

PART B

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4. OVERALL PART TWO SUMMARY

- 4.1 This section sets out in summary form the main facts which the Commission has accepted and the main conclusions which it has reached. Detailed explanation, reasoning and evidential basis for finding the facts accepted in this section and the conclusions drawn are seen in the later sections of the report.
- 4.2 The Commission concludes that there was a material linking of taxation and planning matters in the planning and development history of Mount Murray. Pressures were successfully applied to government in relation to taxation matters in the same way, and as part of the same exercise of seeking to obtain financial advantage for the Mount Murray developer as had been successfully applied in respect of planning matters. Thus the pressures applied on taxation matters included strongly made threats of withdrawal of the Mount Murray project, and of litigation, if the developer's tax requirements were not met. The requirements included the introduction of more favourable new tax legislation. The pressures were, although often extremely aggressive in nature, not applied in an unlawful way. Moreover we expressly find that the developer's professional tax agent/advisor did not exceed any boundaries of professional propriety.
- 4.3 The pressures and demands were not overall dealt with well by government, and there were failures within government.
- 4.4 The irregularities which occurred in respect of the development at Mount Murray, insofar as they related to tax, affected three departments of government. These are the Department of Tourism, the Treasury, and the Department of Local Government and the Environment. The last named department was central to the overall matters concerning Mount Murray, but its relation with tax was by association and it was the first two which were the departments deeply involved in tax issues. The Department of Tourism's activities featured prominently in

both planning and tax issues, and it can fairly be described as the linking department.

- 4.5 Coincident with the applications for and the granting of planning permissions at Mount Murray there were substantial changes in the regime for financial assistance from government for the developers of tourism projects.
- 4.6 A brief introductory background history is appropriate here, and follows. At the beginning of 1987 there were in place schemes for grants and loans and for income tax allowances for development projects. The former related primarily to small scale upgrading projects such as providing en suite accommodation and updating fire protection systems. The amounts disbursed by government in grants in 1987/88 were about £250,000 in total. This was in fact a typical amount in the years continuing well into the 1990s. They did not exceed £0.5 million in any year although occasionally this sum was budgeted for. The picture was similar with loans. The income tax allowances for capital costs in tourism projects were 15% initial allowance and a 2½% annual allowance.
- 4.7 At this time, the beginning of 1987, the Isle of Man Hotel and Guest House Association sought a substantial improvement in the income tax capital allowances for tourism projects from government. There was some sympathy with this request from officers and politicians in government. There was an initial approval in principle by Treasury. A reasoned paper was then put forward by a Department of Tourism member that there should be income tax allowances of up to 250% of capital expenditure on tourist premises. This was considered by Treasury but rejected in January 1988. The Treasury's approach was to suggest that existing aid schemes should be reviewed.
- 4.8 The Department of Tourism did look again at the issue of the capital allowances during 1990 and produced a paper coincidentally with the time when, in November 1990, the developer had meetings with government about the development proposals in respect of which a planning application was first submitted in January 1991. Thus on 14th November 1990 the Department of Tourism submitted a paper to the Treasury, reviving the proposal for the 250%

capital allowances and which, as expressed by the Assessor, would have meant that there was effectively a (government financed) 50% subsidy toward the capital costs of improvements (or projects). This would be achieved over five years. The paper proposed that the system be introduced on an experimental basis within a limited low cost sector of tourism where the impact could be monitored closely. It was not favoured by Treasury officers, and on 27th February 1991 Treasury considered the proposal, did not approve it, and determined that the Assessor should research an alternative option of an initial allowance of 100% of allowable capital expenditure.

- 4.9 Before the research identified in the preceding paragraph had been completed and reported back to Treasury, and at a time when the initial planning approval was under review, and with the January 1988 Treasury decision of rejection still in place, a meeting was held, on 20th March 1991, between the Minister for Tourism and a Tourism member, and the Treasury Minister. This was a meeting of politicians because, although the Treasury Minister was prepared to allow officers to consider the matter, a political decision on the tax issue was required by the Department of Tourism, and a meeting between officials of the departments was not acceptable to the Department of Tourism. The objection to a meeting between officials was because the Treasury officials did not support the proposals in the Department of Tourism's paper of November 1990. A decision to proceed with the 250% capital allowance proposal resulting in the 50% government financial support of allowable items on tourism development projects was taken by the Treasury Minister at that meeting of politicians on 20th March 1991. There is no Treasury record available which justifies or explains this decision. On 16th April 1991 the proposal was announced to Tynwald in the Budget Speech, and an Order implementing the proposals was made by the Treasury in September 1991. The developer did not lobby for this Order to be made.
- 4.10 The concerns of the Treasury officials included their disquiet that the tax situation would be distorted by generating group relief claims or allowing reliefs to be set off against investment income. Group relief means that within a group of companies a loss making company can transfer that loss to a profit making

company in that group, and thereby reduce the tax liability of that profit making company. In simple terms, a relevant effect could be that although the objective of the government support would be to give an incentive to a tourism business to improve its product, and thereby become more attractive and consequentially profitable or more profitable, government support through the tax reliefs could, through the exercise of group relief, be taken up on its existing profits by non-tourism businesses.

- 4.11 From early 1992 the developer, with the assistance of its tax agent/advisor, pressed government for the range of allowable items falling within the taxation reliefs to be widened. Consequently, and mainly because of the Mount Murray development and the threats and demands imposed on government, a widening Amendment to the September 1991 Order was made in December 1992 and approved by Tynwald in January 1993. It was given effect as from April 1992.
- 4.12 The continuing concern of the Treasury officials was indicated first in a memorandum to Treasury from the Assessor on the day that Treasury made this Amendment Order. The memorandum stated that despite various attempts it had not been possible to introduce any restriction for group relief purposes, and it was suggested that such restriction should be provided for in the next Income Tax Bill. If acceptable it should be announced that a restriction would be imposed and would apply from 6th April 1993 (or other decided date) and thus could be backdated as prior notice would have been given. This concern about group relief had been made to Treasury by the Assessor on a number of earlier occasions.
- 4.13 The point was carried forward in the Brief for the Minister when the Amendment Order was to be put to Tynwald for approval. The Brief stated that measures would specifically be introduced into the next Income Tax Bill preventing any group relief set off for incentive allowances awarded in 1994/95 and subsequent years. Supplementary information in the Brief referred to there being only two known projects which would qualify. One was Mount Murray and the other a comparatively small project in the south of the Island. There was nothing

confidential in this information. The Minister did not tell Tynwald any of these things which had been set out in the Brief which we have just identified.

- 4.14 Additionally a Practice Note was issued by the Assessor dated 26th January 1993 explaining that consideration was being given to restricting group reliefs for 1994/95. In fact legislation enabling the restriction of these reliefs was not passed until 1995 and no Order has yet been made restricting such reliefs as is enabled by the 1995 Act. No government monitoring of the financial effect of the Order as such has taken place.
- 4.15 Given the above circumstances and the substantial amounts of money involved, possibly many millions of pounds as appeared from the contemporary documents, the Commission concluded at an early stage that there appeared here to be tax related irregularities connected with the Mount Murray development history as handled by government which required close consideration. This would either enable the Commission to dispel concern or to identify matters which were of concern and which would be evaluated by the Commission so as to enable appropriate final conclusions to be drawn. These conclusions follow in summary form.
- 4.16 The role of the Department of Local Government and the Environment has been explained in the Part One Report but its decisions and actions were still relevant to taxation matters, because of the contemporaneous planning history, the similarity of approach by the developer, the way in which the nature of the development and its permitted planning uses affected the ability to achieve tax benefits, and the interlink between tax and the residential development. For example, a very hard fought for certificate confirming eligibility for tax reliefs for housing resulted in the developer receiving a letter of intent concerning the availability of tax reliefs for the housing phase of the development; this letter of intent was acknowledged by the developer as a valuable marketing tool for the disposal of the residential units, even though in the event no tax relief has been claimed on these units. It was the residential units which were crucial to the viability of the whole development, as was acknowledged by a director of the developer companies.

- 4.17 The Department of Tourism which had a significant role to play in planning matters, also had a significant role to play in taxation matters. It allowed itself to be involved in detailed taxation matters and deemed tax relief commitments to the developers and failed to liaise appropriately with the Treasury until the developers had achieved, as they thought, commitments to certain assured taxation benefits. The Department of Tourism had no authority to allow this situation to develop.
- 4.18 When faced with these circumstances the officers of the Treasury for the most part behaved appropriately in seeking to make good the position created. The Treasury Minister did not accept the cautionary advice of his officers, and took political decisions on the promotion of tax relief legislation following discussions with the Minister for Tourism and a Tourism member at a meeting from which officers were excluded. As earlier explained these actions were taken when there was a current Treasury decision, not at any material time rescinded, opposed to the 250% proposal and the Assessor of Income Tax had not yet reported back on lesser alternative approaches which Treasury had asked him to research. The Order was passed on the basis that legislation limiting the effects of the Order would be implemented. No such limitation has been implemented, and no monitoring of effects was put in place.
- 4.19 The tax relief legislation was intended to promote tourism but the extent of the effect of this legislation upon the General Revenue of the Isle of Man could have been considerable. The loss or risk of loss could have been prevented or mitigated by precautionary measures to limit effects as advised by officers. But these were not implemented and the effects of the tax reliefs were not specifically monitored. The legislation was in part implemented for the benefit of the Mount Murray development and in part it was understood that the Mount Murray development, a high cost project, would be a beneficiary, but when the principal initiating legislation was introduced this was by no means fully understood. Had there been pause for thought in an informed way by the government decision makers it would have been seen that the extent of benefit could be substantial, as the next following paragraph shows.

4.20 The effect of the tax reliefs was to provide substantial benefit for companies associated with the Mount Murray developers which were not companies whose business was tourism. The unforeseen cost to the General Revenue of the Isle of Man could have been many millions of pounds. The Commission has had access to some very detailed figures. Notwithstanding this and so as not to put confidential information into the public arena unnecessarily, it is sufficient for the Commission to say, as with confidence it can do, that the loss of revenue in terms of tax foregone was substantial and it is not unreasonable to look at the initial investment figure put forward by the developers of £20 million and take the 50% subsidy from government in the form of income tax relief amounting in this context to a cost to the taxpayer of £10 million. This is unlikely to be precisely accurate but it gives a reasonable starting point as to the feel for the possible extent of the loss.

4.21 It is acknowledged that there are likely to be some offsetting economic benefits. For example, it has been suggested by some that the Mount Murray development will have created direct and indirect tax revenues which would otherwise not have accrued and that this should be offset against tax foregone. We agree that this is correct as to principle, but it should not be taken into account as we have found as fact that the Mount Murray development would have proceeded to completion whether or not the tourist business incentive allowance had been introduced. There is likely to have been benefit in that some tourist projects have been "incentivised" to come forward but we have not ventured into any economic appraisal of that. (Such figures as we have seen suggest that they do not constitute anything like a complete offset, and furthermore, while the allowances would have an effect on tax revenue which would be foregone very quickly, it would likely be many years, if at all, before all that allowance value was recovered). However the loss or risk whatever its extent truly is could have been prevented to a significant extent if the mitigating steps, or similar, as advised by officers of the Treasury had been implemented. They have still not been implemented although primary enabling legislation has been in place since 1995. At the very least attempts to limit loss could have

been made if appropriate thought and care had been applied by the decision makers in the promotion of these Orders.

- 4.22 We note other cost figures provided by the developer. The Notes of Presentation referred to a cost figure of £8 million for the hotel and connected facilities, which on its face would, with the 50% consequence of the Order, provide £4 million. By May 1991 the developer was talking of the overall related development costs of £50 million. We conclude that there can be little doubt that the introduction of the tourist business incentive allowance at the exceptional rate at which it was introduced did lead to a tax revenue reduction of very many millions of pounds. Whether that loss was justified by the incoming investment which was attracted by those tax allowances can really only be answered by a properly worked through economic analysis and there has been no such appraisal; the government has not carried out such an analysis and the Commission did not deem it realistic or proportionate for itself to work through or commission such a study.
- 4.23 The Ministers for Tourism and the Treasury were at fault in allowing or in making these things happen, particularly without the consequences following from the development at Mount Murray being considered, let alone evaluated. The Minister for Tourism, together with the Tourism member, and with the minister having full knowledge of the scale of the Mount Murray development helped persuade the Treasury Minister to implement legislation favouring the developer contrary to the cautionary advice of the latter's officers. The persuasion was actually done by the Tourism member, on the basis that it was a low cost, low risk approach. He genuinely believed this and was unaware of the Mount Murray proposal. The Minister for Tourism was aware of the Mount Murray development proposal, but seemingly did not bring it to attention as a major development on which a high tourist industry value had been placed. It is difficult to see how it could be regarded as low cost. If he had brought the matter to attention the result of the meeting might have been different.
- 4.24 It is not for the Commission to say whether or not an incentive scheme at 250% is appropriate. That is for government. It is appropriate however for the

Commission to point out the consequence of that incentive for the tax revenues of the Island in circumstances where group relief was, and remains, unrestricted, and in the context of government handling them in such a way that the consequences were not initially pre-considered, when agreed mitigating action was not followed, and when the Mount Murray development was a lead illustrator on this matter. In the event the meeting resulted in allowing tax reliefs amounting to millions of pounds which was a scale not appreciated within the Treasury.

- 4.25 The fact that these benefits were also open to be taken up by any developer is a correct but largely marginal point in the context of the available knowledge at the time the legislation was promoted, made, and approved by Tynwald. The understood genesis, philosophy and purpose of the legislation was to give incentives to failing or stagnating tourism projects to improve their product and become profitable, or more profitable. It was thought that it would apply principally to limited scale existing operations. It was in truth available to large scale operations, but because of lack of transparency, this was not generally perceived. It was however known to the Minister for Tourism and within the Department of Tourism, and, in principle, to Treasury officers; the latter tried to limit the effect, but the former pressed for speedy implementation in full knowledge of the scale of the Mount Murray development proposals and that the proposals were an important source of government financial assistance from the Treasury to the Mount Murray development. There were not any other major developments being actively pursued towards construction at that time.
- 4.26 The Minister for Tourism also allowed, and co-operated with, the developer to obtain assurances on detailed tax matters from the Department of Tourism providing further benefit to the Mount Murray developer when there was no right to do this, with the consequences that the Treasury was faced with the difficulties caused by such assurances.
- 4.27 Furthermore the Minister for Tourism misinformed House of Keys in April 1992 when, in response to a question, he stated, incorrectly, that there was no government financial assistance for the Mount Murray development. At that date he was fully aware of the Mount Murray development and that, through its tax

agent/advisor, it was seeking tax reliefs, and that legislation was recently in force with the effect of providing such reliefs expressly referred to by the Assessor and expressly referred to in an Explanatory Note to the Order already in force respectively as 50% of the actual expenditure incurred and as up to 50% of the gross costs, with its consequential effects upon revenue. Furthermore the developer was then working with the Department of Tourism to have these reliefs extended for its own benefit. While it was the case that the Minister for Tourism suffered from a serious illness during 1991 and 1992 he was aware that the Mount Murray developer was working very hard indeed to have financial assistance from the government over a widened area of allowable items. Less than two months before the House of Keys statement, the developer's tax agent/advisor had said in correspondence to the Department of Tourism expressly that he was seeking financial assistance for tourism development projects from government and wished to have a meeting with the Minister about this. There was a detailed meeting with the Minister on this very matter at that time, the Minister being aware that Mount Murray was one of the tax agent/advisor's "projects" which would receive that financial assistance if the tax agent/advisor was successful in his aspirations. However in all the circumstances we have concluded that this particular incorrect answer given to House of Keys by the Minister was not a deliberate misleading of the House of Keys but a very serious act of carelessness which deserves severe criticism.

- 4.28 The Treasury Minister was at fault in accepting the pressure from the Minister for Tourism and the member from that department to promote the legislation when he did not understand the potential high cost of that legislation, notwithstanding that warnings had been given to him. This error is compounded by the fact that there was in force a very recent Treasury decision which did not accept the 250% proposal and that the Assessor had at the same meeting been tasked to research an alternative approach but had not yet reported back. Furthermore the 1988 Treasury meeting expressly rejecting the 250% approach had not been rescinded. The Treasury Minister was further at fault in not indicating to Tynwald that the Order extending the areas of expenditure which qualified for relief was being taken forward on the basis that there would be limitation of its effects so as to avoid distortion in tax revenue. He was yet further at fault in not ensuring that

provisions to limit these significant effects were enacted and put into force. He was also at fault in not ensuring appropriate monitoring of the effects of these tax reliefs at an early stage. These faults of the Treasury Minister were serious but they had no ulterior motivation. They were failures of governance which, on the basis of contemporary information, could have cost the General Revenue sums in the order of millions of pounds which it had not expected to give up. Insofar as the evolution and making of the Order is concerned the Treasury Minister's faults and our criticism of these faults rank considerably higher than those of the Minister for Tourism.

- 4.29 The actions of the officers in the Treasury were largely exemplary in relation to advice concerning the proposed legislation and to the advice given in relation to the issue of certificates which later supported the grant of the tax reliefs. They should however have ensured monitoring; and new legislation or other measures restricting the manner in which any unrelieved incentive allowances might be utilised was not implemented notwithstanding that this was the basis or consideration upon which the revised tourist business incentive allowances were taken forward.
- 4.30 The Chief Executive and the Development Consultant acting at the Department of Tourism deserve criticism. The Chief Executive allowed himself to be sidelined so that he was not in control of the executive aspects of his department as he should have been, and so that he was not fully understanding of events which were happening within the department. The consequences included allowing the Development Consultant to continue when there was clear evidence of his activities being inappropriate, and failing to understand the necessary approach to operation of the certification of expenditure eligible for the tax reliefs after regaining some measure of control within his own department. He was however in a difficult situation and was genuinely concerned that his continuing employment might be at risk. Whether or not this fear was fully justified is not certain, but it is understandable. It is also true that he was under considerable pressure from the developer and did seek appropriate advice as to how to proceed correctly in the face of that pressure. The consultant is to be criticised for his entry into detailed tax negotiations with the developer's agent without

informing and bringing the Treasury into these negotiations and in seeking to bypass his Chief Executive and others in the departments and work directly, and initially solely, to the Minister.

- 4.31 The Department of Tourism conducted itself poorly in the handling of the taxation aspects of the planning and development history of Mount Murray. It was badly run, mismanaged, carried out actions which it had no right to carry out, and, when it was required, had poor, virtually non-existent communication within the department, and with other departments. This was a very poor level of competence but we do not find that it should be categorised as failing within the wider aspect of corruption. Although in early 1992 it appeared to be doing little to resist the manipulation and pressures of the developer, it was rescued from going further down the road to improper executive decision making by the Income Tax Division of Treasury in this matter, and when Mr Toohey did ultimately come to have control of the department in 1994 and 1995, even though he did not fully understand all relevant procedures, he did seek advice to attempt to ensure that decisions and actions of the department were the correct decisions, or at least, were addressed in an appropriate way.
- 4.32 The Treasury was not either corrupted in this way although there was a serious failure of governance by its Minister. The errors should more properly be described as errors of judgement, understanding and rigour.
- 4.33 The Department of Local Government and the Environment has not really featured significantly as a department in relation to taxation matters and so is neither commended nor criticised. An officer did provide wholly erroneous information to the Treasury in 1994 which left that department seriously misinformed as to the nature of the planning permissions given in 1991. That should not have happened but the Commission find this to have been a careless, albeit very regrettable, mistake, which, in the event, and in the context of this Report, should not be regarded as significant.

4.34 We find no evidence of corruption relating to taxation matters in the narrower, criminal sense, that is to say some improper action taken in return for some material gain, for example, any money gift or other consideration paid or given.

END OF SECTION 4

