PART E

CONCLUSIONS ON PART D

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8. CONCLUSIONS ON LEGISLATIVE CHANGES AND THEIR OPERATION

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i) <u>Introduction</u>

8.1 The developer wished to make the Mount Murray development more profitable by securing more generous tax reliefs than were previously available in the Isle of Man.

8.2 A source of information about the developer's successful efforts to obtain tax reliefs was the files which were maintained by the Department of Tourism and were supplied to the Commission when it commenced its work in 2002. The files showed substantial evidence of the developer's successful efforts to obtain tax reliefs, but this evidence is primarily relating to activities in and after 1992.

8.3 The Mount Murray project came into public view in 1990. Prior to April 1990 the income tax allowances law was that there was an initial allowance of 15% and an annual allowance of 2½% in respect of qualifying capital expenditure on tourist premises. The development secured its initial planning permissions in 1991 and

took these forward into more detailed permissions in 1991 and 1992, when development commenced. By April 1991 the capital allowances available in respect of qualifying capital expenditure on tourist premises had been increased in various stages to a total of 250% over four years, equivalent to one half of the capital cost of such qualifying capital expenditure. The extent of this rise was unprecedented. Within a further twelve months the range of types of capital expenditure which attracted the incentive allowance was widened to accommodate the requirements pressed on government by the Mount Murray developer. By its own statement the developer did benefit from these capital allowances to a significant amount.

8.4 This exceptional rise in allowances started with a modest rise from the pre-1990 amounts to 20% for the initial allowance and 10% for the annual allowance. Then the Income Tax (Capital Relief) Order 1991 replaced the initial allowance and the annual allowance by a first year allowance of 100%. From the same date the Income Tax (Capital Relief) (Tourist Business Incentive Allowance) Order 1991 allowed the grant of a further allowance of 150% spread over three years. By an Order approved in January 1993, but with effect from April 1992, the last named Order was amended to widen the areas of expenditure for which the additional relief was available. This latest step was applied by the Income Tax (Capital Relief) (Tourist Business Incentive Allowance) (Amendment) Order 1992.

8.5 There was a remarkable coincidence of dates. On 14th November 1990 there was a meeting between the developer's representative, Mr Spence, and a representative of the Department of Tourism, Mr Mitchell. On the same date the representative had another meeting, with the Chief Minister, Sir Miles Walker, and a letter was written by him to the planner/architect in the Department of Local Government and the Environment, Mr Vannan. These contacts all concerned the proposed development at Mount Murray. Also on the same date the administrator in the Department of Tourism, Mr Ball, wrote to the Treasury setting out the principles of the proposals which were in effect taken up by Treasury and resulted in the 250% income tax allowances just referred to. By 20th March 1991 the developer had submitted a planning application for the development at Mount

Murray and an initial approval decision had been given, but limiting development to the zoned development area within the application site. On that date, and for at least the second time, the developer's representative met Mr Bell, the Minister for Tourism, and discussed the grounds for review of that limiting initial decision to the extent of leaving with Mr Bell a draft of the grounds for review, or appeal.[1] Also on 20th March 1991 the developer's representative met with senior officers in the Department of Local Government and the Environment as well as submitting the formal reasoned written application for review of the earlier planning decision.[2] On the same date there was a yet further meeting, this time between the Minister for Tourism and the member for Tourism, Dr Orme, and the Treasury Minister, Mr Gelling. This meeting resulted in the Treasury Minister accepting in principle that the 250% allowances proposals should go forward into legislation.[3] There had been opposition by Treasury officials to the proposal, and a meeting between officers of the two departments was cancelled by the Department of Tourism and replaced by this meeting of ministers and the member. On 16th April 1991 the Planning Committee issued formally a planning approval which set out the decision which had been taken on 12th April 1991 to allow the review of the decision by the Planning Committee so that the restriction on the area of development was removed. On the same date, 16th April 1991, Tynwald approved the new 100% first year allowance and the Treasury Minister announced his intention, in his Budget Speech, to introduce the additional 150% incentive allowance. On 4th October 1991 planning permission for 150 houses without the previous conditions restricting to tourist use was given, while on 15th October 1991 the 1991 tourist business incentive allowance (250%) Order was approved by Tynwald.

8.6 On 24th July 2002 the Commission heard oral evidence from Mr John Cashen, who was the Chief Financial Officer at the Treasury from May 1991 to August 2001. He was asked about the Income Tax (Capital Relief) (Tourist Business Incentive Allowance) Order 1991, and its Amendment Order in 1992. He was particularly asked whether it was his understanding that any particular

[1] File A page 50: Spence letter 21.3.91
[2] File A pages 44 - 49
[3] Mr Gelling Document Q23 23.10.03 para 14

development was the initiator for this legislation which the Department of Tourism was wanting, and whether they had a specific development in mind in 1991 and 1992. Mr Cashen, whilst pointing out that the Order was available to any development throughout the Island, said that certainly the Mount Murray development was the catalyst for the Order and "there's no doubt about it, that the Mount Murray development was the originator of that Order".[4] He went on to confirm that the Mount Murray development was the originator of both the Orders, the 1991 Order and the 1992 Order.[5]

8.7 In exactly the same way as there had been threats made in relation to securing appropriate planning permissions, and as we reported in our Part One Report, so there were threats in relation to the taxation or grant relief. There were threats of withdrawing the development or threats of litigation to achieve what the developer claimed it should have.

8.8 In the first planning application dated 16th January 1991 it was stated that a government grant was not required if one adhered to the resort village concept.[6] The Notes of Presentation made the same point, that the developer or the development funded the whole cost.[7] Part of the background to the overall 250% incentive allowances was that the grant system was not achieving the investments in tourism which the government was seeking.[8] The Notes of Presentation put forward by the developer's representative drew attention to the availability of grants but also specifically referred to what was described as an attraction, that is that the Island was a low tax area and offshore financial centre. The issue of grant, which ultimately graduated into the issue of tax allowances, was brought into the context of the planning permission in a letter which Mr Spence wrote to the Minister for Tourism, Mr Bell, on 29th April 1991.

8.9 This was a letter which was not available to the Commission when it wrote its Part One Report. It is a typically threatening letter with the sanction of withdrawal

[4] Evidence of Mr Cashen Q17 Transcript Day 18 page 27
[5] Evidence of Mr Cashen Q17 Transcript Day 18 page 28
[6] File A page 13 para 12
[7] File A page 28 Notes of Presentation page 2
[8] Para 5.25

of the development if the developer's demands are not met.[9] On its first page there is a reference to grant but it is said by Mr Spence "that financial inducements of this nature are avoided if possible because of the 'red tape' which is usually attached to them". The red tape can be plainly deduced as the requirements to set out fully the underlying basis for the proposals including business plan, marketing plan, financing details and so forth.

8.10 It would also be well known that the grant fund was limited and that a grant required for a hotel would most likely have to go for debate in Tynwald.[10] It would be known that the Novotel proposal for grant had failed in 1989 and that the developer had been the subject of detailed comment in Tynwald. Such publicity and revelation of its detailed plan was quite contrary to the philosophy of the developer of Mount Murray. Nevertheless it is said by him in this letter of 29th April 1991 that Mr Spence assumed that for political reasons the occupation of the villas was restricted to tourists only because grants were available. This, he said, was alright because the availability of grants would enable them to market the houses at a discount. However something had happened at a meeting with Mr Bell a few days earlier than the date of the letter as a consequence of which the circumstances were believed by Mr Spence to have altered and he said in stark terms "without either a grant or the removal of the occupancy restriction [to tourism] this scheme will not proceed." So there is inter-relationship here between the giving of a grant and the granting of planning permission. It was shortly after this letter that events were put in motion which, within the month, had led to the unique resolution of the Planning Committee[11] which itself led to the removal of the occupancy condition in October 1991.[12]

8.11 Later on, broadly commencing in early 1992, there were frequent references in the correspondence to the Mount Murray development being tax driven or like references to the importance of tax issues for the development.

[9] Clerk of Tynwald, attachment to letter 19.9.2003
[10] See para 6.41 above
[11] Part One Report paras 3.44 - 3.66
[12] Part One Report paras 3.59 - 3.66

8.12 The 1992 Amendment to the Tourist Business Incentive Allowance Order of 1991 made it a prerequisite of receiving the incentive allowance that the Department of Tourism issue certificates that certain economic criteria would be met by the development. In 1994 there was a highly determined and persistent effort on the part of the developer to secure the issue of a certificate under the tourist business incentive allowance in respect of the housing development. This included what was described by the Privy Council[13] as a surprisingly strongly worded letter dated 19th October 1994 from Mr Spence to the Chief Minister complaining of what Mr Spence called "unauthorised interference by the Treasury". The letter ended with a threat of litigation and, as the Privy Council also pointed out,[14] threats to withdraw from the development and threats of litigation seemed to have been a weapon frequently used by Mount Murray representatives and advisors in their dealings with the public service in the Isle of Man. As earlier indicated these applied equally to planning or taxation matters. The threats of litigation and withdrawal continued but ultimately certificates, or apparent certificates, were issued for housing in 1994 and in 1995. In the event no incentive allowances have been made in respect of the housing development, but the certificates or apparent certificates issued have been used as marketing tools for the housing, and were described by the developer as "valuable marketing tools".

8.13 We have set out in this introductory section to our conclusions what we have found to be the broad overall picture and which indicates that there appeared to be evidence that taxation matters had a considerable part to play in, and in the circumstances surrounding, the planning and development history of Mount Murray. Within that broad overall picture there are a number of detailed points which we have found it necessary to make conclusions upon in order to complete our examination and report into government's handling of that planning and development history. Accordingly we set out in the remaining part of our conclusions a more precise examination of what actually did happen within that broad framework of events so that the full account of how the government

[13] Privy Council Reasons para 9: para 2.2 above
[14] Privy Council Reasons para 9: para 2.2 above

handled these matters concerning the development and planning history of Mount Murray can be reported so far as that is practicably possible.

ii) <u>The Start of Incentive Allowances Legislation</u>

8.14 Sub-section 6 (ii) above details the events which led to the start of the significant increases in the percentages of the income tax allowances. These events lead us to the following conclusions.

8.15 We are satisfied that the evidence shows quite conclusively that the increases were a natural culmination of concerns expressed in 1987 that there needed to be a different approach to the encouragement of reinvestment in the tourist industry.

8.16 Whether or not the efforts made in 1987 were a revival of past ideas from the 1970s or initiation of what was believed to be a new approach we find to be of little significance, as we conclude that it was the activity in 1987 which did ultimately lead to the passing of the legislation which primarily concerns us.

8.17 We find and conclude that Dr Orme picked up an already ongoing process of seeking a better route to investment and/or reinvestment when he produced his paper, probably in late 1987. His contribution we find was the initiative of taking the matter forward and proposing the very high unprecedented overall rate of 250% allowances which intended that government was funding 50% of the cost of the qualifying expenditure.

8.18 The process came to a temporary end in January 1988 when the Treasury rejected what Dr Orme had put to them. However the route, or principle, of income tax allowances to encourage tourist industry investment or reinvestment had been given Treasury approval in 1987, even if the amount had not. It is absolutely clear that the Mount Murray development played no part in the proposals up to that time.

8.19 We also conclude that the revival of the proposals, which came in April 1990, was unconnected with the Mount Murray development. There was at that time an interest in reviewing the system of income tax allowances generally, and the increase in those allowances for the tourist industry was in part due to 1987 references to the tourist industry not being left out of any such review. The first 1990 steps reflected one of the more limited proposals which had been put forward in 1987. From those first steps in 1990 Dr Orme pressed hard for more significant and effective increases in the allowances. The pressure was successful and the 250% overall rate of allowances was again put by the Department of Tourism to Treasury in November 1990. We find, and it is our conclusion, that there is no indication of any evidence that the Mount Murray development had any part to play in the history of these allowances before the end of 1990.

iii) <u>The Developer</u>

8.20 In this sub-section we set out conclusions relating to the developer. This information is relevant for understanding the inter-relationships between taxation matters and housing and the circumstances which surrounded the handling by government of the development at Mount Murray and is an integral part of the planning and development history.

8.21 The Commission is satisfied that the Mount Murray developer had proposals for the development of Mount Murray for some appreciable time before it started to apply for the various consents in early 1991. This is fully explained in sub-section 6 (iii) above. While the provenance of Leigh Estates (UK) Limited is not clear, it is clear that companies closely connected with the Anglo International group of companies had ownership of relevant parcels of land in and prior to 1990 and that there was passing of titles between them. The objectives of all these land transactions is not fully clear to the Commission, nor is it material for us to pursue it further. Two points have emerged however which are material.

8.22 First, we conclude that they cast doubt upon Mr Spence's claim in the covering application letter of 16th January 1991, where, addressing the Chief Architect and

Planning Officer, Mr Spence makes reference to having researched various zoned sites and obtained an option on the Mount Murray site as being the most suitable. It is unlikely that other sites had been recently researched and it appears that the developer had title and not merely an option on the development site.

8.23 Second, on 8th November 1990 approval was given for Conrad Hotels (IOM) Limited to change its name to Radcon Village Resorts Limited. The latter set itself out as the applicant in the application of 16th January. The actual registration of change of name came on 28th January 1991, and it can be noted that up until 21st January 1991 there was a director of 'Radcon Village Resorts Limited' who was also the Secretary of Grandeur Limited, one of the Anglo International group of companies. Furthermore, at some stage before 1st June 1992 and up until at least 1st June 1992 and for some months after that Mr Spence was identified[15] as the beneficial owner of Radcon Village Resorts Limited. Yet Mr Spence was at all material times an employee of Anglo International Holdings Limited.[16] We conclude that in themselves these are matters corroborative of Anglo International Group being very much involved in the initial application for planning permission and the pre-application meetings.

8.24 However, we conclude that the developer's intent in developing the site was not, in late 1990 or at the start of 1991, tax oriented. The way in which it proposed to proceed was set out in the Notes of Presentation where it is explained that, by utilisation of the villas and apartments in securing investments by others, those third party investments would provide substantial assistance in funding the whole development. There was additionally of course the alternative of permanent residential housing development should things not proceed in accordance with the original main proposal. We come back later to the issue of tax orientation as the project proceeded beyond the start of 1991.

8.25 We also conclude that the coincidence of dates at the early stages when the developer was going through the processes of securing planning consents was

[15] Mr Moore Document Q6 Supplementary Statement page 1

indeed no more than coincidence. We are satisfied that the developer was not involved with, nor motivated by, the initial taking forward of the very high incentive income tax allowances. This applies to the events of 14th November 1990, 20th March 1991, 16th April 1991 and October 1991 identified in paragraph 8.5 above. There is nothing other than coincidence which would support this, and the evidence is actually to the contrary, that is that the developer really only started to show interest in the new income tax allowance position later in 1991.

8.26 However, at least one of these dates is important in the inter-relation between taxation and planning. This is the occasion when, on 20th March 1991, the Department of Tourism, having cancelled a meeting between officials of the two departments of Tourism and the Treasury, replaced it by a meeting which Mr Bell and Dr Orme would attend with the Treasury Minister. This was a meeting at a time when Mr Bell was well aware of the development proposals for Mount Murray and their significance from a tourism point of view and from the scale of the development proposed.[17] It was on that very day that he had a meeting with Mr Spence. This latter meeting was concerned with an appeal or review of the Planning Committee decision which had limited the extent of the area over which development might take place. As it happens Dr Orme was the main spokesman at the politicians' meeting of 20th March 1991 and he persuaded Mr Gelling, the Treasury Minister, to go along with his plans. Indeed we have concluded that it was at this meeting that the Treasury Minister made the decision in principle to proceed with the 1991 Order. The basis, or, as Dr Orme put it, "the ploy" used by Dr Orme was that this was a low cost, low risk scheme. Notwithstanding this theme of the argument of persuasion Mr Bell, we find, did not introduce as a relevant issue to be taken into account in the decision the scale, nature and importance of the Mount Murray tourism development. This circumstance really took the proposal quite away from being a low cost, low risk proposal for tourism incentives. It would not have required a great deal of deduction on the part of the Treasury Minister, if he had had that information known to Mr Bell, to realise that the proposal was not a low cost, low risk proposal at all, as had been argued persuasively by Dr Orme.

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[16] C88 Letter from Mr Willers 18.9.1991: Source File F6

8.27 Mr Moore's written statement[18] drew our attention to an agreement dated 1st June 1992 between Radcon Village Resorts Limited, (which owned the Mount Murray site) Gary Spence and Anglo International Holdings Limited. This agreement had been shown to Mr Moore by Mr Willers.[19] It explained that Anglo International had been joined in this agreement to guarantee the performance of the construction contract by Fairport Limited and required Mr Spence, the then beneficial owner of Radcon, to guarantee the payment by Radcon for the work, in respect of which Radcon would receive tax allowances. Mr Spence had agreed to charge all his shares in Radcon to Anglo International Holdings Limited in pursuance of the agreement and in support of his guarantee. Subsequently, we were told,[20] in 1992 Mr Spence defaulted on the agreement and Anglo International Holdings took over his shares which had been pledged as security. Mr Spence continued as a director of Radcon and later Mount Murray Country Club Limited, as it later became under change of name. Mr Willers declined the opportunity to explain this agreement to us. While these circumstances as outlined were no doubt compliant with law, we find that they are a most curious combination and that in reality there is nothing to dissuade us from our conclusion that the de facto control, ownership of the land, and its development, progress and promotion were under the control of the Anglo International Group fully, as a matter of fact rather than of law. This conclusion is further strengthened when we put together, as we do in paragraph 8.29 below, several factors already referred to and already demonstrated.

8.28 We do not have information which directly explains to us why the arrangement identified by Mr Moore should have been put in place. We can understand fully why the assembly of a land site for a major development project should take place by nominee companies, so that there would not be an inflation in the market price of the land through the knowledge that a major development was in the offing, but this arrangement appears to have gone on and continued well beyond that. The only assumption we can make, and this may be right or it may

[17] Paras 6.91 to 6.95 above
[18] Mr Moore Document Q6 supplementary statement page 1
[19] Mr Moore Document Q6 supplementary statement page 1

be wrong, is that it was a manifestation of the philosophy of the developer that the developer and those controlling the development did not wish to be identified. That is the privilege of anyone and is not unlawful.

8.29 The factors just referred to in paragraph 8.27 are that Mr Spence was an employee of Anglo International Holdings Limited at the material time,[21] that Mr Spence was identified as the beneficial owner of Radcon Village Resorts Limited at the material time,[22] that Radcon Village Resorts Limited was the owner of the land at the material time,[23] that there had been interchanges of ownership of the land between companies within the Anglo International Group prior to the submission of the planning application and prior to Radcon Village Resorts Limited becoming owner of the land, and that there was a party who was both a director of Radcon Village Resorts Limited and secretary of Grandeur Limited in the early part of January 1991. Together we find that they show that it is highly likely that Radcon Village Resorts Limited was throughout under de facto Anglo International control, although at that stage they were both on their face, and in legal reality, separate legal entities.

8.30 However the arrangements just described which give the appearance of separation between Radcon and Anglo International achieved significance as the legislative proposals for, and implementation of the tourist business incentive allowances progressed, became law, and started to operate. The arrangement was highly beneficial in those circumstances. It did not alert those responsible for promoting the legislation that there was a major development by a major group of companies which could benefit substantially by the legislation, which allowed group relief to take place. So far as was generally known Radcon was a company on its own and not part of a group. No doubt that was the legal position. It was certainly the position which was relayed to the Income Tax Division of the Treasury by the developer's agent.[24]

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[20] Mr Moore Document Q6 supplementary statement page 2
[21] Para 8.23 above
[22] Mr Moore Document Q6 supplementary statement page 1
[23] Mr Moore Document Q6 supplementary statement page 1
[24] File I page 247 meeting 27.8.1992

8.31 That situation changed in October 1992 when Radcon became part of the Anglo International Group[25] after Mr Spence did not meet his obligations under the agreement referred to in paragraph 8.27 above. After the entry of Radcon into that group, the Anglo International Group obtained significant amounts of taxation benefit.

8.32 While the matters set out above may not appear to be particularly attractive that is not in itself a matter for us, and no doubt was seen by the developer as the appropriate commercial approach, and we do not see it as an unlawful approach.

8.33 We have already concluded at paragraph 8.19 above that there is no evidence that the Mount Murray development had any part to play in the history of the income tax allowances before the end of 1990, and at paragraph 8.24 above that the project was not at that time tax orientated. Taking things slightly further forward we also find that the developer was not instrumental, nor in any way directly involved, in the evolution of and making of the 1991 Order. It simply became aware of it, saw it as an additional bonus, and utilised it to maximum effect. That utilisation was particularly manifested in the vigorous efforts, which ended successfully, in extending the initial 1991 Order to cover the wider expenditures allowed under the 1992 Amendment Order, which Order was made specifically for the benefit of the Mount Murray development, although it did of course apply to other tourism developments which would fall within its criteria.

8.34 With regard to this finding, a detailed examination of the evidence does show the absence of involvement of the developer in the 1991 Order, and Mr Cashen in his appearance before us during our consideration of these taxation matters did change his evidence from saying that the Mount Murray development was the originator of both Orders, to saying that this applied only to the later, 1992, Order. His reason given for this change was that when he initially gave evidence to us he did not have the benefit of being able to refer to the relevant figures. Having now seen the papers he told us that he realises that what he said with regard to the Mount Murray development being the originator of both those Orders might

[25] Mr Moore Document Q6 Supplementary Statement para 8 and Transcript Day 40 page 56

not have been correct in respect of the first of the Orders.[26] However he did confirm his earlier statement that Mount Murray was the originator or catalyst for the second, 1992 amending Order[27]

8.35 This takes us on to the setting out of two particularly important conclusions. These are first that the Commission concludes that the Mount Murray development project was not tax driven, and second that the Mount Murray project would have proceeded whether or not the tourist business incentive allowances totalling up to 250% under the 1990 - 1992 Orders had come into law. Our reasons for this encompass a number of matters.

8.36 First, the Notes of Presentation indicate that the proposed development is self financing, that is partly by the developer itself and partly by monies and income received from those investing in the project. There are a number of early disclaimers that government financial assistance would be required. As explained at paragraph 6.38 above, early emphasis from the developer was upon grant and the absence of need for it.

8.37 Second, we have seen no evidence that the developer was concerned in the evolution of the 1991 250% tourism income tax allowances, nor that it was pressing for these Orders. Indeed the evidence indicates quite positively that they were not so involved. If they were not involved it clearly was a factor which had no bearing upon whether or not the development would proceed. The development process was already underway by the time the Treasury was considering the 14th November 1990 paper from the Department of Tourism. It can be quite reasonably inferred from the evidence that the project was well advanced in terms of its planning and obtaining of necessary consents before the developer did become fully aware of the progress of the Order and to make the decision to take full advantage of it.

8.38 Third, the phrase "tax driven" or similar phrases did not really start to appear until about 1992 and it is highly likely that the use of such words was taking

[26] Evidence of Mr Cashen Q17 Transcript Day 33 page 10

advantage of a recently understood circumstance which was embraced for the purposes of applying pressure to the government and was not founded upon fact. There was not reference to these income tax allowances in Mr Spence's letter to Mr Bell dated 29th April 1991 (see paragraph 6.40) and there would have been reference had it been a material factor at that time. By 1992, of course, the 1991 Order had become law. This reference to taxation would no doubt have been earlier put on a higher scale had the whole project been tax driven from the start.

8.39 Fourth, the evidence of both Mr Willers and Mr Moore was to the effect that, although tax aspects were important, the project was not tax driven. We have quoted this evidence at 6.39 above. These two witnesses were of course directors at Mount Murray at various times, and were in a good position to present reliable information upon the point. What Mr Moore did also say was that when the viability of the whole package was being worked on it was the residential part which was vital to the viability of the whole development, and that in this respect the residential phase was valued as residential as opposed to tourism in its context. This means permanent homes as opposed to tourism.[28] This evidence shows quite directly that it was the removal of the restriction to tourism on the housing which was vital to the development proceeding and not the taxation issues. In itself this also displays an interlinking between tax matters and planning, by the interchange between taxation matters and planning matters on the claimed vital viability factor, the viability factor being utilised to provide pressure under threats of withdrawal.

8.40 Fifth, high pressure lobbying by the developer for legislative reform in respect of the tourist business incentive allowances only started in 1992 and was concerned only with a widening of the expenditures qualifying under the 1991 Order. This widening was, in comparison to the coming into law of the overall 250% tourism income tax allowances, a much lesser benefit. Had they been lobbying for that scale of benefit then it would be contrary to the developer's approach, as we have seen it, to have done so in a discrete low profile way which has left no record of such lobbying. It seems to us to be the position that

[27] Evidence of Mr Cashen Q17 Transcript Day 33 page 10

had they been lobbying for that proposal they would have adopted the high pressure, high profile type of lobbying which occurred elsewhere in the taxation field and in the planning field. It is also the fact that the developer was aware, as stated in the Notes of Presentation, that the Island was a beneficial location from a taxation point of view.

8.41 Sixth, the Amendment Order was not made until the end of 1992, yet the developer had committed itself to and commenced the development much earlier. In July 1992 the developer and its tax agent/advisor were still arguing hard for the extension of the 1991 Order, claiming reliance on assurance at the beginning of the year but saying that, notwithstanding detailed discussions with the Assessor, there had as yet (by 21st July 1992) been no positive response from any government department.[29] Yet the development on site had already started (about the end of June 1992) and progress had been made.[30] Acquisition of most of the land for the golf course had been completed in February 1992 (see paragraph 6.29 above), and for the hotel and other amenities in 1990 (see paragraph 6.28 above). These cumulative points, we find, are collectively strongly corroborative that the developer was fully committed to the development whatever the outcome of the lobby for the extension of the allowances which ultimately were agreed and made later in 1992.

8.42 We find that the developer did lobby hard, aggressively and persistently for the 1992 amendment to the tourist business incentive allowance so as to widen the range of qualifying expenditures. All the evidence indicates that that 1992 Amendment Order was for the benefit of the Mount Murray development. There is no dissenting evidence on this proposition and our conclusion is that it was for the benefit of the Mount Murray development that the amendment was made. When the Order was made the understanding of government was that this would apply in respect of expenditure amounting to £3.8 million and would result in a £1.9 million reduction in taxation income. It is true to say that the actual reduction in taxation was likely to have been very much less than this, for

[28] Evidence of Mr P Moore Q6 Transcript Day 40 page 52
[29] File I page 166 Letter Mr Spence to Mr Mitchell 21.7.1992
[30] File I page 167 Letter Mr Spence to Mr Mitchell 21.7.1992

reasons such as items being included in the £3.8 million which were already eligible under existing legislation. But this does not detract from the importance of the figure of £1.9 million because that was the figure in government's understanding when the legislation to extend the allowances was promoted. It was the figure provided as a result of a meeting between the Assessor and developer's representatives at which it is minuted "It was agreed that if the Treasury were to be asked to extend the allowances they would need to know the likely cost of additional relief. Nugent said that he would itemise the costs and report back to Kelly by Thursday of next week."[31]

8.43 We find that the developer pressed exceedingly hard for the issue of certificates satisfying the three economic criteria which the 1992 Amendment Order required as a prerequisite for consideration of these incentive allowances. This pressure was applied for the whole of the housing development, and did not discriminate between those houses which would be used, or were at that time proposed to be used for tourism purposes, and those which might be permanent residential properties. Indeed an apparent certificate was issued on 21st September 1994 covering the whole of the site to be developed by housing, villas and apartments. There was an acrimonious dispute as to whether or not this document was in fact a valid certificate under the legislation, that dispute being littered with threats of litigation. The arguments for it being a certificate appear as quite valid and strong, but a detailed examination of the whole of the circumstances indicates to us that there is considerable doubt as to whether it should be regarded as a valid certificate under the legislation and on balance we find that it should not be. The difficulties which that document had in being regarded as a valid certificate were as a consequence of the Treasury intervening in circumstances where they were concerned that the Department of Tourism was not applying a proper approach to the issue of these certificates. Had the Treasury not intervened the Commission finds that the evidence is uncertain as to how matters relating to taxation allowances might have proceeded, but the situation is, and we find it as a fact, that no applications were made at that final stage of applying to the Assessor for allowances in respect of housing with the aid of a certificate.

[31] File I page 246

8.44 We do also find that the developer acted in an aggressive way, lobbying vigorously and with persistent threats for both the expansion of the allowances provided by the 1991 Order, and to obtain certificates from the Department of Tourism in respect of the housing development. The developer was able to take advantage of that department which was over zealous in supporting the development and defectively directed, and through the utilisation of group relief, was able to take full and immediate use of the allowances available under the 1991 and 1992 Orders. We find that it is an unfortunate reflection on the handling of matters related to the Mount Murray development history that the developer was able to take this advantage, given the conclusion we set out in the next following paragraph.

8.45 We conclude that there was explicit understanding following the decision in principle on 20th March 1991 to proceed with the 1991 Order that there would be a clear limitation on the availability of group relief or other forms of income set off. This explicit understanding has never been reviewed or revoked formally by the Treasury and so we further conclude that no such limitation has ever been secured and that such omission was directly responsible for the level of income tax foregone as a result of the Mount Murray development.

8.46 We also consider that there was an early intent that the developing company, Radcon, should become part of a group as it did in October 1992 thereby enabling maximum use to be made of group relief. However, we do not find that in so doing, the developer acted unlawfully and do not consider there to be grounds for clawback or any other recovery of tax reliefs afforded.

8.47 We further conclude that the introduction of the unprecedented rate of income tax allowances in 1991, and the widening of those allowances in 1992 at the behest of the developer did provide substantial benefit for companies associated with the Mount Murray developer which were not companies concerned with tourism. 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 an economic assessment. This has not been done by government, nor by the Commission which has not considered it proportionate to engage in this. The revenue coming to the Island from the development at Mount Murray could not be offset against the losses in any such analysis as we have concluded that it would have taken place in any event without the 1991 and 1992 Orders, but, as indicated, the Mount Murray developer with its associated companies was a major beneficiary of these Orders.

8.48 The Mount Murray development would have happened whatever the changes in the tax position after 1990, and that is a material factor in considering what the cost to the Island's income tax revenue was. It cannot be said, and we so conclude, that the incentives did bring in the Mount Murray development, and it is not the case that, therefore, there is a benefit which outweighs the losses which arose through the two Orders. Those benefits would still have arisen had the Orders not been made.

iv) <u>The Impetus for the Second (1992) Incentive Allowances Order</u>

8.49 We conclude and it has been accepted generally that the Mount Murray development was the catalyst, promoter and beneficiary of the 1992 Amendment Order. This has been accepted by many, including Mr Nugent,[32] Mr Cashen,[33] Mr Kelly,[34] and Mr Bell[35] and is not seriously in dispute.

8.50 The involvement of the Mount Murray developer we find started in December 1991 when it appointed Mr Nugent to pursue with government the boundaries of the 1991 Order so as to make the development as profitable as possible in terms of tax allowances.

[32] Evidence of Mr Nugent Q25 Transcript Day 35 page 16
[33] Evidence of Mr Cashen Q17 Transcript Day 33 page 10
[34] Evidence of Mr Kelly Q18 Transcript Day 33 pages 80 & 81 and 121
[35] Evidence of Mr Bell Q9 Transcript Day 36 page 107

8.51 Mr Nugent started his task in January 1992 with an initial communication to the Treasury. He pursued his persuasions and lobbying mainly with the Department of Tourism seeking to obtain concessions that certain works fell within the ambit of the 1991 Order or, if they did not, that legislation would be passed to ensure that they did. Although he did not, when he was in contact with the Treasury, achieve all those matters which he wished to achieve, he did succeed to a great extent and the consequence was the 1992 Amendment Order.

8.52 Mr Kelly added in evidence an ameliorative point; that had Mount Murray gone directly to the Treasury as opposed to negotiating incorrectly with the Department of Tourism, then it is quite likely, he said, that Mount Murray could have got what they wanted in the initial Order. We would accept this in principle and in so far as the actual extensions in the 1992 Order are concerned. However it is a long way from the reality of the events which happened. The 1991 Order was passed long before the time when we have found that Mount Murray became involved in the lobbying process for change in the sense of seeking agreements, confirmation, or change. Furthermore the Mount Murray tax agent/advisor did approach the Income Tax Division at an early stage but did not find that satisfactory, and there is also the evidence of Mr Nugent that Mr Kennaugh suggested that Mr Nugent should take his lobbying to the Department of Tourism (a matter upon which we enlarge later). Thereafter there was an important deficiency in liaison between the government departments.

8.53 The expenditure on capital items coming within the extended qualifying expenditure was, as stated above, estimated by the developer to the Assessor before the Amendment Order was taken forward as £3.8 million.[36] The consequential income tax foregone, at 50%, would be seen as £1.9 million. We have seen no contemporary evidence that the Income Tax Division of the Treasury or anyone else disputed that figure. So it was with that figure in mind that the government took the Order forward into legislation. We discuss in the next sub-section in more detail the cost of the two Orders to general revenue of the Isle of Man.

[36] File I pages 250 Letter Nugent to Assessor 3.9.1992

v) The Cost of 1991 and 1992 Incentive Allowances to General Revenue on the Isle of Man

8.54 We find that the decision to introduce a 250% income tax allowance in respect of qualifying expenditure on tourist premises (100% tourist business allowance plus 150% tourist business incentive allowance) was taken by Mr Gelling at his meeting with Mr Bell and Dr Orme on 20th March 1991. It is said, in mitigation, that this was only a decision in principle. This is true in a formalistic sense in that there would at a later stage need to be a formal decision to this effect. But Mr Gelling was the minister, he made his mind up at the meeting, and it was consequently virtually inevitable that it would happen. Indeed this can be seen as the logic of having a political meeting rather than a meeting of civil servants who doubted the proposal.

8.55 We find that Mr Gelling took the decision without waiting for the research sought from Mr Kelly by the Treasury on 27th February 1991 to be delivered and without any appraisal, whether economic or otherwise, of the likely effects of the introduction of capital allowances amounting to 250% of qualifying expenditure.

8.56 We find that Mr Bell omitted to advise Mr Gelling at their meeting on 20th March 1991 that an application had been made for planning permission in respect of the proposed development at Mount Murray and that this was being spoken of as a £20 million development.

8.57 We find that Mr Gelling omitted to ask Mr Bell at their meeting on 20th March 1991 whether he was aware of any proposed major tourism developments whose claims for allowances in the sum of 250% might imperil receipts from income tax.

8.58 Accordingly, we find it inexplicable that Mr Gelling should have taken such a decision without a single document to support or explain it. We recognise that the Orders implementing Mr Gelling's decision were approved by Tynwald but find their true potential cost was not disclosed to Tynwald at the material times.

8.59 The effect of the tax allowances was to provide substantial benefit for companies associated with the Mount Murray developer which were not companies concerned with tourism. The unforeseen cost to the General Revenue of the Isle of Man could have been many millions of pounds. To assess accurately what the loss actually has been would require an economic analysis. The government has not carried out such analysis and it would be disproportionate and unrealistic for the Commission to seek to do so. The Commission has however had access to some very detailed figures. Notwithstanding this and so as not unnecessarily to put confidential information into the public arena, 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 developer of £20 million and take the 50% subsidy from government, leaving in this context a cost to the taxpayer of £10 million. This is unlikely to be fully accurate but it gives a reasonable starting point as to the feel for the possible extent of the loss.

8.60 It is acknowledged that there are likely to be some offsetting economic benefits. For example, it has been suggested 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, as illustrated in paragraphs 8.35 to 8.41 above, 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. The Mount Murray developer was not at all involved in the introduction of the 1991 Orders, and in spite of the protestations of the developer's agents to the contrary in pursuit of lobbying for extended allowances, the project was by then, 1992, well advanced. However 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 but this has not been assessed. It could not include Mount Murray which would have proceeded without the tourist business incentive allowance. And while the allowances would have an effect on tax revenue very quickly it would likely be many years, if at all, before all that

allowance value was recovered by such offsets.) 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 is now in place. 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. At the very least, the Treasury should have researched the matter and, if appropriate, resolved not to proceed with the restriction of group relief.

8.61 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.

8.62 We conclude that there can be little doubt that the introduction of the tourist business incentive allowance at the unprecedented 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 appraisal and there has been no such appraisal; as stated, the Commission did not deem it proportionate for itself to work through or commission such a study. The benefits which would come would be from any tax, whether direct or indirect, which would come from any additional employment and additional tourist business and suppliers and additional tourist visitors. So far as Mount Murray itself is concerned the taxation benefits to the Isle of Man Government, whether direct or indirect, derive from the expenditures in the Island of the hotel, its employees and its guests. Not only has there been no economic appraisal of these matters, but also there has been no monitoring or research directed to such an appraisal which we have seen in documented form. However we have concluded that the Mount Murray development would have occurred whatever the position on the allowances and so the true economic consequences require examination of the wider picture. In the light of the

magnitude of the allowances which have been made available to the developers of tourist businesses in the Isle of Man, including Mount Murray, we find it extraordinary that no attempt has been made by the Isle of Man Government/Treasury to seek to quantify the period of years over which it might expect to recover, if at all, the tax income foregone in the grant of these allowances.

8.63 There was also the issue as to whether the development was indeed "tax driven". This has some relevance because a different picture of the events can be painted according to whether the Mount Murray development went ahead because of the tourist business incentive allowance or whether it would have gone ahead in any event. In the former alternative it might be said that although it was seen to be a heavy price to pay it did in fact produce the result that was required and was therefore a good investment. This scene could be looked at quite differently in the latter alternative.

8.64 In this regard the Commission has noted that in their case to the Privy Council, the Mount Murray Country Club Limited and its associated companies stated that they "fully accept the following: the obtaining of capital allowances by [Mount Murray Country Club Limited] in respect of the parts of the development which did not consist of housing, i.e. the hotel and sports facilities, was a consideration in its decision to proceed with it and that the development might well not have taken place otherwise, [and that] [Mount Murray Country Club Limited] did in fact obtain capital allowances, the quantum of which was 'significant and not trivial', in respect of capital expenditure on the hotel and sports facilities, which allowances gave rise to trading losses; these trading losses were to a large extent surrendered by way of group relief to other companies in the same corporate group, thus decreasing their own liability to Manx income tax." The latter part of this statement is of course related to a factual position which is reinforced by the findings of this Part Two Report. As to the question postulated in the statement as to whether or not Mount Murray would have proceeded without tax incentives, the six points set out in paragraphs 8.36 to 8.41 above do, in the Commission's view, put this beyond doubt. We find that the development would have

progressed in any event whether or not the tourist business incentive allowance was introduced and/or extended.

vi) The Handling by the Treasury of the Taxation Aspects of the Planning and Development History at Mount Murray

A) The Department

a) General Points

8.65 As to the handling by government departments of these matters we first consider the Treasury. Mr A Corlett represented a number of past or present politicians and officers of the Treasury. Effectively he represented the Treasury. He made oral closing submissions to us, supported by a written note, and it is convenient and appropriate to use those submissions as a very broad framework in setting out our conclusions in respect of the Treasury and those who worked within it or for it.

8.66 The points were made that there was a difficulty for the Commission in that recollections must necessarily dim in relation to events which occurred in the early 1990s, and that the perspective of 2004 is different from that prevailing in the late 1980s and early 1990s when tourism was said to be an industry battling for survival. We have been aware of both these matters throughout our work on both the Part One and the Part Two Report. We have however also noted that there is a very great deal of contemporary documentation, which does not suffer from the frailty of human memory. We do accept and conclude that tourism was, at the material times, an industry which was perceived to be in difficulty, notwithstanding that there is some evidence to the contrary. Thus in his April 1991 Budget Speech the Treasury Minister, Mr Gelling, said "1990 was a rewarding year for the tourist industry. It saw the reversal of the decline in the number of holiday visitors…" although a note of caution was added that for

various reasons the revival might be short lived.[37] We do not however find that the difficulties of the industry can justify improper conduct or failures to understand legislative or other requirements in the task of government, or failure properly to protect the public interest, should any of these things have happened.

8.67 Before proceeding further we should say of this arm of government, the Treasury, that we find that in handling matters concerning the Mount Murray development or circumstances surrounding that development, it acted, save for some significant exceptions, admirably and as one would hope that any arm of government would operate. We will come to those exceptions shortly. However we first set down our conclusions on some points which were made to seek to support the actions of the Treasury.

8.68 First it was said that, in respect of any revenue foregone by the incentive allowance scheme, one had also to look at the collateral benefits which have accrued as a result of the introduction of those allowances. Second, that the incentive allowance were a low risk strategy. Third, that the Mount Murray development, which from its tourism aspect has been successful, would never have happened in the absence of the incentive allowance Orders. Our conclusions on these arguments are that they should not carry weight against any potential criticisms, even if correct, because they are arguments in mitigation, in effect saying that the end justified the means. If there has been misconduct or improper handling of governmental matters, the fact that there was a beneficial consequence cannot justify that improper conduct or improper handling of governmental affairs.

8.69 Looking at the substance of these arguments, in terms of the first of them, revenue foregone to be set against collateral benefits, we have set out our conclusions on this matter in the preceding sub-section and find that there is no evidence or analysis to show the extent of any such offset, or that it is in any way comparable to the revenue foregone. As to the second argument, the claim that this was a low risk strategy, which was indeed the belief of Dr Orme, it was a

[37] Part Two Report Supporting Documents File I. Library Document. Treasury Minister's Budget Speech

belief which was not fully informed nor accurate, as we have explained at paragraph 8.26 above. The understanding of there being a low risk was based upon the amount of tax revenue at risk being very low, it not being known to Dr Orme, or to the Treasury Minister in any material way, or to the Assessor that there was planned a multi million pound development which in due course was to benefit significantly from tax savings. On the third point, as explained in paragraph 8.35 above, we have concluded with strong supporting reasons that the Mount Murray development would have proceeded to completion, as it has done, whether or not the incentive allowance schemes were taken into law.

8.70 It was argued on behalf of the Treasury that the 1991 Order was not linked or tailored to the Mount Murray development. We accept and conclude that this is the position for reasons which we have set out at sub-section 8 (iii) above.

8.71 Whilst dealing with the 1991 Order Mr Corlett made a submission on behalf of the Treasury which we reject completely. He submitted that the Commission's view expressed in its Part One Report that there is a fundamental link between amendments to tax legislation dealing with tourism tax allowances and the planning at Mount Murray is not established by the evidence. This position was in fact quite clearly established on the evidence before the Commission when it completed its Part One Report. In this regard the Commission, in explanation of its approach, dealt with its findings of links between planning decisions and amendments to tax legislation without distinguishing between the 1991 and the 1992 Orders (see paragraph 5.4 of the Part One Report). Further Mr Cashen, former Chief Financial Officer, a self evidently respected source, gave unqualified evidence about the existence of the fundamental link between the amendments to the tax legislation dealing with tourism tax relief and the planning history at Mount Murray (see paragraph 8.34 above). This evidence referred to both the 1991 and 1992 Orders. Furthermore it has now been established without reservation that the 1992 Order was so linked. The Commission's statement as expressed by the Commission and referred to by Mr Corlett was, and is, correct.

16.4.1991 T1401 - T1402

8.72 We turn to the meeting of 20th March 1991 between Mr Gelling, Mr Bell and Dr Orme. Mr Corlett accepts[38] on behalf of the Treasury, and rightly in our conclusion, that the proposal which was eventually contained in the 1991 Order was agreed in principle on 20th March 1991. Mr Gelling and Mr Kelly both gave evidence to us that this was in fact the situation and we have already stated our conclusion to this effect (paragraph 8.26).

8.73 We have set out our conclusions on the 1991 Order in some detail in sub-section 8 (iii) above, but we should add that we accept the evidence of Mr Gelling that a windfall VAT increase in 1991 was not a factor in taking this Order forward, notwithstanding that Mr Dawson had surmised that it was. The proposal we find had been accepted on 20th March 1991 and that was the reason why it went forward.

8.74 It was accepted on behalf of the Treasury that the 1992 Amendment Order was very closely linked with the development at Mount Murray.[39] We have detailed evidence on this earlier.[40]

8.75 There was indeed a material link here between the planning and development at Mount Murray and the evolution of this particular statutory taxation matter. There were similar contemporaneous pressures which had been applied in the planning permission procedures such as persistent strongly worded letters, threats of withdrawal of the whole development, the playing of one department of government against another, and threats of litigation.

8.76 With this 1992 Amendment Order it became clear that the developer was wishing to utilise the allowances not just in relation to the hotel and its ancillaries also, but in respect of the housing development, to seek better profitability. For the most part the role of the officers of the Treasury in these matters was appropriate and praiseworthy.

[38] Submission of Mr Corlett Transcript Day 45 page 20
[39] Submission of Mr Corlett Transcript Day 45 page 21
[40] Sub-section 8 (iv)

b) Involvement with the Developer

8.77 We deal first with the matter in respect of which the Treasury might be regarded as susceptible to criticism. This relates to the close involvement which the developer was allowed to have, through its professional agent Mr Nugent, in the drawing up and drafting of the 1992 Amendment Order. It is the fact, as we find it, that through Mr Nugent the developer was allowed to be over-closely involved in the progress and drafting of the Order. He was shown the draft Order and given the opportunity to comment. He did comment and there were changes, although we do accept that these were changes which simply improved the drafting to achieve its agreed objective, rather than to provide any particular advantage to Mount Murray.[41]

8.78 While we accept fully that prior consultation with those interested in the field with which proposed legislation is concerned is appropriate and commonplace, it is quite different to have consultation only with the one party which would benefit substantially by this legislation, and to go so far as to pass to that party a copy of the draft legislation. Mr Nugent in effect accepted that for the latter to happen was unusual.[42] The closeness which the Mount Murray developer had got to this legislation is exemplified by the statement made by Mr Kelly that the amended Order "should satisfy the requirements of Radcon"[43] when the finalised draft Order was passed to the developer, as had been agreed in a Treasury meeting.

8.79 Whilst we are of the view that criticism of this closeness with the beneficiary of the legislation is justified, we do not classify it as being a particularly serious criticism. It was no doubt consequential upon the failures of the Department of Tourism to liaise with the Treasury when these extensions were being sought, plus the pressures which were being consistently vigorously applied by the developer, and the fact that, as he told us, the Assessor himself did not disagree in principle with what the 1992 Amendment Order allowed.[44] Furthermore there was no attempt to obscure that benefits would accrue to the Mount Murray

[41] Evidence of Mr Nugent Q25 Transcript Day 35 page 98
[42] Evidence of Mr Nugent Q25 Transcript Day 35 page 97
[43] File I page 285 Letter Mr Kelly to Mr Mitchell 22.12.1992

development as a result of the 1992 Amendment Order and this can be illustrated by the Tynwald brief which Mr Kelly supplied to the Treasury Minister when he was moving the bill in Tynwald which expressly referred to Mount Murray as a beneficiary, although these were not referred to in Tynwald on the day. The remaining actions of the Treasury in relation to this Order do indicate diligence and concern for the public interest.

c) <u>Playing off One Government Department Against Another</u>

8.80 In the event one government department was in effect played off against another when, from early in 1992, discussions of detail were taking place with the Department of Tourism in relation to the incentive allowance. As already indicated, the Assessor has said that he was compromised by what had happened. Although the developer's tax advisor/agent did go to the Department of Tourism because he thought that they would be on his side (see paragraph 8.150 (c) below) we do accept on the all the evidence provided by him that he did not enter the discussion with any specific intent to set one government department against another. Nevertheless, whatever Mr Nugent's intent may have been with regard to one department being set off against another, the Commission's clear interpretation of the facts if that it is self evident that such a situation was indeed created. In the discussions the developer was seeking to reach agreements that certain items of expenditure would qualify for the allowances, and to obtain undertakings for new legislation, and other undertakings by government which would then be presented to Treasury. Treasury may then have found difficulty from moving away from what had been already agreed or had been the subject of undertakings. With regard to this activity Treasury called a meeting with the Department of Tourism,[45] at the behest of the Chief Minister, in order to clarify what had been happening in relation to the incentive allowances and their application to developments such as Mount Murray, and a warning was given to the Department of Tourism that one department should not be allowed to be played off against another. This is to the Treasury's credit.

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[44] Annex 9 Mr Kelly's letter of 23.4.2004 point (f)

d) Tourist Business Incentive Allowance Certificates

8.81 As explained in section 7 (i) above the 1992 Amendment Order introduced the certificate requirement for the taxpayer before the investment allowances could be considered for setting off against income tax. We do not find the legislation entirely satisfactory in this respect in that it differed slightly but nevertheless significantly from its source legislation which had been used as a model for these certificate procedures. We have commented on this in section 7 above, but this is not a matter for our particular attention.

8.82 What is relevant is that we do accept that Treasury did apply detailed scrutiny to claims made under the tourist business incentive allowance scheme. We also conclude that there is no evidence which we have seen which indicates that allowances were given which ought not to have been given. Given the scrutiny applied by Treasury, we would not either expect there to be evidence of such inappropriate reliefs. Indeed it was Treasury that drew the Department of Tourism's attention to the issue on 21st September 1994 of an apparent certificate relating to the housing development element of Mount Murray. We have discussed this in section 7 above, and given our conclusion on its validity at paragraph 8.43 above.

8.83 Treasury were much involved in resisting the typical pressures which were being applied by the developer in seeking to obtain certificates for the housing. As we point out in section 7 above and paragraph 8.43, had the 21st September 1994 "certificate" been issued without comment having come from Treasury, then it is quite uncertain as to what would have happened. In the event a certificate was, as we have seen, issued in April 1995 for a limited number of houses. On 16th January 1995 the "letter of intent" had been issued and this was instantly used as a marketing tool for the disposal of the housing units. Again we find that Treasury was acting very much in the public interest in cautioning and advising in respect of the issue of certificates in relation to the housing development.

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[45] File I pages 234 - 235 Meeting 30.7.1992

8.84 Treasury indeed went further. Advice was given by Treasury to the Department of Tourism as to the sort of scrutiny which ought to be applied before certificates were issued by the Department of Tourism.[46] This advice was not, we find, followed by the Department of Tourism in issuing certificates after the advice was given. In this regard however we do accept and conclude that there was no lack of due diligence by the Treasury in relation to these certificates, indeed quite the contrary insofar as they were able to have any practical influence in this area.

e) <u>Group Relief</u>

8.85 We next set out our conclusions in respect of group relief. We explained group relief at section 5.59 above.

8.86 Treasury officials sought to protect the public interest by continuing to draw attention to group relief and other income offsets and did seek to limit the effects.

8.87 A number of points were made in respect of group relief by Mr Corlett.[47] He submitted that group relief was not a significant factor, and that should there be blame attached to Treasury or any of its personnel, it would not be a matter of great significance. It was submitted by Mr Corlett, and also by witnesses, that group relief does not create additional reliefs, that it merely affects the time at which such reliefs are granted. This is not correct. Allowances may be granted but in the absence of income remain unrealised. A stand alone company which does not make profits/income cannot realise its allowances. Only if there is a group situation and other group companies have profits can such company's allowances be realised. Furthermore, even if, as suggested by Mr Corlett and others, there was simply acceleration in granting the reliefs that acceleration may be by a number of years, and if the amount involved is very large, say millions of pounds, the acceleration may in itself be significant. This was exactly what the Deputy Assessor warned against in June 1992 in an advisory memorandum, saying "Certain situations do however exist (e.g. loss offset and group relief)

[46] File II page 365

where immediate advantage can be taken and this we must always seek to protect against." This memorandum explained one of the advantages of tourist business incentive allowances so far as government was concerned as being that "it has effectively reduced the risk of financial loss by the government by way of offering the opportunity of displacing direct financial support with support that only falls to be afforded as and when profit is generated by the business; the allowance itself is spread over three years but even then the relief will only arise over several more years as financial outlay is gradually recouped and exceeded."[48] Furthermore the distribution of the relief between companies may mean that the reliefs are actually applied to a company which has nothing to do with tourism, as we conclude would be the position at Mount Murray.

8.88 It was also claimed by Mr Corlett[49] that it is strongly arguable that a group relief restriction could well have stifled development generally and specifically the Mount Murray development. We find that this is an argument which has difficulties so far as Mount Murray is concerned, with the evidence not always being in the same direction, and we do not accept it. Dr Orme's proposal did not contemplate group relief either in 1987 or 1990. The developer at Mount Murray was Radcon Village Resorts Limited. This was not part of a group until October 1992. Even by the end of August 1992[50] it was said that there was no then present understanding that Radcon was part of a group. By October 1992 there had already been considerable effort put into the Mount Murray development in terms of obtaining planning permissions and lobbying vigorously for an extension to the incentive allowances. The benefits from group relief, so far as relevant, are based upon the existence of the tourist business incentive allowances, and we do note a contrary indicator where Mr Nugent said that group relief was fundamental (see paragraph 6.55 above). We have however concluded as explained at paragraph 8.35 above that the Mount Murray development would have proceeded whether or not there were such incentive allowances. We have also explained our conclusions on the relationship of Radcon with a group of companies at paragraphs 8.27 to 8.32 above.

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[47] Submission of Mr Corlett Transcript Day 45 page 23
[48] File I page 162
[49] Submission of Mr Corlett transcript Day 45 page 23

8.89 Reference in support of Mr Corlett's submission was made by him to consultation which took place with the accountancy profession indicating that they were against any restrictions on group relief. The responses to this consultation which the Commission has seen amounted to two letters. Mr Kennaugh said that such response to consultation would not affect the course to be taken by Treasury.[51] Reliance was also placed upon the Department of Tourism making it clear in a letter dated 17th June 1991 that group relief should not be restricted. That department did make such a "statement", but this was not a view which was shared by Treasury officials at that time. We conclude that little weight should be attached to these submissions of Mr Corlett.

8.90 The point is next made by Mr Corlett that the earliest opportunity for restricting group relief was expenditure incurred on or after 6th April 1996 because that was the time when primary legislation was changed to allow this restriction, and therefore the timing was such that there would have been no effect on the tax foregone relating to the Mount Murray group. It is then argued by Mr Corlett that it would not have been possible to backdate the restriction of group relief because the primary legislation, the Income Tax Act 1995, did not permit that; difficulties in the use of restrospective legislation are then relied upon.

8.91 The Commission accepts the timing of the legislation as narrated by Mr Corlett. However the fact of the matter is that concerns about the effect of group relief were first expressed in the Assessor's office from 1991 onwards and the Treasury Minister was worried about this in June 1991.[52] The 1992 Order went through on the basis that there would be restriction of group and like reliefs. It is the fact that properly drafted legislation can allow retrospective action. It is also the fact that a practical way of achieving this without unfairness to anyone was pointed out in an advice from the Assessor's office.[53] This can be done by making public announcement of the date upon which a proposal for the restriction was announced, and this course of action was advised by the

[50] File 1 page 247
[51] Evidence of Mr Kennaugh Q54 Transcript Day 39 page 88
[52] Evidence of Mr Gelling Transcript Day 37 page 26

Assessor long before 1996. A reasonably efficient ordering of legislation could have allowed primary legislation to have been undertaken before the length of time did become politically unacceptable. If group relief and dividend relief were so material, the incentive allowance could have been held up until the appropriate primary legislation was available. If the package could not be implemented in one, the reliefs should not have been implemented in the absence of the limitations.

8.92 The reality is that this matter was not pursued in any effective way and significant criticism should be made about this fact. The minister, Mr Gelling, agreed that limitation was the basis upon which the legislation went forward, but he did not find it practical to remember the details of legislation which he had promoted and left it to the Assessor. The Assessor did continue to advise about the difficulties for tax income which would follow if restrictions on group relief and similar systems were not restricted, but it was not until 1995 that the primary legislation was in place, and the subordinate legislation which actually imposed the restrictions so far as it might affect development such as Mount Murray has never taken place. In our conclusion this does demonstrate an important and material weakness which occurred in the handling of these matters in the Treasury.

8.93 Attention was also drawn by Mr Corlett to Mr Nugent's evidence that the existence or otherwise of group relief was not in fact crucial to the tax position of his client, as he could organise a restructuring which would enable dividend payments to achieve the same result.[54] There is then Mr Nugent's statement that group relief was fundamental. It is then said that backdating therefore could not have been effected. The Commission does not agree. Radcon did not become part of any group until late 1992. Furthermore there is no reason, as the Commission sees it, why primary legislation could not have been put in place which would allow an Order to limit the income tax allowances to the developing company which actually incurred the qualifying expenditure.

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[53] Mr Kelly Document Q18 Appendix 40

8.94 The submission was also made by Mr Corlett that the attitude to group relief had changed considerably by the time of the Income Tax Act 1995. Attention is drawn to a suggested change in wording, a slightly less peremptory form of words, in a 1994 briefing to the legislative draftsman.[55] Nevertheless the power to restrict did actually go into the Income Tax Act in relation to expenditure incurred from April 1996. Furthermore the particular context of the briefing, we find, merely reflected a change of circumstance. Mr Corlett said this:[56] "In that brief to Mr Boyde there is reference to the use, or the phrase is used 'the Treasury may wish to restrict group relief' as opposed to the words 'measures will be introduced in the next Income Tax Bill preventing any group relief' which was the sentence used in the brief to the Minister in January 1993." This is incorrect because the brief to the legislative draftsman is no less peremptory than in 1993. Mr Corlett omitted the first sentence of the 1994 brief which is a direct requirement that there will be a restriction on group relief. It says "A provision is *required* (Commission's emphasis) enabling the amount of group relief which may arise as a consequence of capital allowances *to be restricted*." (Commission's emphasis). It is in the next sentence, only partly quoted by Mr Corlett, where the flexibility comes in. The part sentence quoted by Mr Corlett as above actually reads "For example, the Treasury may wish to restrict the Tourist Business Incentive Allowance or the proposed Commercial Buildings Allowance so that only 25% of the qualifying expenditure may be allowed in any group relief claim." The true position is that even in 1994 the Treasury was resolving to restrict group relief, with the only change being in the circumstance that the restriction might be less than 100%, say 75%. Yet even this stringent restriction never came into being. So we do not find this to be an adequate explanation as to why the limitation which was the specific basis upon which the tourist business incentive allowance legislation was passed, never came into being. The Commission finds that there appears to have been lack of due diligence here, and that in any event there is no record of the reasoning as to why the limiting condition was never met, or if it had truly been the case, why that policy in relation to it did change, if it did change. There is no written evidence that it did

[54] Submission of Mr Corlett Transcript Day 45 page 24
[55] Submission of Mr Corlett Transcript Day 45 page 26
[56] Submission of Mr Corlett Transcript Day 45 page 26

change, indeed such as we have seen indicates no change, simply a possibility of a slightly less severe restriction. That in itself is a matter for criticism.

f) Impact Assessment and Monitoring

8.95 We turn next to impact assessment and monitoring. The importance of monitoring was recognised in the November 1990 paper from the Department of Tourism. Indeed the promoting paper for the 250% allowance which came from the Department of Tourism proposed that the system be introduced on an experimental basis and only within a sector which did not produce a great deal of tax income (thereby reducing risk to government income), and because it could within its limited area of impact be monitored more closely (see paragraph 6.21 above). Despite this cautionary approach the whole proposal was rushed into a statement of intent to legislate and none of these suggested precautions, including close monitoring, were followed. The need to keep control of the amount of tax being relieved was recognised by the Treasury Minister in June 1991.[57] The need always to protect against immediate relief advantages arising, e.g. from loss offset and group relief, was a warning given by the Deputy Assessor in June 1992.[58] The maximum cost was assessed in February 1991 by the Assessor as £150,000 in terms of tax revenue.[59] This appears to have been the total income tax take from all the Island's tourist accommodation, including hotels, not all of which would have sought to incur qualifying expenditure. That was a completely inaccurate figure in terms of what actually happened. Mr Kelly is however not to be blamed for that, as he was unaware of the existence of the Mount Murray development proposals the initial planning application for which was only submitted in mid January 1991. We accept Mr Kelly's evidence that there has been some informal monitoring of the effects of the incentive allowance, but we find it difficult to accept that there has not been some measure of distortion, given the unprecedented level of relief, the presence of a major development such as Mount Murray, and the immediate availability of relief (by group relief). Also the caution accompanying the proposal from the Department

[57] Evidence of Mr Gelling Q23 Transcript Day 37 page 26
[58] File I page 162
[59] Mr Kelly Document Q18 Appendix 7

of Tourism does not seem to have operated. The Assessor accepts that there may be improvements in this area.[60] He referred to the desirability of introducing economic and regulatory impact assessments for legislation and a greater use of parliamentary committees to scrutinise legislation, in particular tax legislation. We agree and refer to this in our recommendations.

g) Grants

8.96 Before turning to set out our conclusions in relation to the Treasury as a whole and so far as relevant individuals within it are concerned we draw attention to the suggestions which from time to time have been made[61] that the Mount Murray development could have received its financial assistance by way of grants with the clear inference that there was not need for it to pursue support of the incentive allowance system through taxation. We conclude quite firmly that the assistance which would have been appropriate for a development of the size of Mount Murray just would not have been done through the loans and grants system. As explained above[62] grants and loans were directed at comparatively smaller developments, there was an extremely limited budget, the amount which Mount Murray would have required in terms of achieving 50% of the qualifying expenditure was something which all have agreed, if pursued through the grant scheme system, would have needed to have gone to Tynwald for approval. That would have involved detailed public scrutiny of the developer, a matter which, as we have said several times, was contrary to the philosophy of the developer, and perhaps more importantly, the precedent from the Novotel proposal was that Tynwald did not as a matter of course approve such applications.

h) Overall Conclusions on Treasury as a Department

8.97 Overall we find that the officers of the Treasury conducted themselves commendably in relation to the Mount Murray matters. We accept that the Treasury has and had at all material times a sound and indeed strong

[60] Letter Mr Kelly 21.1.2004
[61] Evidence of Mr Bell Q9 Transcript Day 36 page 69; Mr Gelling Q23 Transcript Day 37 pages 55 & 56
[62] para 6.41 above

administration. We find that it did not as a department improperly succumb to pressure applied either to its officers or to its politicians, nor was it by any means dictated to. The minister's conduct in the introduction of the tourist business incentive allowance Orders constituted a mistaken, erroneous course of action, but was not at all related to any impropriety. Insofar as the officers are concerned there are matters which we have indicated are subject to criticism; these are due to lapses in sustaining highest standards rather than succumbing to pressure. Insofar as we have found that Mr Nugent, the agent of the developer, was too closely involved in the making of the 1992 Amendment Order we do not find this to be an improper succumbing to pressure or to improper dictation, but rather perhaps an error of judgement and irritation in the face of this continuing pressure.

B) Individuals within Treasury

a) General

8.98 We turn to individuals within the Treasury. Again for the most part the standards were high and commendable. The only person to whom we do direct substantial criticism is Mr Gelling. Even here we find that such criticism as we make does not arise out of Mr Gelling succumbing to pressures or manipulations from the developer or its agents. A number of other individuals from the Treasury gave evidence. We express specific conclusions in respect of the Assessor and the Deputy Assessor. With regard to the remainder, Messrs Dawson, Cashen, Caley, Carse and Shimmin, the evidence leads us to conclude that they carried out their duties in an exemplary manner and it is not necessary to explain further conclusions with regard to their activities at material times.

b) Mr Gelling

8.99 We find that Mr Gelling did make some errors and is susceptible to criticism. We do not find that these errors had any ulterior motives nor that they were part of any deliberate attempt to withhold information from Tynwald or the community.

They were rather procedural shortcomings and the undertaking of unquantified risk which might have an unquantified cost.

8.100 The first matter in respect of which we criticise Mr Gelling concerns the way in which the 1991 Order was taken forward. Mr Gelling accepted in his written statement[63] that he had agreed in principle to the Department of Tourism's 250% incentive allowance proposals on 20th March 1991, although in giving his oral evidence to us he did not at first accept this.[64] We have given our conclusions on the 20th March 1991 meeting earlier in sub-section 8 (iii) above. It is of course a norm of political life that politicians meet together and make decisions, and there is not any criticism of that. However, in those circumstances, as in any other circumstances, those making the decisions should understand fully what it is they are deciding and the effects that it can be perceived will follow. This decision was made as a result of Dr Orme's low cost, low risk "ploy" persuasions. As explained above at 8.26 this argument was not fully informed. Furthermore there had been advice from the Assessor on the difficulties which might follow from implementing the proposal and there is no evidence that Mr Gelling sought an economic rationale from either the Department of Tourism or his Economic Advisor before proceeding to override the Assessor's advice. While a politician is entitled to override such advice that is not quite what happened here. We were told by Mr Gelling that it was intended that there should be legislative procedures which would limit the damage to the revenue which might follow from the implementation of the 1992 Order.[65] This never happened. Mr Gelling did not check whether or not it had happened.[66] A Treasury minute of 9th September 1992 specifically stated that there was to be a restriction on group relief included in the revised Order.[67] It was later learned that this would have to be done by primary legislation but the protective intent remained. Mr Gelling is to be criticised for that. The Assessor, or his Deputy, continued to give advice on this matter.

[63] Mr Gelling Document Q23 para 14
[64] Evidence of Mr Gelling Q23 Transcript Day 37 pages 11-13
[65] Evidence of Mr Gelling Q23 Transcript Day 37 pages 37 - 44
[66] Evidence of Mr Gelling Q23 Transcript Day 43 page 4
[67] Mr Gelling Document Q23 Appendix 17

8.101 Suffice to say here that Mr Gelling took the 20th March 1991 decision in principle when he was uninformed as to whether it was a feasible proposal or not. Mr Gelling told us that there was no detailed assessment before its Budget announcement of what the effect of the 250% allowance proposal would be on the tax system.[68] There is no written record of how or why the decision was made, none of the discussions at the meeting, and, although we were told[69] that the matter would have been discussed in Treasury, and there was a Treasury meeting on 25th March 1991, the minute is very brief and sheds little light except to indicate that there was a meeting at which it could have been discussed. The Assessor said[70] however that there was no Treasury meeting before the Budget Speech to agree the 250% allowance, although there would have been Treasury support for the Budget and it would have been known what was in the Budget. Oddly, Mr Gelling did not know whether meetings where the matter might be discussed would be minuted or not.[71] He did however say that there would be a record of the Council of Ministers decision on the Budget matters,[72] though the specific item might not have been identified.[73] The item was not identified in any Council of Ministers minute.

8.102 Quite apart from the cautionary approach advised by the Department of Tourism in November 1990 (see paragraph 8.95 above), this acceptance of the Department of Tourism's proposal on 20th March 1991 was at a time when, only a few weeks earlier, Treasury had rejected that 250% proposal because, Mr Gelling said, it was nothing which they had dealt with before,[74] and because they wanted to be sure and certain that they could sustain the proposal of 250%.[75] At that rejection meeting the Assessor had been asked to look at the 100% initial allowance alternative and there was to be a fact finding meeting between officers of the two departments to find out what it was all about.[76] Mr Gelling did not have the results of the Assessor's research available to him, nor was there any such

[68] Evidence of Mr Gelling Q23 Transcript Day 43 pages 13 & 14
[69] Evidence of Mr Gelling Q23 Transcript Day 37 pages 13 - 16
[70] Evidence of Mr Kelly Q18 Transcript Day 32 pages 39 & 40
[71] Evidence of Mr Gelling Q23 Transcript Day 37 page 15
[72] Evidence of Mr Gelling Q23 Transcript Day 37 page 24
[73] Evidence of Mr Gelling Q23 Transcript Day 37 page 15
[74] Evidence of Mr Gelling Q23 Transcript Day 37 page 9
[75] Evidence of Mr Gelling Q23 Transcript Day 37 page 9
[76] Evidence of Mr Gelling Q23 Transcript Day 37 page 10

meeting of officers, before the meeting of 20th March 1991[77] where he accepted the proposal in principle. He did ultimately say[78] that at the meeting they were convinced that 100% would not work, (which is not the "low cost, low risk" emphasis given by Dr Orme); it appears that Mr Gelling was persuaded of this on 20th March 1991.[79] He said that the tourism politicians knew what was required to get people to invest in the Isle of Man and make it work from their point of view. He then effectively said that they would know better about this than the Assessor.[80] This was notwithstanding that the Assessor very recently had been expressly charged by Treasury to carry out research on the 100% alternative and had not yet come back with the results of that research. One can reasonably assume that the Assessor would have carried out the research efficiently and fully, encompassing points made by the tourism politicians as well as other relevant points. Mr Gelling also said that it never came to a situation where the Assessor would say "No, that's not right".[81] But, the day after the meeting, that is 21st March 1991, the Assessor did object,[82] diplomatically, by saying that there was difficulty in doing it under existing legislation, and that his original doubts (which had led to Treasury objecting a little earlier) still applied, that is effectiveness and distortion; so he suggested an alternative approach. Nevertheless the statement of intent to make the Order proceeded to the Budget.

8.103 Furthermore, notwithstanding that he had said he had no idea whatsoever as to what the total tax loss might be if the scheme went ahead,[83] that the 250% allowances had been rejected by Treasury on 27th February 1991 because they were waiting for the Assessor's opinion as to whether it was something which they could afford to do at the time,[84] that the Assessor had put the first year costs on then (April 1991) levels of investment in the order of £500,000, Mr Gelling made no request to the Assessor as things moved forward to update the costs estimates nor to monitor the costs of the proposals.[85] By way of explanation, this

[77] Evidence of Mr Gelling Q23 Transcript Day 37 pages 18 - 20
[78] Evidence of Mr Gelling Q23 Transcript Day 37 page 20
[79] Evidence of Mr Gelling Q23 Transcript Day 37 page 20
[80] Evidence of Mr Gelling Q23 Transcript Day 43 page 12
[81] Evidence of Mr Gelling Q23 Transcript Day 37 page 20
[82] Mr Gelling Document Q23 Appendix 8
[83] Evidence of Mr Gelling Q23 Transcript Day 37 pages 6 & 30
[84] Evidence of Mr Gelling Q23 Transcript Day 37 page 7
[85] Evidence of Mr Gelling Q23 Transcript Day 37 page 23

figure of £500,000 differs from the figure of £150,000 referred to in paragraph 8.95 above because this latter figure refers to the then potential current tax loss, and not levels of investment and grant costs. The former figure of £500,000 is however comparable to a figure of £19.8 millions worth of expenditure for which relief was given in the 2002/3 Income Tax Year.[86] Returning to Mr Gelling he was additionally quite unaware of the Mount Murray proposals[87] and the effect it might have on these estimates. Later however Mr Gelling did accept that a cost benefit analysis approach was the proper way of dealing with these matters and it later became part of the system in the Treasury.[88] What he said to us was, in respect of cost benefit analyses, that "I'm quite sure at that time there would not be. There is now of course. We insist in having all that detail in, what benefit it is to the economy of the Island and what drain it might be, that's part of what they give to us. But I don't think so at that time." It is a matter of regret and criticism that there was not such monitoring or consideration at the time, but it is commendable that that has now been recognised.

8.104 In the event the later improved economy growth rate did provide a sustainable situation.

8.105 We should also add that Tynwald would know what the effects of this 1991 Order were, in percentage terms, as this was explained in its Explanatory Note. This Note said that the maximum relief under the Order would, when taken with government grants, be 50% of gross expenditure. Tynwald would not however know the realistic extent of income tax which would be foregone, and so was not informed as to the scale which could be involved, and we discuss this further in paragraph 9.17 below.

8.106 The next matter in respect of which Mr Gelling is criticised concerns the 1992 Order when he failed to take action which was intended to limit the effects of group relief. This was a matter about which, as early as June 1991, he had worried and realised they would have to be careful as to who was actually

[86] Evidence of Mr Kelly Q18 Transcript Day 33 pages 98 and 104 & 105
[87] Evidence of Mr Gelling Q23 Transcript Day 37 pages 27 & 34
[88] Evidence of Mr Gelling Q23 Transcript Day 37 page 58

applying so as to be able to keep control on the amount of tax being given by the relief.[89] In short the Treasury had promoted the 1992 Order on the basis that, with particular concerns in mind,[90] there would be a restriction on group relief and it was intended that there would be a statement to Tynwald which would have allowed retrospective restrictions, but he never made that statement, nor, although enabling primary legislation was ultimately passed, have such restrictions ever been brought into law, nor has there been monitoring or control on the amount of tax being given by the relief.[91] Mr Gelling said[92] that he failed to refer to the proposed restriction on group relief as a matter of political judgement on taking the feeling of the Court of Tynwald. As this was the basis upon which the Order was passed, and the statement which would justify retrospective legislation on this matter, this was, as he then accepted in oral evidence,[93] an unfortunate error on his behalf. Further details of this matter are set out in sub-section 6 (vii).

a) The above and other matters critical of Mr Gelling were put to him for his comments, and he has responded and disputed them by letter to be seen in Annex 9. The Commission has considered this letter carefully but it has not introduced any new evidence or any point of view which has led the Commission to change its reported conclusions in any material way. However we do emphasise again, as strongly as we can, that there is no question that Mr Gelling, in the actions to which we refer, was doing anything other than genuinely trying to do the best he could, according to his abilities, for the interests of the Isle of Man. Unfortunately, notwithstanding this, criticism needs to be made.

b) In his letter to which we have just referred Mr Gelling makes an initial point that the end result of the tourist business incentive allowance has been the resurgence of the Isle of Man tourism industry and the emergence of tourism development at Mount Murray "of which we can all be proud". As indicated several times elsewhere we reject this argument insofar as it may purport to say

[89] Evidence of Mr Gelling Q23 Transcript Day 37 page 26
[90] Evidence of Mr Gelling Q23 Transcript Day 37 page 36 et seq to page 52
[91] Evidence of Mr Gelling Q23 Transcript Day 37 page 51
[92] Evidence of Mr Gelling Q23 Transcript Day 37 page 48
[93] Evidence of Mr Gelling Q23 Transcript Day 37 page 51

that the end justifies the means, or that one can overlook criticism which would otherwise be justified. On substantive grounds these points do not have any weight either. As indicated at paragraphs 8.139 to 8.142 below there is little or no evidence to substantiate the effect of the tourist business incentive allowance upon the tourism industry, and the evidence as summarised at paragraphs 8.35 to 8.41 above is extremely strong that Mount Murray would have developed whether or not tourist business incentive allowances were in existence in extended form or otherwise.

c) Mr Gelling makes a number of observations in his letter about events at and following the political meeting on 20th March 1991. His comments are not inconsistent with events as set out in paragraphs 6.118 and 6.119 above, nor do they change the conclusion of the Commission as to events as they occurred at that meeting. Mr Gelling then says that he should not be blamed personally for any weaknesses in record keeping as explained in paragraph 8.101. Apart from where the paragraph specifically refers to Mr Gelling the Commission does accept that their concern is not so much directed at Mr Gelling, although as minister he had responsibility, but more importantly to concerns that there is absolutely no record of any discussion of the issues, whether in Treasury or in the Council of Ministers, between 20th March 1991 and 16th April 1991 when Mr Gelling delivered his Budget Speech and declared his intentions in relation to tourist business incentive allowances. The system was clearly at fault if a proposal which is likely to, or could, cost tens of millions of pounds can be adopted by the Council of Ministers without any written record of the proposal, the discussion and the decision. Even if it was discussed in the Treasury and Council of Ministers, the Commission has no evidence that the potential (e.g. for Mount Murray alone, on then available knowledge, some £10 million) was disclosed to Treasury and the Council of Ministers. We do know that Mr Gelling made no such disclosure to Tynwald either on Budget Day (16th April 1991) nor in October 1991, when the Order was approved by Tynwald. There was not even an informal note taken of the 20th March 1991 meeting. It is difficult to accept as a matter of logic that it would be highly unusual to take a note, as Mr Gelling states in his letter, for a meeting at which such an important subject matter was discussed and decided upon, even in principle, simply because it was

"between three politicians". The likelihood is that this is simply consistent with our above stated findings that the decision was made in uninformed circumstances. In any event it is concluded, and this must surely be unchallengeable, that it is unacceptable in any corporate situation that decisions of a minister, or a chief executive, or a board cannot be recorded in writing at any point. But this is what happened in the circumstances under discussion.

d) Mr Gelling makes the valid point that the Island is used to making adventurous and entrepreneurial advances in the financial field, and encompasses the 250% tourist business incentive allowance in this point. The Commission emphasises that it does not criticise the 250% rate as such, but only the way in which it was dealt with, given that it was an unprecedented scale of increase.

e) Mr Gelling next challenged the Commission's view that he effectively overrode the Assessor's concerns so that the Order proceeded to its announcement in the Budget. He said that there was no undue haste and there were checks and balances of Treasury, Council of Ministers and Tynwald. He then refers to this being a low risk, low cost project with benefit for tourism which brought forward Mount Murray. A cost figure of £150,00 or less is mentioned. We have already explained that the evidence does not support these last two conclusions, nor does it support any claim that it was low cost, low risk. In the Commission's conclusions there was very considerable haste between the meeting of 20th March 1991 and the declaration of intent to implement the 250% relief, less than a month later, given the length of time since its emergence in 1987, contrary resolutions within Treasury and unimplemented research towards an alternative solution as also resolved by Treasury. Nor is there any evidence that the "checks and balances" included an understanding of the potential cost of the tourist business incentive allowance, indeed such evidence as there is indicated misunderstanding. A more satisfactory statement on cost in the light of then available knowledge would be to the effect that a reasonable broad estimate of the cost of the tourist business incentive allowance in 1991 in respect of the Mount Murray development alone would have been £10 million (i.e. one half of the likely cost advised to Mr Vannan in November 1990).

f) Mr Gelling then makes a number of points resisting criticism made about failure adequately to monitor or update the cost of the tourist business incentive allowance proposals. The validity of the criticism is fully made out in this Part Two Report, but some individual points may be repeated here. We first note that officers should have been reporting on these matters to Treasury, and we also discuss that elsewhere in our Report. However there is no indication that they were specifically asked to do so. Moreover continued references to "comparatively trivial" (as Mr Gelling puts it) sums of £150,00 as vulnerable is incorrectly based on a failure to take into account the effect which the Mount Murray development would have in this sense, and the failure to take into account group relief. The effect and importance of these we have already explained several times. Mr Gelling also says that it was difficult or impossible for him to receive detailed information about how the process was working by reference to individual tax figures because of s106 of the Income Tax Act 1970. This is an irrelevant point; s106 refers to information from tax returns and the like. The observation which the Commission is making in the present context is based upon knowledge in the public arena, and the totality of cost, not that of individual taxpayers.

g) Mr Gelling seeks in his letter to avoid evidence which he gave to the Commission and to dispute that he told the Commission that, with regard to tourist business incentive allowance, he did not know what could be afforded. His evidence on this is available for all to read. On Day 43 at pages 26 to 27 it is recorded that when he was asked what it was on 20th March 1991 which swung the proposal favourably so far as he was concerned he replied that "We thought we could afford it". This context indicates the "we" meant those politicians at the meeting. A little further down the same page he was asked what sort of sums he (and his politician) colleagues had in mind they could afford, he replied that "you can't quantify it. You don't know what's going to be claimed". He then agreed that he did not know what could be afforded. He then went on to appear to explain that that lack of knowledge did not matter because the development had to be successful otherwise tax relief would not follow. However he agreed that this did not take account of group relief. Group relief of course took away any validity to his justification of the position. Mr Gelling referred back again to the figure of

£150,000 as being specific cost figures mentioned by the Assessor. This of course also did not take account of group relief, and we have explained and put this figure into context in paragraph 8.95 and 8.103 above.

h) Finally with regard to his letter, the Commission makes three further points which Mr Gelling obfuscates in his letter. First he appears to withdraw from his acceptance of "unfortunate error" referred to in paragraph 8.106 above. He claims quite erroneously that it was a matter of no significance. To the contrary it was a matter of considerable significance. Treasury had resolved that when the 1992 Amendment Order was passed this should be accompanied by a restriction on group relief, and indeed it was an important basis of it going forward. The restriction was to be enabled in the then next Income Tax Act. Meanwhile a statement to Tynwald to announce this restriction would enable retrospective legislation to achieve the resolution of Treasury. In his letter Mr Gelling refers to taking "the mood of the House" as the reason for not reading it out. But this does not take away the importance of the effect of failing to read out what would allow restrospective legislation. It was an important error and Mr Gelling was right to identify it as an unfortunate error when he gave oral evidence. Second, Mr Gelling says that Tynwald was not misled as to what was proposed when he moved the 1991 or 1992 Orders because the explanatory note to the 1991 Order identified that it referred to 50% of allowable costs. However, if it was known that there was at least one development, said to be costing £20 million and which therefore might be eligible for £10 million tourist business incentive allowance tax relief then this surely would add a totally new and highly significant factor for Tynwald to take into consideration, and a compelling reason why Mount Murray should have been mentioned. This leads to the third point. Mr Gelling says that there is no code of practice to say that he was required to disclose this information, and goes on to refer to exemptions of commercial confidence and to refer again to s106 of the Income Tax Act 1970. But commercial confidence and s106 of the Income Tax Act 1970 are completely irrelevant when there was public knowledge of the development at Mount Murray as evidenced by the submission of a planning application for the development on 16th January 1991 and the claim that it would cost £20 million, as Mr Spence informed Mr Vannan in November 1990. There was in fact compelling reason to inform Tynwald about

that development and the possible tax relief cost so that they would be fully informed as to what they were enacting. If Mr Gelling thought that the maximum potential cost of the General Revenue was £150,000 then he was making a proposal to Tynwald on a mistaken and uninformed basis.

c) <u>Mr Kelly</u>

8.107 Mr Kelly acted throughout with considerable professionalism and with awareness of the public interest. He consistently advised of the difficulties which could follow from the making of the tourist business incentive allowance Orders and advised upon appropriate steps to be taken for damage limitation. He also took appropriate steps to avoid one government department being played off against another as he perceived it, and also sought to assist the Department of Tourism in adoption of a more appropriate and rigorous approach in the allowances certification procedures. We commend him highly on these matters. He has also worked very hard in providing assistance to the Commission by way of information, documentation, procedures and his view of material happenings. The Commission is extremely grateful to him for this. Notwithstanding what we have just said, we consider it our duty to make the points which follow. These however are matters which generally relate to the Treasury as a whole rather than to Mr Kelly. They are referred to within the context of Mr Kelly insofar as he was, and is, head of the Income Tax Division which is the division most closely concerned with a number of the issues. With the possible exception of matters concerning consultation, these should not at all be construed as matters for criticism of Mr Kelly, but rather an identification of some areas where improvements might be made. Mr Kelly does accept that there are areas where lessons are to be learned and we agree with that. The issue of consultation may, at worst, be regarded as a matter of judgement in the absence of any approved procedures and that this is a judgement with which the Commission does not agree, rather than a criticism, and any negative consequence is completely outweighed by those matters in respect of which Mr Kelly must be properly praised.

8.108 No action was taken to restrict the eligibility of the tourist business incentive allowance from claims of group relief, notwithstanding that this was the basis upon which the allowance was taken forward nor otherwise was action taken to restrict the manner in which any unrelieved incentive allowances may be utilised. Such utilisation could and did include the Mount Murray development which secured significant tax allowances and, as explained in paragraph 8.59 above, on the basis of 50% of the development costs being put forward by the developer had, as then perceived, a possible potential for many millions of pounds in tax relief. There is no record of Mr Kelly or the Treasury having considered the matter after the enactment of the Income Tax Act 1995. Accordingly, there is no record of the reasoning as to why the restriction, which was the basis of the making of the Amendment Order in 1992, and was a matter of concern before the 1991 Order was not pursued and nor is there any record of any change of policy and this indicates lack of due diligence. Nor, if there was a change of policy, is there any record as to why there was such change. This also indicates lack of due diligence. In the consultation process concerning the drawing up and drafting of the 1992 Order, the only outside party to be consulted was the tax advisor to the Mount Murray developer, which was specifically intended to be a principal beneficiary of the legislation and for whose benefit, it is generally acknowledged, the Order was made. Furthermore that party received, unusually, a copy of the draft legislation for comment.

a) There has been a failure to have any formal monitoring of the effects of the tourist business incentive allowance.

b) The matters set out above have been drawn to Mr Kelly's attention for comment and he has responded by letter dated 23rd April 2004. So far as material this letter is to be seen in Annex 9.

c) With regard to the first of the above matters, that related to attempted mitigation or limitation of tax foregone, the Assessor has made a number of points in his letter of 23rd April 2004. The Commission accepts much of what he says and this is reflected within the overall contents of the Report. The first and main point of disagreement is with his view that even if a restriction for group relief had been

introduced it would not have had the desired effect so far as Mount Murray is concerned because the enabling legislation was too late to have any material effect and also because the group structure would in any event permit losses to be utilised. As explained in paragraph 8.91 this fact could have been met by appropriately drafted legislation relating to both group relief and any other forms of profit/loss redistribution and by deferral of implementation of tourist business incentive allowance until appropriate restrictive measures were in place. Reference is also made by Mr Kelly to public consultation being firmly against any restriction of group relief. The Commission does not see this as a factor of significant materiality as only two consultation responses have been identified and Mr Kennaugh told us that this would not have made any difference to action taken concerning group relief.[94]

d) As to the above matters concerning formal monitoring and appraisal, Mr Kelly acknowledges that a more formalised system of monitoring might be appropriate and generally acknowledges that lessons have been learned in relation to future projects with similar cross departmental initiatives, but he points out that the impact was continuously monitored on a case by case basis, and that overall tax receipts remain buoyant. We accept this, but it does not really fully meet our concerns. The period of time between the conception of a new tourist business and the delivery of its first meaningful income tax returns, together with annual financial accounts, may extend to several years during which time the Assessor may have no knowledge of the proposed development. The cost to the General Revenue in terms of income tax foregone may not be observed until some years later. If several major developments were initiated at the same time without the knowledge of the Assessor, the substantial future cost to the General Revenue could remain hidden for years. We believe that consideration should have been given to the introduction of a procedure for the monitoring of the likely cost of the tourist business incentive allowance, such monitoring to have been undertaken by the Assessor in conjunction with the Department of Tourism each year. Mr Kelly also indicates that economic appraisal would be a responsibility for the

[94] Evidence of Mr Kennaugh Transcript Day 39 page 88

Department of Tourism. This does not meet our concern that government has not carried out an appraisal and there is no such appraisal.

e) Mr Kelly disclaims personal responsibility for the lack of record of policy change, indicating that any such failure would be a failure in the Treasury administration system. The Commission does not direct personal blame to Mr Kelly on this issue.

f) Mr Kelly, in his letter of 23rd April 2004, does not accept that criticism concerning consultation should be directed to him. He denies impropriety, says that it was his job to consult, that consultation with interested parties is approved practice, that he was authorised by the Treasury resolution to communicate the content of the draft Order to Pannell Kerr Forster, that no amendments of substance were made by the developer, and that there is a question as to how far the second Order (to which this consultation relates) was required in any event. The Commission does not consider that there was any impropriety and does not take issue with a number of these points raised by Mr Kelly. The Commission do consider that it was a misjudgement, no more, to limit consultation to one party when there are a number of recognised bodies with a relevant interest in the subject matter of the Order, who could or should equally have been consulted, given that the Order was not limited in application to Mount Murray notwithstanding that Mount Murray was the body to which the Order was initially and primarily directed. On a point of detail Mr Kelly was not authorised to communicate the contents of the draft Order to Pannell Kerr Forster but only to communicate the decision that an amending Order would be made.

d) <u>Mr Kennaugh</u>

8.109 Mr Kennaugh played an equal, and probably more direct, part with the Assessor in seeking to protect the public interest as we have explained this in paragraph 8.107 above. He also is to be highly commended in this respect. Nevertheless the Commission has found the matter which we set out in the next following paragraph puzzling. The Commission concludes that there is probably a confusion of memory over the passage of time, but this does not take away the

value of what he has said as an objective comment upon the events in question which occurred.

8.110 The Commission finds there to be some contradiction in Mr Kennaugh's attitude to and evidence upon the emergence and eventual issue under the tourist business incentive allowance Orders of the certificate for 23 houses on 10th April 1995 confirming that the three prerequisite economic criteria were met. He expressed the view that had he seen the certificate, he would have expressed his concerns about it in robust terms. However he had been fully involved by the Attorney General in the discussions and provision of instructions to the Attorney General before the certificate of 10th April 1995 was issued. Specifically he was invited to comment and to suggest amendment to the Attorney General's letter of 4th April 1995. He gave specific approval to the draft and whilst this letter was not the certificate, he must have been well aware because of his involvement with events relating to that certificate that its issue was likely to follow quickly once the answers were provided by the applicant. It is also the fact that the Attorney General suggested to Mr Toohey that any draft certificate might be provided to Mr Kennaugh to ensure his satisfaction with it. Whether or not he was so provided is unclear in the papers, but, whether he received it or not, the certificate followed the format of the letter of 4th April 1995 closely, and there was no departure from the thinking which had been demonstrated in the letter of 4th April which he had approved. Whilst the Commission does not find it easy to explain this apparent contradiction on his part, we emphasise that we have no reason or evidence to indicate anything untoward in Mr Kennaugh's conduct. We have also referred to this matter at paragraph 7.48 above.

vii) The Handling by the Department of Tourism of the Taxation Aspects of the Planning and Development History of Mount Murray

A) The Department

a) General

8.111 We turn to our conclusions on the Department of Tourism. We start by noting that it is commendable that the department should in the early 1990s have been seeking to improve investment in the tourist industry, and thereby improve tourism. The efforts which started in 1987 had been taken forward in 1990. A thoughtful paper was produced in November 1990. There was a coincidence of dates concerning events at the Mount Murray development and the progression of the incentive allowance legislation. Whilst at first sight this must produce a query as to whether there was something further than coincidence, we are quite satisfied that it was coincidence only.

b) Meeting of 20th March 1991

8.112 Progress was appropriate and not susceptible to criticism until the meeting which took place between politicians on 20th March 1991. Seeking to persuade Treasury that the proposals for the incentive allowance should be taken into legislation was a perfectly normal course for those in tourism endeavouring to promote the interests of tourism. The fault which we see here was not in promoting the ideas in the November 1990 paper, but in putting them forward in a way which was not properly informed nor fully informative. The argument put at that meeting and accepted by Treasury was on the basis that this was low risk, low cost. We heard from the Chief Executive of the Department of Tourism[95] that the original incentive allowance as then being promoted really was aimed at trying to attract investment by the proprietors of smaller properties into improving their property. However the promoter, in the form of Dr Orme, was not aware that it could be high cost, that group relief could affect the cost and that there was a major hotel and leisure development which was already under way in terms of seeking necessary approvals. The fact was that within the Department of Tourism generally the development at Mount Murray was known and was supported. It should have been brought into the equation. The Minister for Tourism was aware of the proposal and, on the very same day as the meeting,

[95] Evidence of Mr Toohey Q10 Transcript Day 44 page 23 and Document Q10

had been lending support to the development in terms of discussing the review of a limiting condition imposed on the planning permission which at that time had been granted.

c) <u>Detailed Discussion on Tax Allowances</u>

8.113 The next point concerns the role which this department of government took upon itself in discussions with the developer when it was campaigning to extend the items to which the capital allowances would apply. The department got itself into a position early in 1992 where it was, at the least, giving the impression to the developer that promises had been made with regard to the extension of the allowances including possible legislation, and there was inadequate contact with the Income Tax Division at the Treasury on these matters.

8.114 Consistently the developer's agent wrote after meetings or discussions stating that agreements had been made. It is not now accepted by the Department of Tourism that agreements or undertakings were made, but at the time there was no challenge to those claims that agreements had been made. The ultimate effect was that when the Income Tax Division of the Treasury had to deal with these issues it was in a more difficult position than it would have been had it been fully involved from the start, as it should have been. Indeed, if the claims made by the developer's agent were correct, steps were being taken within the Department of Tourism which were quite outside its remit. We conclude that in reality one department, the Department of Tourism, allowed itself to be in a position where it was in effect perceived to be played off against another, the Treasury, and this was because of these faults in the Department of Tourism.

8.115 We conclude that there is no doubt that part of this mishandling was because of the position of the Chief Executive as we have explained it in our Part One Report. He was in practical terms excluded to a considerable extent from events going on in his department, particularly those being taken forward by Mr Mitchell. He was not aware of these events to any relevant degree, and therefore was not in a position to bring it to a halt. Fortunately the actions taken by the Treasury ultimately did bring this matter back under control.

d) Tourist Business Incentive Allowance Certificates

8.116 The next matter relates to the certificates introduced under the 1992 Amendment Order. As already explained these certificates were required to certify that statutory economic criteria had been met. We conclude that the Department of Tourism did not know, in any meaningful way, how the certification system should work.

8.117 It was content to receive a draft of a certificate from the developer and to issue that as the certificate required under the legislation. This is what happened in relation to the first two certificates which were issued, that is those in respect of the hotel development and to its extension. No information was sought in terms of business plans, financing or other information. It was claimed[96] that such information would be understood informally because of the continued contact with the developer and the project. This contact may or may not have produced the right answers. However we conclude that even if proper procedures had been applied it may well have been appropriate to issue these certificates. The criticism is that proper procedures were not applied.

8.118 The matter came to the notice of the Treasury when what purported to be a certificate in relation to all the housing development was issued on 21st September 1994. The Department of Tourism denied that it was a certificate and was merely something to be checked by the Income Tax Division. We have already concluded that it was not a valid certificate for reasons set out in section 7 above. Again the department followed the same pattern of action. A draft certificate was sent to the Department of Tourism by the developer and the "certificate" was issued immediately with no information justifying issue being sought from the developer.

8.119 By now the Chief Executive had taken over and he was not familiar with the procedures required under the 1992 Amendment Order. If he was not familiar he

[96] Evidence of Mr Toohey Q10 Transcript Day 34 pages 66 - 68, 74 & 75, 81

should not have simply accepted the say so of the developer that a certificate, draft or otherwise, should be issued. But under pressure, as we have seen, he did seek advice. The department had the advantage of an advisor from the Treasury, who specifically advised how the information as to whether or not to issue certificates should be obtained. Apart from an initial letter which was not followed up that advice was not followed. Ultimately a further certificate was issued, for 23 houses, in the following year but not in compliance with the advice which had come from the Treasury as to the appropriate procedures to be followed. Mr Toohey has claimed that this specific advice from Treasury was at his request. We certainly accept that other advice he received was at his request and, as we indicate, he does deserve credit for seeking such advice. However he did not seek the advice referred to in this paragraph. This advice was given following the issue of the letter or "certificate" dated 21st September 1994 which had caused concern to Treasury and resulted in a letter dated 30th September 1994 from Mr Kennaugh to Mr Toohey.[97] This letter stated that Mr Toohey was endeavouring to advance matters a little ahead of what was possible. It also suggested a meeting to "determine just what pieces of relevant information the developer still needs to provide us with to complete our requirements for both phases". The meeting took place on 13th October 1994 and the advice referred to above was given. Details of that meeting are set out at paragraphs 7.25 to 7.28 above.

8.120 In the event no harm came from the purported issue of certificates related to housing, although it did provoke a great deal of aggression and threats of litigation from the developer. The harm did not come in the sense that claims have not been made to the Assessor for tourist business incentive allowance in respect of the houses following the issue of certificates, valid or alleged to be valid, which were the necessary prerequisites to any such claim. The matter was however poorly managed and can be fairly described as mismanagement. Mr Toohey has commented in his letter to the Commission dated 23rd April 2004 that the fact that there has not been any "funding" from tourist business incentive allowances so far as the housing is concerned should make much of this issue

[97] File II page 334

academic. Regrettably this comment misses the point that poor government management of the issue should not be regarded as of academic value.

8.121 As explained in paragraph 7.59 above, procedures relating to certification have now been agreed with the Income Tax Division, and we are advised that they work well. Notwithstanding the very long time taken to reach this position, it is a positive advance to which we refer further in our recommendations.

e) <u>Overall Conclusions on Department of Tourism</u>

8.122 In giving our overall conclusions on the Department of Tourism it is important to draw attention to a point made by Mr Toohey in his letter to the Commission dated 23rd April 2004. He claims that development matters were just one element and a minor element of the department. There is some substance in this point and it does have to be borne in mind that the Commission has concentrated in a more detailed way upon development matters in the department than upon other matters. That is of course the element with which the Commission is primarily concerned, but this is not a minor development matter, nor is the powerful evidence of Mr Downie, identified at paragraph 8.147 below, who, as a member of the department, severely indicted procedures and communications within the department, a minor matter. The evidence of Mr Dominic Delaney MLC, also a member of Tourism, is similar and consistent with that of Mr Downie.[98] The Chief Minister said that Mount Murray was very significant, and "the largest, one of the largest investments" they had seen.[99] Mr Toohey himself told us it was the first major tourism development for many years.[100] So while the criticisms which we make in our conclusions are primarily focussed upon development matters in the department, they should not be regarded as other than the most serious criticisms which inevitably must reflect upon the running of the department as a whole.

[98] Evidence of Mr Delaney Q58 Transcript Day 33 pages 55 & 56
[99] Evidence of Sir Miles Walker Q16 Transcript Day 30 page 16
[100] Black File used in Days 30 & 31, page 15, Mr Toohey Document Q10 1.7.2002

8.123 We conclude that, notwithstanding Mr Toohey's claims to the contrary, the matters upon which we have just set out our findings do indicate that there was extremely poor management of the Department of Tourism at material times with regard to development matters. 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. Although a very poor level of competence this does not however fall into that category which we have explained in our Part One Report as corruption. In early 1992 it appeared to be doing little to resist the manipulation and pressures of the developer, but 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. What happened was highly regrettable but it was no more than what we have just said, extremely poor management.

B) Individuals within the Department of Tourism

a) Mr Toohey

8.124 We turn now to consider officers within the department. First the Chief Executive, Mr Toohey. We have considerable sympathy for Mr Toohey in the situation with which he was faced. We accept and recognise the concern which he had about losing his job, which to him was a real concern, were he to press too far in seeking to regain control of his department. We also accept that, as explained by Mr Toohey in his letter to the Commission dated 23rd April 2004, there were practical difficulties in controlling Mr Mitchell given his consultancy status, and that that was a further difficulty for Mr Toohey. We note that he attempted to improve the situation with Mr Mitchell by requiring the production of the witnessed statement of 6th May 1992. We further accept that after Mr Mitchell's departure in mid 1994 he was subjected to aggression and bullying by the developer's representative Mr Spence with regard to the issue of certificates.

We also further accept that he took an appropriate course in seeking advice, including from the Attorney General, as to how best to act in relation to the certificates under this continuing pressure.

8.125 Nevertheless it is clear that Mr Toohey did not manage to regain full understanding and control of his department, and the Chief Executive should succeed in that task. Likewise, notwithstanding that he did attempt to bring Mr Mitchell under control, he does not appear to have succeeded and things went back to the state they were in prior to that May 1992 statement. Furthermore, we find that, although the certificate procedure was a new one so far as the Department of Tourism was concerned, it was not all that difficult a procedure. Also specific advice was given to him by the Treasury. Yet Mr Toohey appears not to have fully understood the procedures (although he does not accept this in his letter of 23rd April 2004 to the Commission). Ultimately, although there was again some mitigation in the sense that he was following advice from the government's legal department, on issue of the certificate of 10th April 1995 he failed to follow that elementary advice which had come from the Treasury as to how to obtain appropriate information to determine whether or not certificates should be issued. (See paragraphs 7.43 to 7.46 above). Mr Toohey has written to the Commission[101] confirming that he did follow the advice of Treasury and refers to a letter written by him on 14th October 1994 and referred to at paragraph 7.27 above. The Commission accepts fully that he wrote such letter as advised, but we refer here particularly to 10th April 1995 although the criticism is also relevant to the letter of 16th January 1995. Mr Toohey refers[102] to the long established practice of seeking and following the advice of the Attorney General. The Commission does understand this and has at all times been aware of it. We have however seen no indication in the papers that Mr Toohey, when asked to confirm on actions to be taken, ever brought to the notice of the Attorney General the advice which had been received on 13th October 1994 and which he had set down in his letter of 14th October 1994.

[101] Letter Mr Toohey 23.4.2004 - See Annex 9
[102] Letter Mr Toohey 23.4.2004 page 3 - See Annex 9

8.126 Additionally it took many years before the production of draft guidelines was considered, and procedures were agreed with the Income Tax Division. In his above mentioned letter to the Commission Mr Toohey says that the primary reason for the delay was "quite simply that it was some years later that a tourist business incentive allowance (with possibly one minor claim in the interim) was requested by a hotel operator on the Isle of Man". The Commission accepts this factual situation but fails to see that it provides justification for delay after the very difficult circumstances of 1994 and 1995 (and we do accept that they were difficult). We would have thought that it would not necessarily be known when the next tourist business incentive allowance application was going to be submitted. The difficulties of 1994 and 1995 should have demonstrated that it would be prudent to have an appropriate system in place when the next application did come, whenever that might be.

8.127 In his letter of 23rd April 2004 Mr Toohey has set out a number of points, some of which appear to seek to justify the events which occurred or to say that the end result was beneficial. The Commission has already indicated that it cannot accept arguments, which we have consistently been receiving in this part of our Inquiry, that the end justifies the means. It cannot be right to say, as Mr Toohey does, that the department had a brief to secure the project and there is now a much needed hotel and leisure complex, when the securing of that development involved the corruption of the planning system so that by covert means there was secured permission for 175 permanent residential dwellings which, as Mr P Moore, a director of Mount Murray Country Club Limited, told us (see paragraph 8.39 above), provided the vital element for viability of the whole development. Nor is it right to say, as Mr Toohey does, that the department of which he was head had no part to play in the planning process as to what is or is not approved. The Part One Report shows that his department had a great deal to do with obtaining the approvals, and in a way which was not creditable, though Mr Toohey had little involvement in that. Mr Toohey told us that he has recently received information from the Income Tax Division that in their opinion tax benefits have been totally justified in relation to the economic return to the Island's economy. As we have explained in sub-section 8 (v), a very detailed

examination of evidence from that division, and of the wider evidence which we have, demonstrates that that conclusion cannot be correctly made.

8.128 We conclude that these were serious failings. Especially significant is the fact that Mr Toohey was the Accounting Officer for the department from 1988[103] and his inability to function properly as set out above undermines such other internal controls as he represented. Nevertheless while these are weighty criticisms we do also conclude that there is much mitigation because his failings at the material times were those of failing to surmount adequately quite significant difficulties which he had in carrying out his role, because of the activities of others.

b) <u>Mr Mitchell</u>

8.129 We next turn to Mr Mitchell. We have noted the involvement of Mr Mitchell in relation to Mount Murray matters in our Part One Report (e.g. paragraphs 11.136 to 11.141). There is little we need to add here except to say that he was most unsatisfactory in the role in which he played for government on these tax issues relating to Mount Murray. His failure here was in pursuing the negotiations with the developer's agent in relation to taxation matters without keeping the Income Tax Division appropriately in touch with what was happening, and failing to reply to the developer's agent when the latter was making claims that agreements and undertakings had been given, if it truly was the case that such agreements and undertakings had not happened or been given. We do however conclude that agreements were reached in those early 1992 meetings. This is shown by the correspondence and in attachments.[104] For example on 27th February 1992 Mr Nugent wrote[105] that he "would be grateful if [Mr Mitchell] would confirm [Mr Nugent's] understanding of the allowances which you are prepared to grant is correct…" then he identified further items in respect of which he asked for specific confirmation that this would qualify for the allowance, though saying that he thought they were in accordance with "the general agreement reached at [their] meeting". It is consistent with the

[103] Civil Service Commission 3.6.2004
[104] Letters Mr Nugent 18, 24 & 27.2.1992
[105] File I page 53

evidence from Mr Nugent,[106] the evidence of Mr Kennaugh[107] as to Mr Mitchell's concern when difficulties arose, and also consistent with some correspondence from Mr Spence. Such agreements and commitments should not have been made and were not within Mr Mitchell's power to make. It is a matter for significant criticism.

8.130 Mr Mitchell was also involved with the issuing of the certificates but not those relating to the housing development. He had left the department by then. He was involved in the issue of those relating to the hotel and its extension and the same comments which we have referred to above in respect of Mr Toohey apply equally to Mr Mitchell. In summary he was an unfortunate choice, as it turned out, for an officer who was intended to assist the tourism industry at that difficult time. He clearly failed in the standards required of his appointment.

c) <u>Mr Ball</u>

8.131 The only other officer in the Department of Tourism whom we have seen as connected with these matters with which we are concerned is Mr Ball, now the Director of Leisure. We need say no more than that, insofar as he was involved with these matters, his conduct was exemplary.

d) <u>Mr Bell</u>

8.132 We next turn to consider the Minister, Mr Bell. In doing so we have taken into account a letter dated 15th March 2004 from Mr Bell to the Commission. This letter is in effect a series of submissions by Mr Bell in defence of his position in relation to matters which were put to him during the course of the hearings by the Commission in its enquiries and investigations of evidence for the Part Two Report.

8.133 We have found the letter helpful and we have taken it fully into account. We make no comment on its tone, save to say again that the Inquiry is inquisitorial

[106] Evidence of Mr Nugent Q25 Transcript Day 43 page 41

and therefore matters which are potentially material to our investigations have been raised and put to witnesses for their comment. Mr Bell, and other witnesses, understandably may not have liked these questions, but they have been put because the totality of the evidence has raised questions which do need to be answered by the Commission. To put these questions to the witness gives the witness the opportunity to give his or her account of the events in question, and to agree or reject, with reasons, the matters being put to them. Mr Bell and the other witnesses, would like it much less if they were not given their opportunity to respond and put their answers, views and version of events for the Commission to take into account before reaching its own final conclusions on the issues in question. It would have been unfair to have done otherwise.

8.134 Mr Bell has stated in his letter that the Commission has not investigated matters with an open mind, but has sought to justify a link between planning and tax relief relating to Mount Murray, and to prove its preliminary view of which it informed Mr Bell at the start of the investigations into the Part Two Report. The Commission has approached matters with an open mind, and the conclusions which it has reached are based on evidence which the Commission has scrutinised very carefully, including questioning witnesses closely on such evidence. Taking the issue of the Commission's preliminary view: if a Commission, on its preliminary reading of substantive documentation perceives that it appears to raise the possibility that a witness may be subject to significant criticism, then it is fair to inform that person of this situation and to give that person the opportunity on these grounds to seek legal advice and representation, and otherwise to take whatever steps the person deems appropriate in this situation. This is normal practice. It is also normal practice, logical, and commonsense for the Commission to examine and investigate closely, by questioning or otherwise, whether that preliminary view was correct or otherwise. It has nothing to do with open or closed minds. It is quite the reverse. If the Commission had a closed mind it would not have bothered to ask detailed questions on the issue. Likewise on the matter of the link between planning and tax relief, as summarised in paragraph 8.13 and explained in 8.71, there was

[107] Evidence of Mr Kennaugh Q54 Transcript Day 39 page 24 and File I page 124

clear evidence before the Commission in its investigations leading to the Part One Report of such a link. Because of litigation the matter was not pursued at that time and the Commission did not distinguish between the 1991 and 1992 Orders. In its current detailed investigations the Commission has established that the developer had no involvement with the making of the 1991 Order, the substantive Order, but there is generally full acceptance that the developer was very much involved in securing benefit for Mount Murray with the 1992 Order. There is no justification for Mr Bell's claim that the Commission has not approached matters with an open mind, and, insofar as such matters are capable of demonstration, these findings are consistent with the Commission's open minded approach.

8.135 Mr Bell also asks the Commission to reverse findings made in its Part One Report and produced some further material said to justify such a course. The Commission would regard it as inappropriate to re-open issues on which there was ample opportunity to make whatever submissions were thought appropriate, but in any event has considered the submissions that are now made and the material that goes with them and could find no justification to reverse the findings already made in the light of all the evidence.

8.136 In the following paragraphs we refer to the above letter of 15th March 2004 as Mr Bell's 'letter'. Mr Bell also wrote a letter to the Commission dated 4th May 2004 which was in response to a number of points of criticism of Mr Bell which the Commission was then minded to include in this Report, and Mr Bell was invited to comment on these points. Mr Bell has responded in his letter of 4th May 2004 and we refer to this letter as Mr Bell's 'response'. It has been taken fully into account and is, so far as material, to be seen in Annex 9.

8.137 Mr Bell, in his letter of 15th March 2004, says that he had very little involvement with the 1991 Order. We accept this, subject to the events of 20th March 1991 to which we return below. He also submits that the 1991 Order was prepared and approved for reasons not connected in any way with the Mount Murray development. We also accept this as explained in sub-section 6 (ii) and stated, for example, at paragraphs 8.24 and 8.25 above. Mr Bell does however make a

similar submission to that made by Mr Corlett on behalf of Treasury interests that there is no evidence which supports the Commission's findings at paragraph 5.4 of the Part One Report that the 1991 Order was fundamentally linked to the Mount Murray development. Paragraph 5.4 of the Part One Report did not in fact make the finding as put by Mr Bell. Mr Bell's submission is rejected for the same reasons as Mr Corlett's submission is rejected as is explained at paragraph 8.71 above, and as is also explained in 8.134 above. The Commission's finding as expressed by the Commission was, and is, correct.

8.138 Mr Bell also argues in detail that the discussions in early 1992 with the developer's tax agent/advisor about the details of expenditure qualifying for incentive allowances did not constitute corruption of the system of government so far as the Department of Tourism is concerned. As indicated at paragraph 8.123 above, we agree. We do however find that there was mismanagement and fault in the Department of Tourism as is also concluded at paragraph 8.123. We return below to this issue so far as it concerns Mr Bell.

8.139 Mr Bell makes a further point similar to Mr Corlett's submissions, namely that the tourist business incentive allowance Orders have been good for the Isle of Man, referring to a 65.1% real increase in income generated by tourism, and to evidence from Mr Gelling that government income is being boosted by increased tax receipts from the tourist business incentive allowance Orders, and a suggestion that the Mount Murray development would not have happened without them. As we stated at 8.68 above in respect of Mr Corlett's submission we do not accept these as arguments which should carry weight against potential criticisms, even if correct, because they are in effect saying that the end justifies the means. If there has been mishandling or misconduct by government a beneficial consequence cannot justify that conduct. As it happens, as is seen elsewhere,[108] the Commission does not accept that these points are established, or, so far as the Mount Murray development point is concerned, correct.

[108] See para 8.69 above

8.140 They are not made out because there is no economic analysis upon the issue. The figure of 65.1% comes from the October 2003 Treasury Review of Economic Strategy and is in the period 1992/93 to 2000/2001. Notwithstanding that increase of 65.1%, which compares with an overall National Income real increase of 83.1% in the same period, the percentage contribution in both years is 6%. Further, as we have found, the Mount Murray development would have taken place without the tourist business incentive allowance legislation, and there is no information as to what extent that development has contributed (as we can assume it has) to the increase in real income. We consider that no conclusions, one way or another, can be drawn from this information as to the extent of the benefits arising from tourist business incentive allowances. This is illustrated by the comment in the same Economic Strategy document[109] immediately following these figures that "National Income data apart, the clearest indication of the economic success enjoyed by the Island in recent times comes from the labour market". The information provided as to employment by sector[110] shows that those employed in the "tourist accommodation" category was significantly less in 1996 than in 1991 and in 2001 was significantly lower than in 1996. Insofar as "entertaining and catering" is concerned, this figure was lower in 1996 than in 1991, but significantly higher in 2001. These figures further reinforce our view that no relevant conclusions can be drawn from the figure of 65.1%.

8.141 Similarly our view is reinforced by the Passenger Survey Annual Report 2002 issued by the Economic Affairs Division of the Treasury. Relevant extracts are to be seen at Annex 10. These show that the number of period visitors staying in paid accommodation has not increased in the last four or five years preceding the Survey compared with the four or five years preceding the 1991 and 1992 Orders, indeed they have decreased, with little change in the intervening years.[111] Likewise the number of (visitor) bed nights spent on the island has approximately halved over this period with a gradual decline from 1990 to this position.[112] The scheduled passenger departures of period visitors staying in

[109] L127 Review of Economic Strategy October 2003 page 3
[110] L127 Review of Economic Strategy October 2003 page 4
[111] Table 2.1 Annex 10
[112] Table 2.10 Annex 10

paid accommodation has dropped significantly since 1990 and 1991.[113] Also the number of business visitors has not shown any material change from the position in 1989 and 1990, although a decline in the 1990s started recovery in 1996.[114] In contrast the number of period visitors visiting friends and relatives has doubled over this period.[115] These Survey figures not only do not support the argument that significance can be placed upon the figure of 65.1%, but, if anything, cast doubt upon that argument.

8.142 Likewise the evidence of Mr Toohey with regard to the extent to which tourist business incentive allowance has been used lends little support to the claim that it has been a material factor in any expansion of the tourism industry. Mr Toohey explained in his letter to us dated 23rd April 2004 that the reason he had delayed production of guidelines in relation to the issue of certificates relating to tourist business incentive allowance was because they were so little used. Following the events of 1994 and 1995, he said it was "some years later that a TBIA (with possibly one minor claim in the interim) was requested by an hotel operator in the Isle of Man." Nor does the evidence of Mr Willers support the view that tourist business incentive allowance has been a material factor in any expansion of the tourism industry. Speaking of the investment in residential units for tourism purposes, he said that the 250% incentive was not sufficient to encourage people to invest, and that it was uneconomic to do so.[116]

8.143 Notwithstanding agreement with substantial parts of Mr Bell's submissions we do conclude that Mr Bell is to be criticised on a number of matters. Mr Bell has addressed these matters in his letter and in his response and we refer to Mr Bell's submissions within the context of the criticisms which next follow.

8.144 First, at the meeting with Mr Gelling on 20th March 1991 when Mr Gelling was persuaded by Dr Orme to agree in principle to total tourism allowances of 250% on the basis, as Dr Orme saw it, of this being a low cost, low risk scheme, Mr Bell was fully aware of the Mount Murray development proposal and its potential for

[113] Table 1.2 Annex 10
[114] Table 5.1 Annex 10
[115] Table 3.1 Annex 10

taking substantial advantage of the proposed allowances so that the proposal was not in fact a low risk, low cost scheme. He failed to draw this to attention at the meeting and we conclude that that is a matter for significant criticism. We have referred to this in section 6 and in paragraphs 8.26, 8.100 and 8.112 above.

a) In his response Mr Bell accepted that the political decision taken on 20th March 1991 may well have been of material relevance to the scale of tax relief which the developer of Mount Murray was eventually able to secure, but makes the point that the political decision taken on that date was not in any way linked to the Mount Murray development. The Commission does not disagree that the political decision of 20th March 1991 was not made to benefit Mount Murray and this is explained fully in this Report. This is a quite separate matter to the criticism of Mr Bell identified above.

b) In his response Mr Bell disagrees with the Commission finding that it "seems hardly credible" that the Mount Murray development was not in his mind at the meeting of 20th March 1991, and argues in detail that the fact that the development would be large scale was not a reason for it having any particular bearing on that meeting. He makes a number of points, reiterating that tourist business incentive allowance was not brought forward for Mount Murray, that the meeting was arranged at the behest of Dr Orme, that Dr Orme would argue the issues and that he (Dr Orme) was not aware of the Mount Murray development at that time, and that the April 1991 Budget was the last opportunity to bring in tourist business incentive allowance before the General Election in 1991. On general terms these matters are accepted by the Commission, but they have no bearing on the point of criticism which the Commission makes about failure to draw this high cost proposal to attention.

c) Mr Bell does however make one point which is relevant when he says in his response that there was no reason why he should have the Mount Murray development particularly in mind during the 20th March 1991 meeting with Mr Gelling. It is this point which, to the Commission, seems hardly credible. The

[116] Evidence of Mr Willers Q2 Transcript Day 37 pages 81 & 82

Commission does not agree with it. The factual basis for the Commission's view can be seen summarised at paragraphs 6.91 to 6.93 above with relevant material in following paragraphs. By way of further detail it can be added that the developer had let it be known in November 1990 that sums of the order of £20 million were involved, and that Mr Bell saw it as vitally important to the tourist industry. In his own evidence to the Inquiry he spoke several times of the great importance of Mount Murray to the tourist industry which in 1991, he said, had become totally unsaleable, was on its last legs, and that Mount Murray was essential, that if the tourist industry was to be relaunched the development was to be completed, and that to try to relaunch the industry was the department's remit.[117] Mr Bell further described this Mount Murray development as a "vitally important project for the Isle of Man and one which he ultimately believed saved the tourist industry, and that they were very anxious to get the site through". He also said that it "was the first major investment in tourism for over twenty years and they were very anxious to see that this project went through to kick start what was remaining of the industry, to give it any chance of survival at all."[118] Mr Bell did in fact strive very hard indeed in early 1991 to get the project through, and to such effect that on 13th May 1991 he was able to say to the developer that he (the developer) would be able to go ahead exactly on the basis which he wanted.[119] Given such importance which the project had, the determination of Mr Bell to ensure its development, that on the same day he was having a meeting with the developer to discuss appealing the restrictive condition attached to the planning permission which had by then been granted, and also to discuss the continued support for the proposal, there was every reason why Mr Bell should have Mount Murray on his mind. For these reasons the Commission does not find it credible, and does not accept, that the project was not on his mind when he had that meeting of 20th March 1991 with Mr Gelling and Dr Orme. The Mount Murray was high cost and extremely important, and to a reasonable and objective observer would very likely affect materially the extent of reliefs payable under tourist business incentive allowances if they were to be made law.

[117] Evidence of Mr Bell Q9 Transcript Day 9 pages 35 and 58
[118] Evidence of Mr Bell Q9 Transcript Day 32 pages 6 and 27
[119] File A page 189 Telephone message Mr Bell to Mr Spence 18.5.1991

d) Mr Bell's response also challenges the Commission's view that if the Assessor had better understood the scale of the Mount Murray scheme and costs involved he might more effectively have briefed the Treasury Minister as to financial implications (see paragraph 6.103 above). He queries the relevance of this and also claims that it is inconceivable that the minister and his officers did not understand the possible financial implications. It is not easy to understand why the minister should not be properly briefed on financial implications, the scale of which we have set out in sub-section 8 (v) so far as is possible; and the fact is that the minister did not understand the financial implications, as we have explained in 8.100 and following paragraphs. Although Mr Bell argues to the contrary, if the scale of reliefs which might be claimed under tourist business incentive allowance had been more fully understood then a more cautious approach or different approach might, and should, have been taken, and it is a quite open question as to how it might have been viewed by Tynwald if the full financial scenario had been explained to them. In any event it is quite unsupportable that taxation measures should be put forward without either the promoter or the decision making body being properly informed as to the financial consequences of such measures.

e) In his response Mr Bell also dismisses the Commission's conclusion that the Mount Murray development took tourist business incentive allowance away from being a low cost, low risk, proposal. This is on the mistaken basis that the relief could only be claimed if the development was a success and made a profit. It is mistaken because it does not take any account of group relief, in relation to which it is accepted by the Mount Murray Country Club Limited that capital allowances which were significant and not trivial were taken up and surrendered by way of group relief to other companies in the same corporate group thereby decreasing their own liability to Manx income tax. It is further argued that group relief was never part of the tax planning for the Mount Murray development. This is a point with very little weight given the information just set out that there was in fact significant use of group relief, and that in his very first letter on these matters to the Assessor on 6th January 1992 Mr Nugent specifically asked for confirmation that any losses created using either the tourist business allowance or the tourist business incentive allowance would be available for loss and group

relief purposes in the usual way,[120] and that in oral evidence he described its applicability as "absolutely fundamental" (see paragraph 6.55 above).

8.145 Mr Bell's letter to the Commission of 15th March 2004 refers to the reasons for the 21st March 1991 meeting being that the April 1991 Budget was the last opportunity before the general election to have meaningful tax changes introduced. Even if this is the case it does not bear upon the criticism we make. We can accept Mr Bell's explanation as to why such a meeting took place, but this would not be a reason to cancel a prior meeting between officers and replace it by a politicians only meeting. We find it much more likely that that officers' meeting was cancelled for the reason given by Mr Dawson,[121] that the officers were unhappy with the proposal. But in any event we do not criticise Mr Bell for attending the meeting. Such meetings are quite usual happenings between politicians.

8.146 The next matter in respect of which we criticise Mr Bell is his continued use of Mr Mitchell in the Department of Tourism to the exclusion of the Chief Executive, Mr Toohey, with the consequence that Mr Toohey was not able to exercise appropriate authority as Chief Executive Officer. We have noted this particular situation at paragraph 11.138 of the Part One Report. So far as tax related matters are concerned this situation had specific adverse effect in relation to the detailed tax discussions with the developer early in 1992, and with the economic criteria certification in 1994 and 1995. We have drawn attention to the general effect upon Mr Toohey's general ability to run the department in paragraphs 8.122 to 8.124 above.

8.147 Mr Downie, member for the Department of Tourism, gave illuminating evidence[122] on this issue, and we accept that evidence. He came to the department in January 1992. He told us that communication in the department was not good, and that it was an intolerable situation for senior members of staff,

[120] File I page 31
[121] Evidence of Mr Dawson Q60 Transcript Day 40 pages 15 & 16
[122] Evidence of Mr Downie Q19 Transcript Day 35 page 124 seq and Document Q19 7.10.2003

with Mr Mitchell only providing information directly to the Minister.[123] The information situation was so bad that nobody in the department could give Mr Downie details of the incentives available for the Mount Murray development. Mr Mitchell's response to requests for information on this was that it was up to the minister to tell Mr Downie.[124] This was still in mid 1992. He complained to the Chief Minister about this situation,[125] and he complained to Mr Bell[126] who was said to be a very busy man but was very reluctant to share information about the department with Mr Downie.[127]

8.148 There was of course also the witnessed statement from Mr Mitchell (see paragraph 6.79 above) dated 6th May 1992 which showed how really bad things were in the department. There can be no justification for allowing such an unacceptable state of affairs in the department, perhaps illustrated by Mr Toohey's fear of arguing about the situation too strongly in case he lost his job (see paragraph 6.84 above) and Mr Bell must take responsibility and criticism for this. Had Mr Toohey been allowed to have proper control within the department there would have been the opportunity to address the propriety of the tax discussions indicated with the developer's agent and perhaps even the certification procedure. Mr Bell acknowledged[128] that there were problems with communication within the department, but that he was not aware of this until a later stage. If Mr Bell had failed to understand that there were such problems then he is to be criticised for that also.

a) Mr Bell makes reference to these matters in his response. There are two points which he makes which should be mentioned here. Mr Bell says that he only became fully aware in September 1994 of the extent to which Mr Mitchell was excluding the chief executive from information. In this regard we refer to the matters set out in paragraph 8.147 and their references. We refer particularly to Mr Downie's evidence that he complained to Mr Bell in 1992 about poor administration and about Mr Mitchell. The effect of such complaints was, said Mr

[123] Evidence of Mr Downie Q19 Transcript Day 35 page 125
[124] Evidence of Mr Downie Q19 Transcript Day 35 page 129
[125] Mr Downie Document Q19 Letter to Chief Minister 20.5.1992
[126] Evidence of Mr Downie Transcript Day 35 page 134
[127] Evidence of Mr Downie Transcript Day 35 page 134

Downie "He [Mr Bell] didn't really have much to comment".[129] We also refer to the letter of complaint by Mr Downie to the Chief Minister in May 1992 concerning general conduct of the department, reliance on Mr Mitchell, and communications. Mr Bell may or may not have seen this letter, but it seems unlikely that it would not have been brought to Mr Bell's attention by the Chief Minister. It may also be the fact that Mr Bell was not fully aware of Mr Mitchell's manner of doing business until September 1994 but he had ample opportunity long before that to be fully aware and he should have been, and we do not see that he has met the criticism we make.

b) Mr Bell makes the further point that the Commission should not rely on Mr Toohey's fear that he might lose his job if he argued too strongly against Mr Mitchell, that he (Mr Bell) did not accept this position, and it was not correct that Mr Toohey would lose his job. Mr Bell's views on, or knowledge of, this are not germane. It was Mr Toohey's fears, real or otherwise, which matter. We accept Mr Toohey's evidence on this point, which in the nature of things, he would be unlikely to communicate to Mr Bell.

8.149 The third matter in respect of which we criticise Mr Bell is his engagement with Mr Mitchell in the detailed tax allowance discussions with the developer's agent in early 1992. Mr Bell refers to this matter in his letter of 15th March 2004. He states that there was nothing wrong with discussing with Mr Nugent his suggestion for amending the 1991 Order. He cites legal approval for working closely with the private sector and approved practice with regard to consultation. He further argues that the amendments were for the benefit of the tourist industry generally, and that the meetings and correspondence in February 1992 were directed to the generality of the effect of the amendments, and were in general terms rather than specifically referring to the Mount Murray development.

8.150 Of course some of these points have validity but they do not take away the force of our clear conclusion that the meetings/correspondence in February 1992 and following were primarily directed to Mount Murray with the knowledge of all

[128] Evidence of Mr Bell Q9 Transcript Day 42 pages 99 - 102

parties, that the conduct of Mr Bell and Mr Mitchell in these discussions raised clear understandings on the part of the developer's agent that agreements and commitments had been made, and that this was indicated to Messrs Bell and Mitchell, but no denial or qualification followed.

a) Mr Bell, in his response, disputes that the meetings/correspondence in February 1992 and following were primarily directed to Mount Murray with the knowledge of all parties. The Commission is satisfied that it is correct on this issue. The letter of 19th March 1992 from Mr Nugent to Mr Mitchell includes as its first heading "Radcon Village Resorts Limited". There is no explanation in the letter as to why the title is by then Mount Murray specific. However the opening words refer to "recent meetings, previous detailed correspondence and your meeting and correspondence with Gary Spence, Norman Dean and Robert Pearce [the latter two have Radcon or Carlson/Radisson connections]. This letter seeks to bring together all of the relevant issues, with a view to clearly identifying the nature, amount and availability of allowances in respect of the Mount Murray tourist development." (Parentheses inserted by Commission). This letter puts beyond doubt that tax discussion with the Department of Tourism, and others, about tax allowances at Mount Murray had been carried on for some quite material time prior to 19th March 1992, possibly and even likely, in February. The reference in the schedule to the letter of 24th February to "Hotel or holiday village developments" is also quite compelling, given that there were no other projects of the holiday village nature at the time other than Mount Murray . And the references to items in respect of which Mr Nugent asked for specific confirmation of allowances in his letter of 27th February 1992[130] (see paragraph 8.129 above) makes the same point even more strongly. In any event the 1992 Amendment Order concerning the tourist business incentive allowance which emerged from these meetings is not in dispute as being primarily directed towards benefit for Mount Murray.

b) Mr Bell's response also seeks to argue that neither he, nor Mr Mitchell, nor the Department of Tourism entered any agreement or gave any undertakings relating

[129] Evidence of Mr Downie Q19 Transcript Day 35 page 134

to tax matters. He relies on a number of items of evidence which, apart from one and possibly two, do not bear on the validity or otherwise of the Commission's findings. The reality is that the contents of the letters of 18th, 24th and 27th February 1992 put the position beyond doubt in the view of the Commission. The first of these letters identifies the three main subject matters under discussion. They are (1) the period over which the allowances will continue to be available at current rates; (2) details of the specific expenditure which will qualify for allowances; and (3) the timing of the availability of the allowances. In many instances these issues involve technical interpretation of legislation which is clearly a matter for Treasury not the Department of Tourism. Thus the very first question under (1) relates to establishing "whether the allowances can be claimed based upon the rates of allowances prevailing in the year in which the expenditure was commenced, or in accordance with the rate of allowance prevailing in the year in which the expenditure was actually incurred". In the letter of 24th February (on the second page) there is reference to the schedule saying "the fourth column of the review incorporates some further notes to reflect the points which were agreed". Many of the items in that fourth column refer to items of work with the comment that such items will qualify, or that relief is agreed subject to a qualifying measure, or clearly qualify, or are appropriate for qualification. The letter of 27th February 1992 specifically refers to agreements (see sub-paragraph (a) and paragraph 8.129 above). The view of a meeting held on 30th July 1992 between the Assessor and his Deputy and Messrs Toohey and Mitchell indicates the same interpretation as the Commission.[131] That these matters have been agreed has never been denied in correspondence. The first relevant point to which Mr Bell draws attention is that Mr Nugent said that he was not asking for technical interpretation of the legislation. This evidence is not consistent with what the correspondence shows. The second point referred to above is a reference to an oral statement by Mr Mitchell and Mr Toohey that they had given no undertakings whatsoever. As to this Mr Toohey was not involved in these matters so may well have given no undertakings, but the correspondence is quite clear that undertakings or agreements were understood to have been

[130] File I page 53
[131] File I pages 234 & 235

given, Mr Nugent emphasised that, and this has not been denied in the correspondence.

c) Mr Bell, in his response, refutes the Commission's conclusion that his actions enabled the Department of Tourism to be played off against the Treasury. He relied upon evidence by Mr Nugent who did not accept that he was creating such a situation, although he agreed that he went to the Department of Tourism because he thought that they would be on his side.[132] Whatever Mr Nugent's position may be, and he may very well not have intended to divide and rule, on a true interpretation of the facts the Commission find it self evident that such a situation was in fact created, and it is the evidence of the Assessor that he considered that his position was compromised by these events.[133]

8.151 It is also accepted by all, including Mr Bell, that it would have been wrong for him or Mr Mitchell to make such agreements or give undertakings. In his evidence to us[134] Mr Bell said that [the meeting] was clearly related to Mount Murray but was a general thing as well. He agreed absolutely[135] that the Department of Tourism had no authority to enter into any agreement with Mr Nugent on these tax matters. We find Mr Nugent's letters of 18th and 24th February 1992 with their schedules referring to agreements, his letter of 27th February 1992, the continuing failure to deny or qualify such alleged agreements notwithstanding Mr Nugent's continuing written attempts to get further answers, Mr Nugent's own confirming evidence[136] that he understood that there was agreement, and Mr Bell's failure to be able to explain[137] why letters were not sent to Mr Nugent, establish overwhelmingly that these agreements and undertakings were made by Mr Bell and Mr Mitchell. This was a wrong action taken without power to do so and deserves criticism.

8.152 The fourth and fifth matters which concern Mr Bell refer to the answer which he gave in the House of Keys on 7th April 1992. There are two separate financial or

[132] Evidence of Mr Nugent Q25 Transcript Day 35 page 28
[133] Annex 9
[134] Evidence of Mr Bell Transcript Day 36 page 75
[135] Evidence of Mr Bell Transcript Day 36 page 76
[136] Evidence of Mr Nugent Q25 Transcript Day 43 pages 41 - 43

taxation points here and we deal with them separately as they are different points. The first point concerns the issue of financial assistance via tax following the question "Will public money be required in this development?" Mr Bell has also addressed this matter in his letter of 15th March 2004 and correctly draws attention to his reply in the following terms.[138] "As I have said on many occasions, no applications for financial assistance have been submitted, nor has there been any intimation that an application will be submitted in the future". He then deals first with what he sees are prospective allegations that at the time of his answer there were applications for government financial assistance, actual or intimated in the form of tax reliefs to the Mount Murray developer, and also work done on the public highway outside the development. We will return later to the latter point but concentrate on the former for the moment.

8.153 Mr Bell explains that he does not believe that he misled the House of Keys and that in any event did not do so deliberately or knowingly. When he gave the answer he said that he had in mind only the issue of grants, not tax incentives. He argues that it is misleading to say that there is no real difference between grant and relief, in that one way or another it is funded by the taxpayer. He first says that there is only loss under the tax relief scheme if the taxable profit would have come into the Island irrespective of the tax relief available. He then relies on the proposition that the Mount Murray development would not have come to the Island without tax relief and therefore there would be no loss to the taxpayer. We have concluded that the Mount Murray development would have come to the Island with or without the tax reliefs (paragraph 8.35 above), and we therefore do not accept this first point.

8.154 Next Mr Bell refers to tax group relief, saying that this may merely accelerate the utilisation of the reliefs but nothing more, and adds that the developer was not relying on group relief when the developer initiated the development. We accept the latter of these propositions as put (see paragraph 8.35 above), and accept that the former could be relevant to loss (but see our conclusion on financial cost in sub-section 8 (v)), but it is also the position that if there is no income there is

[137] Evidence of Mr Bell Q9 Transcript Day 36 page 82

no relief and so group relief can become very important. He also stated incorrectly that group relief has not really been used in relation to the Mount Murray development. The developer informed the Privy Council that it had used group relief, and substantially (see paragraph 2.61 above). However none of these matters are to the point which is that the developer did receive financial assistance and that was expressly what Mr Nugent was seeking when he sought a meeting with Mr Bell through his letter of 18th February 1992 (see paragraph 6.56 above).

8.155 We conclude that the answer which Mr Bell gave to the House of Keys, and as set out at paragraph 8.152 above, was incorrect. The developer had asked for financial assistance, had said in correspondence in exact terms that he was asking for financial assistance, and had fought very hard to get that assistance in terms of extended expenditure tax allowances beyond what the law allowed,[139] and succeeded in getting that financial assistance to a considerable extent of what was being sought. The financial assistance could only be through public money because he was asking government for it. Mr Bell appeared in evidence to recognise that the answer he gave was incorrect.[140] The Order allowed contribution of 50% of the eligible development costs from government and that is how Dr Orme had described it in his 1987 paper. When Mr Bell was asked why 50% of the eligible development cost did not equal financial assistance, he replied "Of course it does, yes".[141] He could give no other answer because that is the fact of the matter. Mr Bell went on to qualify his answer by saying that the two were equal in "a different way to what we believed the question was being drafted at the time", and we return to this point shortly. He very soon after went on to say[142] that he should have included in his answer the information that there would be a contribution of public money of 50% of the development costs.

8.156 It is one issue for an answer to be incorrect and another as to whether the purveyor of the answer knew that it was incorrect. Mr Bell says that he did not

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[138] Annex 9
[139] File I page 246
[140] Evidence of Mr Bell Q9 Transcript Day 36 pages 88 & 89
[141] Evidence of Mr Bell Q9 Transcript Day 36 page 87
[142] Evidence of Mr Bell Q9 Transcript Day 36 pages 88 & 89

knowingly or deliberately give an incorrect answer. In considering this answer one must look at the question as well as the answer, and Mr Bell recognised this in his submission to us. He also referred to what he considers Members understood the question to mean. As seen in paragraph 8.152 above the question concerned whether or not public money would be required in the development, so the answer has to look at public money or financial assistance together.

8.157 In his oral (and written) evidence to us Mr Bell gave his explanation of his intentions. In explanation of his understanding of the question Mr Bell's position was that he had interpreted the question as relating to grants, and we here refer back to his qualification at paragraph 8.153. Mr Bell spoke[143] about the whole debate being about direct grant and loan going into schemes and that that was the focus of the issue at the time. He then went on to say that he could only put his hands up and say he should perhaps have investigated in more depth the answers which were given to him. He said that he was deficient in this respect.[144] He added in mitigation that he was in an extremely stressful situation at the time and perhaps did not give it the attention intended or which should have been given. We could perhaps add, although this has not been raised, that the Tourism Development Scheme 1991 does define "financial assistance" as financial assistance under the Scheme, and this is consistent with what Mr Bell said he considered to be the focus of the issue .

8.158 The issue therefore is whether Mr Bell did on this point intend to mislead the House of Keys. We draw attention again to Mr Nugent's letter of 18th February 1992 when in requesting the meeting with Mr Bell he wrote "A substantial factor in that decision making process is the *financial assistance* (Commission's emphasis) available in relation to Isle of Man based Tourist Operations." This was the letter which set out with detail and clarity the agenda for the meeting which followed on 21st February 1992, seven or so weeks before Mr Bell's incorrect answer. That was a meeting in respect of which Mr Bell agreed that both he and Mr Nugent were aware that one of the developments being

[143] Evidence of Mr Bell Q9 Transcript Day 36 page 87

discussed was Mount Murray.[145] Mr Bell agreed[146] that Mr Nugent's letter of 18th February 1992 made it crystal clear that the tax matters under discussion between them were regarded as financial assistance, and held up his hands to that. He said he should have paid more attention to it at the time, but his answer was given in good faith on the answer drafted for him.

8.159 We have inquired of Mr Bell's health, and this has not revealed anything which, at least as perceived at lay level, should have affected his ability to think. He was, on any view of the evidence, in possession of all relevant information to show and know that the answer given to the House of Keys was incorrect. But did he give the answer deliberately? We find this particular question very finely balanced, but we conclude that the evidence does not satisfy us beyond reasonable doubt that he deliberately misled the House of Keys, and so we do not find that he did so mislead. Unlike the planning issues he was rather further from the centre of activities on the taxation matters, although he was significantly involved, and it is not beyond reasonable possibility that this particular aspect of the answer was an act of carelessness. If it was carelessness it was a very serious act of carelessness, and, as he accepted,[147] a minister has responsibility for what he says to the House of Keys and for what goes on in his department. We find that his conduct in this matter should be severely criticised, and we so criticise. Mr Bell has also referred to this matter in his response. Much of his argument is based upon his claim that the Mount Murray development would not have proceeded without tourist business incentive allowances. The Commission finds this to be an incorrect basis for reasons set out at paragraph 8.35 and following paragraphs above.

8.160 The issue of public financial assistance for the developer with regard to the construction of public highways improvements necessitated by the Mount Murray development was raised during the course of Mr Bell's evidence. This is the second of the two points referred to in paragraph 8.152 above. This matter was

[144] Evidence of Mr Bell Q9 Transcript Day 36 page 88
[145] Evidence of Mr Bell Q9 Transcript Day 42 page 73
[146] Evidence of Mr Bell Q9 Transcript Day 36 page 88
[147] Evidence of Mr Bell Q9 Transcript Day 36 page 89

covered in the Part One Report[148] and the Commission does not consider it appropriate to revisit the matter in this Part Two Report.

8.161 Mr Bell's response has an overall conclusion in which he makes a number of points. In the Commission's view these do not give justifiable reasons for modification of the Commission's position on these matters, and indeed, as is to be seen within this Report, the Commission agrees with a number of these points and does not need to comment further apart from on three matters. The first of these is a further reiteration of Mr Bell's claim that the Mount Murray development would not have proceeded without tourist business incentive allowances and therefore there has to be taken into account all the benefits which flow from that. As the Commission has indicated many times the evidence before the Commission strongly indicates that this is not a correct or justifiable conclusion, and such benefits as do flow from it which we have acknowledged as a matter of general understanding, including income tax and National Insurance contributions from those employed at Mount Murray and VAT on construction costs and services provided, are not a consequence of tourist business incentive allowances. However, as to Mr Bell's claim that income tax, and its extent, paid by any specific taxpayers, in this instance the Mount Murray business itself, should be taken into account as a benefit from tourist business incentive allowance, neither he nor the Commission is in any position to make this judgement. This is the position whether or not tourist business incentive allowances determined that the Mount Murray development should proceed, a separate matter on which we have already indicated our clear conclusion. The second point is that Mr Bell refers to tourist business incentive allowances playing a significant part in raising tourism income by 65.1%. The Commission has discussed this issue fully in paragraph 8.139 and following. The third point is that Mr Bell says that there was not corruption of the system of government in relation to tourist business incentive allowance, and we accept that as explained at paragraph 8.123 above.

[148] Part One Report para 11.135 and sub-section 13 (vi)

e) Mr Downie

8.162 Mr Downie was appointed a departmental member to the Department of Tourism in January 1992. He was immediately concerned about the lack of management structure and proper procedures. He was also concerned about the lack of communication within the department especially so where Mr Mitchell was concerned. By the end of 1992 he advised the Chief Minister that he no longer wished to work within the department, and he was reassigned in May 1993. He has provided valuable evidence in respect of the weaknesses in the Department of Tourism during his time spent there. We should add that his evidence on poor communication in the department was consistent with like evidence from another politician witness, Mr Delaney.

f) Dr Orme

8.163 Dr Orme pursued the existing impetus for incentives for investment in the tourism industry. His particular contribution was the introduction of an unprecedented 250% allowance into the argument for such incentives and his continuing pursuit of his objectives. He was motivated entirely by seeking to advance the interests of tourism on the Island generally without any particular concerns for any developer or development. He was unaware of the complication of group relief or other tax offsets, but saw his proposals as low cost and low risk.

viii) The Handling by the Department of Local Government and the Environment of the Taxation Aspects of the Planning and Development History of Mount Murray

8.164 The Department of Local Government and the Environment's direct involvement in the matters which we have reported upon in this Part Two Report are limited to a single action of a junior officer in the provision of erroneous information to the Treasury which ultimately had little significance in the overall picture which we have here reported.

END OF SECTION 8