

# PUBLIC VERSION

**Title of Report:** Medical Services Levy  
**Paper No:** 181/10  
**Date:** 29 July 2010  
**Report of:** Taxation Officer / Financial Secretary

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1. **Purpose**

To allow Executive Council to consider detailed policy points on the proposed re-introduction of a Medical Service Levy (MSL).

2. **Recommendations**

Executive Council is recommended to approve that:

- (a) the fundamental basis for calculation of MSL will be emoluments from employment rather than total income.
- (b) emoluments will include direct cash payments and indirect employment allowances such as 'benefits in kind', as defined by the Taxes Ordinance.
- (c) exemptions as set out in section 7 of this paper are agreed.
- (d) MSL is not allowed as a deduction in computing a person's chargeable income (option 1 in section 8).
- (e) Extra Statutory Concessions 1 and 2 should be expanded so they also exempt MSL in the circumstances set out in paragraph 9.
- (f) MSL will be payable in respect of all FIG employees.
- (g) the Attorney General be requested to arrange drafting of the necessary legislation to introduce MSL from 1 January 2011.
- (h) the potential legal implication as to how the levy/tax should be described as set out in paragraphs 11.3 – 11.5 be noted.

### 3. **Summary of Financial Implications**

	2010/11	20011/12	Full Year
	£	£	£
<b>Medical Department Additional Revenue</b>	485,000	970,000	970,000

These figures are already included in the approved budget for the current year and future budget projections.

### 4. **Background**

4.1 Medical Services Levy (MSL) was first introduced in 1979 as a tax on emoluments in respect of employment. It was abolished in 1994. Its reintroduction was considered as part of the package of proposals during the budget process earlier this year. This was agreed by the Budget Select Committee in May 2010.

4.2 The following contribution rates were approved:

Employees	1%
Employers	1.5%
Self-employed	2.5%

4.3 The monies raised from the re-introduction of MSL will be credited to the Medical Services budget in order to offset some of the costs of providing and maintaining those services, which are increasing as demand on the service grow and costs inexorably rise. However, in order to keep administration to a minimum it is proposed that the collection of MSL will be through the existing systems for Payments On Account of Tax (POAT) and Income Tax.

### 5. **First Principles**

5.1 The former MSL was not applicable to all income. It was essentially applied to an individual's income from employment. The employee paid a proportion of his emoluments and his/her employer paid a proportion of those emoluments. The prime decision that needs to be made is whether the same principles should be adopted or whether it should be applicable to all income. It is suggested that a similar principle as before should apply. Otherwise it would have been simpler to increase income tax and corporation tax. In addition, since the definition refers to employment, MSL will not be payable on any form of welfare allowances (including housing benefits and fostering, attendance or carer's allowances).

5.2 The previous legislation (the Medical Services Levy Ordinance) achieved this by granting a number of income exemptions; that is types or sources of income that would not be subject to MSL. It is envisaged that a similar approach will be followed but there will need to be changes to the list of exemptions to modernise the legislation and reflect changed political dimension.

## 6. **Definitions**

6.1 The definition of ‘emoluments’ is fundamental to the system. This will define what is subject to MSL and what isn’t. The previous Ordinance defined emoluments as:

*“any wages, salary, commission, bonuses, allowances (including a housing allowance or other like allowance) or other emoluments paid in cash by or on behalf of an employer to an employee, and includes leave pay”.*

6.2 Whilst this may still be relevant for most employees there are others that receive significant benefits in kind, which are recognised by the tax system. It is proposed that the definition should be extended to include benefits in kind as defined by the Taxes Ordinance to minimise any attempts at avoidance substituting such benefits for salary.

6.4 Insofar as self-employed individuals are concerned, it is proposed that ‘taxable net profit’ should be the basis of the MSL liability. However, if an individual is employed and self employed, they should be treated as separate employments so that any losses from self-employment cannot be used to reduce the MSL liability from normal employment.

## 7. **Exemptions and ‘Taxable Income’**

7.1 Assuming that members are content with the above approach, the previous Ordinance was used as a base to determine appropriate exemptions. However, there have also been various changes to the Taxes Ordinance since 1994 that give rise to potential anomalies. These will also be considered below.

7.2 The following exemptions were contained in the previous Ordinance and it is proposed that these should be retained:

- a) Governor and Consular Staff – the official emoluments of the Governor, Consuls, Vice-Consuls and members of the permanent consular services of foreign countries and emoluments of persons in the permanent service of the UK government.
- b) Pensions – all pensions and annuities paid to retired persons and any sums received by way of commutation of a pension.
- c) HM Forces – the emoluments paid from UK funds to HM Forces; gratuities in respect of war services; pensions granted to deceased relatives of HM Forces; and wound and disability pensions granted to members of HM Forces.
- d) Defence Related Contractors – emoluments paid to outside contract staff providing services connected with the defence of the Falkland Islands. It is proposed that this exemption is retained for companies exempted under the Taxes and Duties (Special Exemption) Ordinance 1987. Therefore, if the

tax status of those companies is amended in the future, the consequent amendments regarding applicability of MSL will be similarly reflected.

7.3 It is further proposed that the following exemptions should be amended:

- a) School children – the previous Ordinance exempted emoluments paid to full-time school children under the age of 15 years. It is suggested that this should be amended to 17 years, in line with the Retirement Pensions Ordinance 1996.
- b) MLA's – the previous Ordinance exempted allowances paid to unofficial members of ExCo and LegCo. This brought them in line with official members. MSL was not charged on allowances paid to official members since the definition of emoluments included only payments from an employer to an employee. However, since members' allowances are taxable with effect from November 2009 it is suggested that they should also be subject to MSL.

7.4 Following an examination of the Taxes Ordinance, there are a number of areas that are also worthy of consideration regarding potential exemptions:

- a) FIGO London Allowance – This is exempt from income tax and it is therefore suggested that it should also be exempt from MSL.
- b) Child Allowance – This is to be taxable from 1 January 2011 but, if it was also subject to MSL, this would hit the less well off. IT is therefore suggested that it should be exempt from MSL.
- c) ...
- d) ...
- e) Foreign Companies – Whilst it is intended that only Falkland Islands income and Falkland Islands resident Employers will be subject to MSL, there are certain exceptions to this. For instance there are some individuals whose employers are resident overseas but their remuneration for income earned for duties performed in the Falkland Islands is subject to Falkland Islands income tax. It is proposed that this income would also be subject to MSL. The reverse could also apply – In this case, MSL will only be payable on remunerated activities that are subject to FI income tax.
- f) Bounties – Under the Taxes Ordinance, the FIDF bounty is not taxable but the Police and Fire Service bounties are. This essentially follows the UK practice. The UK Reserve military members have always been paid a bounty, in recognition of the commitment to training and attendance, and also for being 'battle ready' having taken annual fitness, etc tests. In the UK the Special Constables (reserve police) are not paid, and if they receive (exceptionally) any bounty it is treated as taxable pay. Similarly with fire service volunteers, if they receive amounts for call out, training days etc, this is taxable pay. The Military reserve bounty became tax free

in 1979. The essential difference is that the FIDF bounty is related to fitness and ability whereas the police and fire bounties are related solely to attendance. It is therefore proposed that liability to MSL should be the same as liability to income tax.

## 8. **Potential Anomalies**

8.1 Section 59(i) of the Taxes Ordinance 1997 states that 'no deduction in respect of any amount paid or payable under section 5 of Medical Services Ordinance 1979 shall be allowed in computing a person's chargeable income'. Therefore, if this provision were to remain, companies and businesses would not be allowed employer contributions as an allowable deduction in their accounts. Some have argued that they would be paying tax twice on part of their profit.

8.2 This would also affect individuals. The amount paid in MSL would be based on their full emoluments and MSL would not be allowed as a deduction in calculating their taxable income. It could therefore be argued that they are being taxed twice on the same income.

8.3 The above arguments are not accepted. In the case of companies, they are allowed to deduct salaries and wages in calculating their profit figures. In the case of individuals they are allowed a significant personal allowance before their income becomes taxable. If such deductions were allowed there would be a dramatic reduction in the total amount of revenue since income tax and corporation tax receipts would effectively fall in the same amount as the MSL payable.

8.4 However, there is an additional impact on anyone who is self-employed who also has employees in their business. They would end up paying 1½% for their employees' wages and another 2½% on their profits. This 'penalty' is not suffered by a company.

8.5 There are 3 options for consideration:

Option 1 – to maintain the previous provision to disallow MSL as a deduction in computing a person's chargeable income

Option 2 –to allow MSL as a deduction under section 97 of the Taxes Ordinance. This would allow companies and businesses to deduct this as an expense in their accounts but not an allowable deduction by an individual against income tax.

Option 3 – to reduce the self-employed MSL rate (to say 1½%) and maintain the previous provision to disallow MSL as a deduction in computing a person's chargeable income

8.6 If option 1 is chosen MSL would be implemented as before. However, under the previous MSL regime, the self-employed percentage was the same as the employer percentage. Under the proposals as announced, the self-employed percentage is the equivalent of the employer and employee percentages added

together. Nevertheless, it could be argued that the self-employed individual has more opportunity to reduce his tax liability than an employed individual does, particularly if that person resides in the business premise. The budget projections assume that this option is chosen.

- 8.7 Option 2 would reduce the tax liability of self-employed individuals but it would also result in a reduction in the tax liability of companies (since they could deduct the MSL paid as a business expense in their accounts). Based on the 2008 tax data, it is estimated that the net reduction in tax take could amount to approximately £120,000. This option is therefore not recommended!
- 8.8 Option 3 would retain the original intention for companies and individuals but would reduce the MSL burden somewhat on the self-employed. It would however, reduce the burden on all the self-employed, not just those with employees. Based on the 2008 tax data, it is estimated that the net reduction in tax take could amount to approximately £30,000. Whilst not insignificant, Members may consider this to be a reasonable compromise since it would take account of the potential double charge for those that employ others.

## **9. Extra Statutory Concessions**

- 9.1 An Extra Statutory Concession (ESC) is a relaxation in practice which gives taxpayers a reduction in tax liability which they would not be entitled under the strict letter of the law. It is proposed that ESC 1 and ESC 2 are expanded to include MSL from 1 January 2011.
- 9.2 ESC 1 was introduced in 2003 and exempts any person from the charge to Falkland Islands income tax, who works in the Falkland Islands for less than 30 days in any 12 month period. Those in the Islands for 30 days or more will be liable to MSL.
- 9.3 ESC 2 was also introduced in 2003 and exempts non-resident fishing crews from paying Falkland Islands income tax on their emoluments earned whilst working in Falkland Islands waters.

## **10. Financial Implications**

- 10.1 At the rates initially proposed, it is estimated that MSL will generate net additional revenue of £760k for a full year (£380k for 2010/11). The revenue estimate is based on total employment income and self-employment income for 2008 as declared for income tax purposes. This figure excludes the amount payable by FIG as an employer on emoluments of approximately £14m.
- 10.2 As was the case under the old legislation it is proposed that FIG should be subject to the new tax. It is estimated that the amount payable by FIG would amount to £210k for a full year (£105k for 2010/11). This will add an equivalent amount to expenditure and therefore the bottom line affect will be neutral.

## **11. Legal Implications**

- 11.1 Attorney General's Chambers will need to undertake the drafting of the necessary legislation to implement this proposal. Legislation to introduce a Medical Services Tax was included in the Legislative Programme for the current year (as announced by the Governor at the session of the Legislative Assembly on 26 May 2010) and is included in the list of legislative priorities agreed by MLAs. For that reason, the drafting of this legislation will be given the appropriate priority within AG's Chambers.
- 11.2 The 1979 MSL Ordinance may have some use as a starting point but it will be completely rewritten, in order to reflect the modern drafting practice as well as to ensure that the new legislation fully and accurately implements the policy. The new legislation will be very different in style from the old legislation and the structure may well be different as well, although it is difficult to judge the extent of that at this stage.
- 11.3 The Legislative Programme referred to the introduction of a Medical Services Tax instead of a Medical Services Levy and there is a clear issue as to how the measure should be described. This is not a new issue and has been considered by Executive Council (with its previous membership) in the context of an earlier (unsuccessful) proposal to reintroduce this measure, which was to have been referred to as an Employment Tax rather than as a Medical Services Levy.
- 11.4 The advice of AG's Chambers in relation to whether the measure should be described as a "tax" or as a "levy" can be summarised as follows:
- (a) The approach being taken consistently by Attorney General's Chambers in the drafting of legislation is one of "plain language drafting" and an important corollary to that approach is that language should not be used to obscure (let alone conceal) the true meaning of legislation.
  - (b) The measure being proposed would far more accurately (and transparently) be described as a tax rather than as a levy.
  - (c) Although there are precedents from other jurisdictions for taxes to be described as levies, the nature of the proposal is that payments are to be charged as a percentage of earnings, which is a tax (whatever label is attached to it). There is a high degree of congruence between the income tax base and that proposed for this measure.
  - (d) Moreover, the machinery that is going to be used to collect these payments is the system of Payments on Account of Tax (for employees) and Income Tax Assessment (for the self-employed) that machinery will be operated by Taxation Officers from the Taxation Office.
- 11.5 There is a separate issue as to whether the measure can even legitimately be described as a Medical Services Tax rather than as an Employment or Payroll Tax, because of how the proceeds are to be accounted for. Although the re-introduction may have been inspired by the increasing cost of providing medical services, there will still not be complete hypothecation (because, although the revenue raised will be earmarked by means of a code for the Health and Medical

Services budget, it will still be paid into the general Consolidated Fund.) nor of additionality (because it replaces existing funding from other sources rather than representing funding for additional expenditure).

11.6 There are issues that arise in relation to specific aspects of policy:

- (a) Paragraph 7.3(a): The proposed approach of setting a lower age limit of 17 years is consistent with that already taken in relation to Retirement Pension Contributions. However, the same issue that arose recently in relation to the upper age limit for Family Allowance arises in reverse here, in that there will be children aged 16 who have left school and entered full time employment but who would exempt from liability under this proposal – depending on when in the year a child’s birthday falls, this could be the case for nearly a full year.
- (b) ...
- (c) ...

## 12. **Human Resources Implications**

- 12.1 The Payroll Manager will be required to make adjustments to the CHRIS payroll system to accommodate the new MSL deductions.