. From 6 April this year, I am proposing the introduction of a national insurance holiday for employers who take on extra staff. This scheme will run for an initial period of two years, and will be reviewed regularly so that I can determine its impact.

For those employers who do take on extra employees, there will be no employer national insurance contributions to pay while the scheme is in operation. So that we can provide benefits for the economy and the community at the same time, I can

inform this Honourable Court that I consider that this scheme will be of most benefit to: young people who are not in education, employment or training; the long-term unemployed; Manx-educated and supported graduates; and those people who leave the public sector as a result of cost-saving measures.

I feel, Honourable Members, that this is a responsible measure with a clear goal. It can be said to be revenue-neutral, in that the people who may find employment as a result of it do not currently pay any national insurance contributions. We can consider its future during the review of national insurance and benefits, which will also have a two year delivery time. That review will also address my concerns that certain people, while receiving significant income during their normal working lives, are able to reduce or eliminate their national insurance contributions through using anomalies in the rules which we now have. I do not consider that such a situation meets my test of fairness, and I intend to deal with it.

### Company taxation

Madam President, the last area of taxation to consider is that for companies. As was widely reported, the European Union has accepted that the abolition of the attribution regime for individuals announced by my predecessor as Treasury Minister is sufficient to remove what had been considered to be the harmful elements of our tax system. The zero-ten company tax system continues, and both existing businesses and potential new investors in the Isle of Man can have confidence that we have delivered stability and the retention of a highly competitive aspect of our economic offering.

If I simplify the European Union's message to us it was this, "Apply your zero-ten regime across the board and without rules which give a different position for international and local investors." Taking away the attribution regime does this, and leaves us in the situation where company profits can only be taxed when paid out as dividends received by Isle of Man shareholders. That is easy to understand and administer.

Comments have been to me made by various people - including some Honourable Members - that the new system will lead to unacceptable tax planning, to a two-tier system which favours the wealthy and to a reduction in our revenues. I have some sympathy with those views, and I will now give this Honourable Court my response so that it is clear how the Treasury intends to deal with the issue.

Madam President, Government's own analysis which was supported clearly by the responses to our consultation on business taxation in 2010 is that our economy will be damaged seriously if we move away from the current zero-ten system. Government has been asked by virtually all sectors of our economy to do all that it could to retain zero-ten. We have acted responsibly and have delivered what is needed. That is a very significant achievement, and one which cannot be underestimated.

We are proceeding on the basis that there may be some tax deferral through the use of company structures, because according to my latest figures attribution charges in the 2010/11 tax year resulted in approximately £3.5 million in tax. But this ought not to ultimately lead to a loss of revenue because we will tax company profits when they are distributed to shareholders. That is the position in which we find ourselves

as a result both of the needs of the economy and of the European Union Code Group's findings: and it is one which I am prepared to accept.

If people engage in what has been described in a European Court case as "wholly artificial arrangements intended to escape the national tax normally payable", then I am sure that all Honourable Members and a very large majority of our population will expect the Assessor of Income Tax to challenge these arrangements and seek the tax which should have been paid. He has pre-existing statutory powers which can be used for this purpose and will apply them as necessary. We may consider bringing those powers up to date, as they have been on the statute books since the 1980s.

The Assessor will be monitoring the flow of revenue carefully in the coming months and years. If for any reason he sees that the pattern of revenue collection is changing more than we had initially estimated, then he will report his findings to Treasury and I will then need to consider what action to take. If I felt obliged to bring in new legislation then the Isle of Man would in turn be obliged to report it to the European Union for it to be assessed by the Code of Conduct Group, and we could find ourselves once again in a period of uncertainty and challenge. Honourable Members will share my desire not to be put back in that situation.

A further review by the Code of Conduct Group coupled with loss of revenue could lead to the end of the zero-ten system itself.

We have a low tax system in the Isle of Man, and I trust that with the advantages it brings – both personal and business - there will be no need for people to seek to achieve an even lower tax burden. While a Treasury Minister cannot dictate forms of ethical behaviour to the population of the Isle of Man, he can point out the consequences of some actions as I have just done.

I will say no more about taxation for now Madam President, as I think that my message is clear, fairness and equity, and move to summing up my budget.

## **CONCLUSION**

There are many measures that I have announced today that I wished we were in a position to avoid. The financial facts Honourable Members speak for themselves. So my objective in compiling this year's budget has been to be fair. Fair to the taxpayer who expects us not just to put up charges to deal with Government's problems but to be more efficient. Fair to the person on average earnings who does not utilise to the same level the generous levels of tax reliefs that some have come to enjoy, and most of all, fair to those on low and fixed incomes who need our assistance, but not to a point where they can earn more on benefits than they would get in work.

I believe that those who can work should. For their own benefit, for the wider benefit of society and of course Government revenues. We are fortunate to have retained near full employment at a time when large numbers of young people across Europe are desperate for work. I do not intend letting our young people become a lost generation and the changes to National Insurance are specifically designed to ensure that they get the work experience they need, at a time when employers may need a little extra help to take a chance on a new employee.

Our Strategy for rebalancing the public finances has sought to balance the need to grow the economy and deliver on financial savings. Successful Governments do not deeply cut when the economy slows, as this is what led to the Great Depression. So I have deliberately used reserves to support our economy rather than create a downward spiral. We ignore the lessons of history at our peril.

I have mentioned fairness a number of times today. There is a danger that I acknowledge that we all have a different view of what fair means. The production of this budget has involved the Council of Ministers in debating on a number of occasions these very differences amongst ourselves. So what I look for today is your support for Council in the challenge we have set ourselves. These are - to rebuild our finances, to protect the vulnerable, and to grow our economy. I feel that this budget does exactly that!

I have not had the time to consult as widely as I might, but what's still needed is clear. A roadmap of how each Department will live within its means over the next three or four years. We will do that this summer, as part of medium term spending review.

Honourable Members I would like to thank my Treasury Team of Mr Lowey, Mr Braidwood and Mr Henderson, and my officers, all of whom have supported me in the preparation of my first budget.

I have been given the task of balancing the budget, and this will mean saying no on more than one occasion as we move forward. We cannot consider any new spending proposal until our finances have been rebalanced and we owe it to our constituents not to mislead them by making promises which we cannot keep. Let us focus our energies on agreeing the key services that we need to support, and those which we will reluctantly have to stop. This will be far more productive than objecting to each and every necessary change. Please look at the whole picture, not just a small piece of the jigsaw. During the recent election campaign many people told me, and other successful candidates, that they expected firm leadership to deal with the problems now facing us. Let us not disappoint them as they have placed their trust in us to deal with the problem.

I know that we can and will emerge stronger in the years ahead, but change we must and change we will.

I commend this budget to this Honourable Court.

Hon E. Teare ACIB MHK  
Minister for the Treasury  
21<sup>st</sup> February 2012.