



## Isle of Man Government

Reillys Ellan Vannin

**INCOME TAX**

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### 1. Introduction

Income tax was first introduced in the Isle of Man by the Income Tax Act 1918 which is described in its preamble as being "An Act to provide for a Tax on income". The system of taxation introduced by the Income Tax Act 1918 introduced was based broadly upon the system then in operation in the United Kingdom and in many respects the similarities remain. This is an important factor as regards the interpretation of the provisions of the Manx Income Tax Acts because in a case where the interpretation of a provision or an expression in those Acts has been the subject of an appeal in the courts of the United Kingdom, the judgment in that appeal is a persuasive authority for the adoption of the same interpretation in a similar case in the Isle of Man.

The Income Tax Act 1918 was followed by successive amending Acts in the years that followed until the then existing legislation was consolidated in the Income Tax Act 1946. This was, in turn, followed by successive amending Acts until the then existing legislation was consolidated in the Income Tax Act 1970.

The Income Tax Act 1970 has since been amended by the —

- (i) Income Tax Act 1971;
- (ii) Income Tax Act 1973;
- (iii) Income Tax Act 1974;
- (iv) Income Tax Act 1976;
- (v) Income Tax Act 1978;
- (vi) Income Tax (Retirement Benefit Schemes) Act 1978;

and

- (vii) Income Tax (Amendment) Act 1979.

These Acts are collectively referred to as being "the Income Tax Acts 1970 to 1979". Section 120 of the Income Tax Act 1970 includes the following definitions —

"Income Tax Acts" means this Act and any other enactment relating to income tax;

"Manx income tax" and "Manx tax" means income tax payable under the Income Tax Acts.

The Income Tax Bill 1979 contains the new income tax provisions that were proposed by the Finance Board as a part of the Budget for 1979/80. The Bill was given its first and second readings by the House of Keys on 30th October and 6th November, 1979, respectively. It was then referred to a Select Committee for consideration. As it is unlikely to complete all its stages and obtain the Royal Assent before some time in 1980, the Bill is likely to be known as the Income Tax Act 1980 when it is enacted. It is proposed that the provisions of this Bill, when enacted, shall have effect in respect of the income tax year commencing on 6th April, 1979, and of each succeeding income tax year.

# Taxation of Distributions from Corporate Taxpayers

## Guidance Note GN 49



This booklet is intended only as a general guide and must be read in conjunction with the appropriate legislation. It does not have any binding force and does not affect a person's right of appeal on points concerning their own liability to income tax.



# CONTENTS

	<b>Page</b>
<b>1 Introduction .....</b>	<b>3</b>
<b>2 Overview of the concession .....</b>	<b>3</b>
2.1 Investment holding companies .....	4
2.1.1 Companies with rental income.....	5
<b>3 Ordering .....</b>	<b>5</b>
3.1 Box 1 .....	6
3.2 Box 2.....	6
3.3 Box 3.....	7
3.3.1 "Old Reserves" subject to Isle of Man Income Tax.....	7
3.4 Box 4.....	8
3.5 Other reserves .....	8
<b>4 Computing reserves .....</b>	<b>10</b>
4.1 Box 1 reserves .....	10
4.1.1 Trading losses .....	12
4.2 Box 2 reserves – trading companies.....	13
4.2.1 Alternative method .....	15
4.2.2 Offset of distributions paid under previous concessions.....	15
4.2.3 Previous tax exempt or NRCD companies .....	16
4.2.4 Companies taxed under the zero-rate extra statutory concessions for 2005/2006 and earlier.....	17
4.3 Box 3 reserves .....	17
4.3.1 Profits that have been subject to foreign tax .....	17
4.3.2 Investment holding companies - "old reserves" .....	18
4.4 Box 4 reserves .....	20
4.5 Distributions exceeding the total of boxes and other income reserves .....	21
4.6 Statutory 10% Tax Credits – Calculation and Offset with Distributions .....	23
4.6.1 Common Questions relating to the calculation of statutory 10% tax credits..	24
<b>5 Applying for the concession .....</b>	<b>28</b>

5.1	Tax return requirements .....	28
5.2	Transitional provisions .....	29
5.2.1	Claims for New Income Sources after 2015 .....	30
5.3	New companies .....	31
5.4	Existing Company - Commencement of Resident Ownership on or before 5 April 2015 .....	32
5.4.1	Treatment of Earlier Distributions .....	32
5.5	Existing Company-Commencement of Resident Ownership after 5 April 2015	34
5.6	Previous Distributions .....	34
<b>6</b>	<b>Practical application of the concession.....</b>	<b>35</b>
<b>7</b>	<b>Winding up and liquidation.....</b>	<b>37</b>
7.1	Declaration of dissolution .....	38
7.2	Liquidation .....	38
7.3	Return of share capital.....	38
<b>8</b>	<b>Groups .....</b>	<b>39</b>
8.1	Group relief .....	41
<b>9</b>	<b>Foundations.....</b>	<b>41</b>
<b>10</b>	<b>Distributions paid to trusts and estates .....</b>	<b>42</b>
<b>11</b>	<b>Assessment of income distributions .....</b>	<b>42</b>
11.1	DPC and 10% reserves .....	42
11.2	ARI reserves .....	42
11.3	Box 1 .....	43
11.4	Box 2.....	43
11.5	Box 3.....	44
11.6	Box 4.....	46
<b>12</b>	<b>Protected cell companies .....</b>	<b>46</b>
<b>13</b>	<b>Contact information .....</b>	<b>47</b>
<b>14</b>	<b>Appendix 1 – Example Layouts for Reserves Schedule .....</b>	<b>48</b>
<b>15</b>	<b>Appendix 2 – Summary of Previous Distribution Concessions .....</b>	<b>50</b>
<b>16</b>	<b>Appendix 3 - Preparing Reserves Schedules – Which Figures to Use .....</b>	<b>52</b>

## **1 Introduction**

This guide explains the Isle of Man legislation, policy and practice regarding the taxation of distributions made by resident corporate taxpayers.

Not all distributions made by a corporate taxpayer are income distributions. However, in Isle of Man primary income tax law, all **income** distributions are taxable.

This guide sets out the operation of the published concession found in PN 174/12 which relaxes the application of the primary income tax law in relation to certain income distributions, made after 21 February 2012.

- The term "corporate taxpayer" is defined in section 120 Income Tax Act 1970, but most commonly applies to companies. For ease of reference, the term "company" will be used in this guide.
- The term "distribution" is defined in section 2PA Income Tax Act 1970, as is the term "income distribution".

Aspects of the concession are complex and this Guidance Note will be revised to include further examples covering the more complex aspects in the future. The Assessor is willing to give advice on any scenarios or circumstances that are not covered in these notes where necessary.

For the taxation of distributions from corporate taxpayers made prior to 21 February 2012 please refer to Guidance Note 38 'The Pay & File Income Tax System for Companies' which can be downloaded from the Guidance Notes page of the Division's website.

The Assessor is not responsible for ensuring compliance with Company Law and cannot comment on the legality of a distribution made. However, for the avoidance of doubt, any distribution debited from the profit and loss reserve of a company is an "income distribution" for the purposes of section 2PA Income Tax Act 1970, even if the result is a negative balance on the profit and loss reserves.

## **2 Overview of the concession**

For distributions made between 6 April 2006 and 21 February 2012, the application of primary law to certain income distributions was relaxed by various published concessions. The detail of these concessions is contained in Guidance Note GN 38.

On 22 June 2012, the Assessor published Practice Note PN 174/12, which removed those concessions for income distributions made after 21 February 2012 and introduced a new concession relating to the taxation of distributions.

The general principles underpinning the new concession are:

1. distributions by a company of its accumulated income profits should be taxed when they are received by individual members
2. distributions by a company of its accumulated capital profits should not be taxed when they are received by individual members
3. repayment of the par value of share capital and any share premium reserve of a company should not be taxable distributions when received by individual members
4. economic double taxation should, in general, not occur in the Isle of Man.

All distributions made by a company will be considered in the same way, whether the distribution is made during the life of the company, or as part of its liquidation or winding up.

**This concession will not be applied automatically, it must be applied for.**

Section 5 sets out how a company may go about making a claim for the concession to apply to a distribution.

To prevent economic double taxation in the Isle of Man when a distribution is made from accumulated income that has already been subject to taxation in the Isle of Man, that tax paid will be recognised when the distribution is taxed in the hands of the shareholder.

Distributions of capital are not taxable, but there will be no tax relief for capital losses.

A distribution will only be considered to be out of capital profits when all income profits have been distributed.

There will be an ordering system to allocate accumulated income and capital profits, and to offset distributions against accumulated profits.

If a company has reserves of profits which have been subject to DPC, ARI, the statutory 10% or 20% rate of tax, or the deemed employment (PSC) legislation those reserves can be distributed without reference to this ordering system.

## **2.1 Investment holding companies**

Due to the different tax rates on income from trade, and income from investment that applied between the 2000/2001 and 2005/2006 years of assessment, this concession will operate differently for those companies that did not have income from a trade during any of those years.



For the purposes of this guide, the term **“investment holding company”** is used to refer to any company which had no income from a trade and was assessable to income tax at the higher rate between 2000/2001 and 2005/2006.

The term **“trading company”** is used to refer to any company which had income from a trade which was assessable to income tax at either the lower rate or standard rate for trading companies between 2000/2001 and 2005/2006.

### **2.1.1 Companies with rental income**

For the avoidance of doubt, rental income is not income from a trade.

Rental income may have been received from either commercial or non-commercial property. However, the rate of tax for each type of property for those years of assessment was different.

#### **Commercial property**

If the property that was let during the 2000/2001 – 2005/2006 tax years was commercial property (i.e. the tenant was carrying on a trade from the property), the rates of tax charged on the income were the same as the rates of tax charged for trading income.

For this reason, any company with commercial property rental income for the years of assessment 2000/2001 to 2005/2006 will be considered as a **“trading company”** for the purposes of this concession.

#### **Non-commercial property**

A company with only non-commercial property rental income or a combination of non-commercial property rental income and investment income for the years of assessment from 2000/2001 to 2005/2006 is an **“investment holding company”** for the purposes of this concession.

## **3 Ordering**

As stated in the previous section, capital profits may only be distributed once all accumulated income has been distributed. PN 174/12 sets out an ordering system to allow the allocation of a distribution against the accumulated income and capital reserves of the company.

This system involves putting reserves into a series of boxes, as outlined below. Practical examples of how the figures to go into the boxes are calculated for a range of scenarios are included in section 4.

When a distribution is made it will be offset against the reserves in the lowest numbered box first, only moving to the next box when the lowest one is empty.

### **3.1 Box 1**

Accumulated income profits which have been taxed at 0%, but which have not been subject to DPC or attribution, are to be put into this box.

If a trading company was not subject to DPC or attribution because it distributed 55% or more of its distributable profit, the balance of the distributable profit after that distribution will go into Box 1.

After the repeal of the ARI, all companies subject to income tax at 0% will put their taxable profit for the accounting period into Box 1.

All companies with any overseas income that has been subject to foreign tax at a rate less than the higher rate in the Isle of Man should include the net amount in Box 1.

(N.B. This does not include foreign taxed income which forms part of a company's distributable profit that has been attributed or on which DPC has been paid. These net profits after foreign tax will be included in the profits which have been subject to DPC or attributed.)

### **3.2 Box 2**

For **trading companies** this box will contain accumulated income profits for the periods of account forming the basis of the income tax assessment for 2005/2006 or earlier, **less** any agreed capital profits (which should be allocated to box 4, see below) and distributions already made from these profits under any of the previous published concessions.

These profits will, in the majority of cases, have already been charged to Isle of Man income tax at a rate of at least 10% so, to avoid economic double taxation when the income is distributed, the concession relaxes section 25A(3) Income Tax Act 1970 and allows distributions from these profits to carry a non-refundable tax credit equivalent to the rate of tax paid on those profits.

Section 4.2 explains how this figure is determined and how the value of the non-refundable tax credit is calculated.

These accumulated income profits will only be allocated to Box 2 if a claim for the concession is made by the latest transitional date set out in section 5.2.

The ability to allocate these accumulated reserves to Box 2 ceases at the end of the transitional period.

The accumulated income profits of **investment holding companies** (as defined in 2.1 above) for the periods of account forming the basis of the income tax assessment for 2005/2006 or earlier, after adjustment for earlier distributions and agreed capital profits or losses, are to be allocated to Box 3.

This is in recognition of the fact that the rate of tax suffered on those profits was always equal to the higher rate of income tax in the Isle of Man and to provide an equal treatment with profits on which foreign tax was paid at the same rate.

### **3.3 Box 3**

This box will contain the accumulated income profits of a resident company which have suffered foreign tax at a rate of at least the Isle of Man individual higher rate applying in the period during which the profits arose.

With effect from 6 April 2010 the individual higher rate of income tax increased from 18% to 20%.

- Foreign income earned in an accounting period that ended before 6 April 2010 can be included in box 3 so long as it suffered foreign tax at a rate of 18% or more.
- Foreign income earned in an accounting period ending on or after 6 April 2010 can be included in box 3 where the foreign tax suffered is at a rate of 20% or more.

All income subject to foreign tax at a rate equal to, or higher than, the Isle of Man higher rate for all companies should be put into Box 3. Section 4.3.1 explains how the figure of income subject to foreign tax to go into box 3 is determined.

#### **3.3.1 "Old Reserves" subject to Isle of Man Income Tax**

The accumulated income profits of **investment holding companies** for the period of account forming the basis of the income tax assessment for 2005/2006 or earlier, after adjustment for earlier distributions and agreed capital profits or losses are also to be allocated to this box.

Section 4.3.2 explains how the figure of income subject to Isle of Man tax up to 2005/2006 to go into Box 3 is determined.

These accumulated income profits will only be allocated to Box 3 if a claim for the concession is made by the latest transitional date set out in section 5.2.

The ability to allocate these accumulated reserves to Box 3 ceases at the end of the transitional period.

Distributions from Box 3 are income distributions, not capital. However, the Assessor will not seek to tax that income further in the hands of the recipient. The distribution will therefore not form part of the recipient's taxable income but will be included in their gross income for the purposes of the personal allowance credit calculation, as shown example 16.

The income distribution must be declared on the recipient's income tax return and the Assessor will ensure no tax is charged on the distribution in the assessment.

The resident individual income tax return will be amended to allow details of these distributions to be provided for consideration in the personal allowance credit calculations.

It should be noted that this treatment only applies to distributions made from Isle of Man resident companies.

The Assessor **must** have been notified of the company's residence prior to the distribution being made in order for the concession to apply. If the Assessor is not notified of the Company's residence in the Isle of Man before the distribution is made, the concession cannot apply to that distribution and it will be taxed as any other overseas dividend from the country where the company is also resident.

Please refer to paragraphs 16 to 20 of Practice Note PN 144/07 "Tax Residence in the Isle of Man" for more details of tax residence for companies.

### **3.4 Box 4**

This box will contain accumulated capital profits.

Section 4.4 explains how the figure to go into Box 4 is determined in respect of both historic profits and future capital profits.

### **3.5 Other reserves**

It is possible for a company to make distributions without reference to these boxes and the ordering provisions, provided that it has any of the following other reserves:

- profits subject to income tax at 10% since the 2006/2007 tax year
- profits subject to DPC
- profits which have been attributed in accordance with ARI.

All of the income in these reserves will have been subject to a charge of some kind, and so can be distributed at any time without reference to any reserves the company also has in Boxes 1 to 4.

Equally, a company with these other reserves may choose to have a distribution offset against its Box 1 to 4 reserves in preference to its other reserves.

**Example 1**

Company A has the following reserves at 30 June 2012:

Profits subject to tax at 10%	25,000
Profits subject to DPC	0
Profits attributed	0
Box 1	25,000
Box 2	75,000
Box 3	0
Box 4	15,000

It has elected to be taxed at 10% for the accounting period. It makes a distribution of £20,000 on 30 June 2012 and can choose to treat that distribution as coming from either its reserve of profits subject to tax at 10%, or from its Box 1 reserve.

Where a company makes a distribution that exceeds the total of its other reserves, or its Box 1 to 4 reserves, then the balance must be offset against the other.

For example, if company A above had distributed £75,000, it could have chosen to offset the distribution as follows:

£25,000 against its profits subject to tax at 10% reserve  
 £25,000 against Box 1  
 £25,000 against Box 2

Or

£25,000 against Box 1  
 £50,000 against Box 2

If the distribution had been £125,000, the distribution could have been offset as follows:

£25,000 against its profits subject to tax at 10% reserve  
 £25,000 against Box 1  
 £75,000 against Box 2

Or

- £25,000 against Box 1
- £75,000 against Box 2
- £15,000 against Box 4
- £10,000 against its profits subject to tax at 10% reserve.

#### 4 Computing reserves

The following sections set out how the reserves to go into each box are calculated.

##### 4.1 Box 1 reserves

Only profits that have been subject to tax at 0% and not also subject to a DPC charge or attribution are to be put into Box 1.

The figure to go into Box 1 is the distributable profit for accounting periods in the DPC or ARI regimes, less any distributions that have already been claimed as being from these reserves to meet the distribution requirement for periods in the DPC or ARI regimes.

For all subsequent accounting periods, the figure to be put into Box 1 is the taxable profit subject to tax at 0%, less any distributions made from that profit during the accounting period.

##### Example 2

New Company commenced trading on 1 July 2006, has only one source of income and has an accounting period end of 30 June.

##### 30 June 2007

Taxable/Distributable profit	200,000	<b>Box 1</b>	
Less: dividends paid by 30 June 2008	-120,000	Balance b/f	0
Reserves for Box 1	80,000	Reserve for year	80,000
		Balance c/f	80,000

**30 June 2008**

Taxable/Distributable profit	125,000	<b>Box 1</b>	
Less: dividends paid by 30 June 2009	-70,000	Balance b/f	80,000
Reserves for Box 1	55,000	Reserve for year	55,000
		Balance c/f	135,000

**30 June 2009**

Taxable/Distributable profit	350,000	<b>Box 1</b>	
Less: dividends paid by 30 June 2010	-200,000	Balance b/f	135,000
Reserves for Box 1	150,000	Reserve for year	150,000
		Balance c/f	285,000

**30 June 2010**

Taxable/Distributable profit	250,000	<b>Box 1</b>	
Less: dividends paid by 30 June 2011	-200,000	Balance b/f	285,000
Reserves for Box 1	50,000	Reserve for year	50,000
		Balance c/f	335,000

**30 June 2011**

Taxable/Distributable profit	330,000	<b>Box 1</b>	
Less: dividends paid by 30 June 2012	-200,000	Balance b/f	335,000
Reserves for Box 1	130,000	Reserve for year	130,000
		Balance c/f	465,000

**30 June 2012**

Taxable/Distributable profit	400,000	<b>Box 1</b>	
Less: dividends paid by 30 June 2013	-250,000	Balance b/f	465,000
Reserves for Box 1	150,000	Reserve for year	150,000
		Balance c/f	615,000

Where a company has more than one income source, the taxable income from each source should be recorded separately for each accounting period. This will allow a clear line of sight for each source of income in the event that an adjustment is required, such as when group relief is received.

**4.1.1 Trading losses**

If a company has a trading loss, the figure to be entered into Box 1 for that profit source for that accounting period is 0.

The trading loss will be offset against the profits for the source of income, or accounting period against which the relief is claimed under the normal loss relieving provisions.

The following examples illustrate the most common ways that trading losses can be utilised.

**Example 3**

Carrying on from the previous example, New Company has trading income and investment income for the accounting period ended 30 June 2013.

The profits and losses for the period are:

Agreed trading loss:	(50,000)
Investment income:	30,000



**Option 1: Claim for loss relief against other income in the period**

Taxable profit - Trade	(50,000)	<b>Box 1</b>	
Trade reserves for Box 1	0	Balance b/f	615,000
Investment income	30,000	Reserve for year	0
Less: loss against other income	(30,000)	Balance c/f	615,000
Taxable investment income	0		
Investment reserves for Box 1	0		
<b>Loss Memorandum</b>			
Loss b/f	0		
Loss for year	(50,000)		
Less: loss utilised	30,000		
Loss c/f	(20,000)		

**Option 2: Carry trading loss forward**

Taxable profit - Trade	(50,000)	<b>Box 1</b>	
Trade reserves for Box 1	0	Balance b/f	615,000
Investment income	30,000	Reserve for year	30,000
Investment reserves for Box 1	30,000		
		Balance c/f	645,000
<b>Loss Memorandum</b>			
Loss b/f	0		
Loss for year	(50,000)		
Less: loss utilised	0		
Loss c/f	(50,000)		

If a company surrenders or receives group relief, the reserves will be calculated in the same way.

**4.2 Box 2 reserves – trading companies**

This box will contain accumulated income profits for the period of account forming the basis of the income tax assessment for 2005/2006 and earlier for all **trading companies**, less

any agreed capital profits and distributions already made from this reserve under previous published concessions.

In the majority of cases this will simply be the profit and loss reserve balance at the accounting date used in the 2005/2006 assessment. However, in some cases there will need to be an adjustment to deduct known capital gains included in that figure for allocation into Box 4.

Section 4.2.2 shows an example of how to offset previous distributions.

Distributions from these reserves will carry a non-refundable tax credit equivalent to the rate of tax paid on the profits. The rate of tax credit is equivalent to the rate of tax charged on the taxable profit in the corresponding year of assessment, not the actual amount of tax paid.

To avoid the complexity of having to reconcile the taxable profit for each year, the tax credit will be applied to the accounting profit in the accounts used as the basis for each year of assessment. (N.B. The taxable profit for the year is **not** the starting point for computing Box 2 reserves.)

As the rate of tax prior to 1999/2000 was 20%, it is not necessary to identify the accounting profit for each individual year prior to that if a trading company has been paying tax since an earlier year. That accounting profit can be determined using the other figures.

**Example 4:**

Old Company commenced trading in 1985 and had a profit and loss reserve balance to 30 June 2004 of £750,000.

Profit and loss account balance at 30 June 2004 (2005/2006 assessment basis period)	750,000			
	<b>Accounting profit</b>	<b>Rate of tax</b>	<b>Tax credit</b>	<b>Gross dividend</b>
1999/2000	19,500	15%	3,441	22,941
2000/2001	27,000	14%	4,395	31,395
2001/2002	12,500	12%	1,705	14,205
2002/2003	24,500	10%	2,722	27,222
2003/2004	28,000	10%	3,111	31,111
2004/2005	31,500	10%	3,500	35,000
2005/2006	35,000	10%	3,889	38,889

<b>Accounting profits 1999/2000 to 2005/2006</b>	<b>178,000</b>			
Balance of accounting profits pre 1999/2000	572,000	20%	143,000	715,000
<b>Total accounting profits</b>	<b>750,000</b>			

#### 4.2.1 Alternative method

The Assessor accepts that the computation of the non-refundable tax credits for each year of assessment will be time consuming and complex, and that companies may no longer have all of the necessary underlying records in order to prepare the box 2 computation to claim the PN 174/12 concession.

In order to simplify administration and allow a company to apply for the concession contained in PN 174/12 without the need to undertake a complete Box 2 computation, the Assessor is willing to grant a non-refundable tax credit of 10% against those reserves.

#### Example 5:

Old Company commenced trading in 1985 and had a profit and loss reserve balance to 30 June 2004 of £750,000.

	<b>Accounting profit</b>	<b>Rate of tax</b>	<b>Tax credit</b>	<b>Gross dividend</b>
Profit and loss account balance at 30 June 2004	750,000	10%	83,333	833,333

#### 4.2.2 Offset of distributions paid under previous concessions

If a company has already made a distribution from reserves under the previous concessions, that distribution must be deducted from the reserves in order to arrive at the Box 2 reserves and tax credit figures.

#### Example 6:

Trading company commenced prior to 1999/2000, with a 31 May accounting period end.

- The company has only had trading income, and has no agreed capital profits.
- The company has made distributions from reserves of £650,000 under previous concessions.

Without offset of the previous distribution, the Box 2 reserves position would be:

Profit and loss account balance at 31 May 2004 (2005/2006 basis period)	750,000			
	<b>Accounting profit</b>	<b>Rate of tax</b>	<b>Tax credit</b>	<b>Gross dividend</b>
1999/2000	19,500	15%	3,441	22,941
2000/2001	27,000	14%	4,395	31,395
2001/2002	12,500	12%	1,705	14,205
2002/2003	24,500	10%	2,722	27,222
2003/2004	28,000	10%	3,111	31,111
2004/2005	31,500	10%	3,500	35,000
2005/2006	35,000	10%	3,889	38,889
<b>Accounting profit 1999/2000 to 2005/2006</b>	178,000			
Balance of accounting profit pre 1999/2000	572,000	20%	143,000	715,000
<b>Total accounting profit</b>	750,000			

The previous distribution is offset against the reserves on a first in, first out basis:

	<b>Accounting profit</b>	<b>Dividend paid</b>	<b>Balance</b>	<b>Rate of tax</b>	<b>Tax credit</b>	<b>Gross dividend</b>
1999/2000	19,500	19,500	0	15%	0	0
2000/2001	27,000	27,000	0	14%	0	0
2001/2002	12,500	12,500	0	12%	0	0
2002/2003	24,500	19,000	5,500	10%	611	6,111
2003/2004	28,000		28,000	10%	3,111	31,111
2004/2005	31,500		31,500	10%	3,500	35,000
2005/2006	35,000		35,000	10%	3,889	38,889
Balance of accounting profit pre 1999/2000	572,000	572,000	0	20%	0	0

The company has £100,000 reserves remaining for distribution from Box 2 with non-refundable tax credits.

#### 4.2.3 Previous tax exempt or NRCD companies

Where reserves up to 2005/2006 were accumulated whilst the company was a tax exempt company or the company had made a declaration under the Non-Resident Company Duty Act 1986 (NRCD), those reserves will not have been subject to tax in the Isle of Man.

Unless it can be proven that those reserves were in fact subject to tax in another jurisdiction at a rate at least equal to the higher rate in the Isle of Man, the tax credit attaching to the reserves will be 0%. If it is proven that the necessary rate of tax has been paid in another jurisdiction, the relevant amount of those reserves will be placed into Box 3.

#### **4.2.4 Companies taxed under the zero-rate extra statutory concessions for 2005/2006 and earlier**

Where any profits up to 2005/2006 were assessed under one of the zero-rate extra statutory concessions (e.g. space industry) the tax credit attaching to the reserves will be 0%.

In this case, the company will not be able claim the 10% credit in section 4.2.1 above against those reserves.

### **4.3 Box 3 reserves**

As stated in section 3.3, Box 3 will contain two income reserves:

1. Profits that have been subject to foreign tax at the Isle of Man higher rate or more in the year in which they were received.
2. The accumulated income profits of **investment holding companies** for the period of account forming the basis of the income tax assessment for 2005/2006 or earlier, after adjustment for earlier distributions and agreed capital.

#### **4.3.1 Profits that have been subject to foreign tax**

The figure to go into Box 3 is the profit subject to foreign income (i.e. the taxable profit), less the foreign tax **paid**.

#### **Example 7:**

UK Rent Company's only source of income is UK taxed rents. Accounts to 30 June 2013 show the following:

Adjusted rents	100,000
Tax paid	(20,000)
Net UK rents	80,000

The figure to go into Box 3 for the accounting period is £80,000.

Evidence of the payment of foreign tax may be required to support the claim for this concession. Inclusion of a provision for foreign tax in the accounts may not be sufficient if

the foreign income is new, if there has been a change in rate, or if evidence of tax paid has not been provided for a number of years.

#### **4.3.2 Investment holding companies - "old reserves"**

As stated in section 2.1, an "investment holding company" is any company which had no income from a trade and was assessable to income tax at the higher rate in the years 2000/2001 to 2005/2006.

All of the income arising in these years, and in any earlier years of assessment, will have been subject to income tax at the higher rate so the Assessor does not wish to charge any further tax on this income when it is distributed.

The figure to go into Box 3 for an investment holding company is the profit and loss account reserve for the period of account forming the basis of the income tax assessment for 2005/2006 or earlier, after adjustment for earlier distributions and agreed capital gains.

#### **Example 8:**

Old IHC Ltd commenced receipt of investment income in 1985 and had a profit and loss reserve balance to 30 June 2004 of £225,000.

It also has an agreed capital reserve of £750,000, which was made on the sale of investments in earlier years.

In the years ended 30 June 2005 – 2008 the company's distributable profits totalled £325,000, from which no distributions were ever made. As a result Old IHC Ltd paid Distributable Profits Charges (DPC) totalling £58,500.

The company was considered *relevant* for the purposes of the Attribution Regime for Individuals (ARI) during the years ended 30 June 2009 – 2011 and as a result its profits, which totalled £150,000, were attributed in full to its resident shareholders. No actual distributions were made from those attributed profits.

During the year ended 30 June 2012 Old IHC Ltd received UK rental income of £50,000 in addition to other Isle of Man investment income totalling £120,000. The UK rents suffered tax at source at a rate of 20%.

The ARI was repealed with effect from 5 April 2012 therefore the company's distributable profit, attributable to its Isle of Man resident shareholders, for the year ended 30 June 2012 is apportioned as follows:

**Total Income** **170,000**

Less: Income subject to foreign tax at 20% or more (50,000)

**Distributable profit** **120,000**

**Profits to repeal of ARI**

1 July 2011 – 5 April 2012  $120,000 \times 280 / 366 =$  91,803

**Profits after the repeal of ARI**

6 April 2012 – 30 June 2012  $120,000 \times 86 / 366 =$  28,197

The tables below show how the pools of income and capital profits should be allocated:

<b>DPC Pool</b>	
Balance b/f	266,500
CY profits	-
Balance c/f	<b>266,500</b>

<b>ARI Pool</b>	
Balance b/f	150,000
CY profits	91,803
Balance c/f	<b>241,803</b>

<b>Box 1 Pool</b>	
Balance b/f	-
CY profits	28,197
Balance c/f	<b>28,197</b>

<b>Box 2 Pool</b>	
Balance b/f	-
CY profits	-
Balance c/f	<b>Nil</b>

<b>Box 3 Pool</b>	
Balance b/f	225,000
CY profits	40,000
Balance c/f	<b>265,000</b>

<b>Box 4 Pool</b>	
Balance b/f	750,000
CY profits	-
Balance c/f	<b>750,000</b>

The treatment outlined in this example is transitional and only applies to the profits of **investment holding companies** that were assessed to Isle of Man income tax for the years of assessment from 2000/2001 to 2005/2006, and earlier.

All subsequent profits of **investment holding companies** are to be considered in line with the treatment for the other reserves set out in this Guidance Note.

#### 4.4 Box 4 reserves

Box 4 will contain the capital gains of the company if it has made any. As stated in PN 174/12, distributions of capital will not be taxed but there will also be no relief against income reserves for capital losses.

In future, the Box 4 capital reserve will be filled with the net capital gains or losses for the accounting period.

N.B. Capital gains and losses on the disposal of assets used in a trade on which capital allowances have been claimed should not be recorded in Box 4, as these are already dealt with in the computation of the trading profits.

However, true capital gains on disposal of these assets (i.e. where proceeds received exceed the initial cost as well as the written down value) can be recorded in Box 4.

#### Example 9:

Company G has the following results for the accounting period ended 30 June 2013:

Taxable trading profit	75,000
Net gain on sale of investments	125,000

Reserve boxes for the accounting period are filled as follows:

Box 1	75,000
Box 4	125,000

Company G has the following results for the accounting period ended 30 June 2014:

Taxable trading profit	15,000
Net loss on sale of investments	(5,000)

Reserve boxes for the accounting period are filled as follows:

<b>Box 1</b>	
Balance b/f	75,000
Add: profit for year	15,000
<b>Balance c/f</b>	<b>90,000</b>

<b>Box 4</b>	
Balance b/f	125,000
Less: loss for year	(5,000)
<b>Balance c/f</b>	<b>120,000</b>



However, for older companies, the accumulated capital profits figure for earlier periods will also need to be calculated.

If this is not reported separately as a capital reserve in the accounts forming the basis of the 2005/2006 assessment, it will need to be identified and separated from the income reserves.

As a **transitional measure only**, the total income reserves for the first accounting period which the concession is being applied for can be deducted from the accounting profit figure and the resulting balance will be accepted as the capital reserve figure.

This adjustment is only done in respect of the accumulated reserves of the accounting period for which the concession is first claimed. There is no adjustment for such differences in future accounting periods.

See 4.5 below for the treatment for accounting periods and distributions after the concession has been applied for.

**Example 10:**

Capital Company has been trading since 1999 and has a 31 May accounting period.

31 May 2013 accounting profit		1,250,000
Less:		
ARI reserve	95,000	
DPC reserve	85,000	
10% reserve	25,000	
Box 1 reserve	34,000	
Box 2 reserve	850,000	
Box 3 reserve	10,000	
<b>Income reserve total</b>		<b>1,099,000</b>
Difference = capital		151,000
Box 4 reserve	151,000	

**4.5 Distributions exceeding the total of boxes and other income reserves**

Where a company's profit and loss reserve exceeds the total of its boxes and other income reserves (i.e. DPC, ARI and profits subject to tax at 10%), any distribution over and above the total will be treated as an income distribution unless it can be proven to the satisfaction of the Assessor that the distribution is, in fact, capital.

This scenario can occur where a company's taxable profit is lower than its accounting profit; such as when a qualifying asset is purchased and a capital allowance claim is made. The Assessor recognises that the subsequent disposal of that asset may result in a balancing charge which may present a risk of double taxation when that taxable profit is also allocated to Box 1.

To prevent any such double taxation it may be necessary to make the Box 1 reserve negative when the initial distribution is made, as shown below:

**Example 11:**

New Company Ltd commences trading 1 October 2012. During the year ended 30 September 2013 the company purchases qualifying plant and machinery for £100,000.

The company's accounting profit for the period is £90,000 after allowing for depreciation of £10,000.

New Company Ltd makes a claim for a 100% first year (FYA) capital allowance.

The company's income tax and box computations would be:

Profit per accounts	90,000
Add: depreciation	<u>10,000</u>
Adjusted profit	100,000
Less: 100% FYA	<u>(100,000)</u>
<b>Taxable profit</b>	<b><u>Nil</u></b>

<b>Box 1</b>	
Balance b/f	0
Add: profit for year	0
<b>Balance c/f</b>	<b>0</b>

On 30 September 2013 New Company Ltd pays a dividend of £50,000 to its resident shareholders.

As New Company Ltd has no income allocated to its boxes, nor does it have any capital profits, the distribution should be allocated to box 1 as shown below, making the carry forward balance negative:

<b>Box 1</b>	
Balance b/f	0
Add: profit for year	0
Less: distribution	50,000
<b>Balance c/f</b>	<b>(50,000)</b>

In the following year New Company Ltd has an accounting profit of £210,000 which includes a profit on disposal of £110,000, which was realised on the sale of the plant and machinery for £200,000.

New Company Ltd's income tax and box computations would be:

Profit per accounts	210,000
Less: gain on sale of fixed asset	(110,000)
Adjusted profit	100,000
Add: balancing charge	<u>100,000</u>
<b>Taxable profit</b>	<b><u>200,000</u></b>

<b>Box 1</b>	
Balance b/f	(50,000)
Add: profit for year	200,000
<b>Balance c/f</b>	<b>150,000</b>

<b>Box 4</b>	
Balance b/f	0
Add: profit for year	100,000
<b>Balance c/f</b>	<b>100,000</b>

New Company Ltd ceases to trade 30 September 2014 and distributes its accounting reserve of £250,000 on dissolution.

The £150,000 from Box 1 is taxable as a gross dividend in the recipient shareholders' hands whilst the gain of £100,000 realised on sale of the plant and machinery is distributed as capital from Box 4 with no tax payable by the shareholders.

#### **4.6 Statutory 10% Tax Credits – Calculation and Offset with Distributions**

The tax credit attaching to a distribution from profits subject to tax at 10% is calculated in accordance with Section 25B Income Tax Act 1970. Distributions carrying a statutory 10% tax credit are offset against the profits subject to tax at 10%.

In order to preserve the benefit of capital allowances and loss relief, the statutory 10% tax credit attaching to any distribution of the profit of an accounting period is **not** limited to the tax charged for that accounting period.

Section 25B(2) Income Tax Act 1970 requires that the gross amount of the distribution is calculated using the amount of income distributed, grossed up by the rate of tax paid on the profits.

As the maximum available for distribution from profits subject to tax at 10% for an accounting period is the net profit after tax, this is the maximum distribution which may carry a statutory 10% tax credit under section 25B.

Any income from other sources (i.e. those subject to tax at 0%, or capital gains) should be separated out to go into their respective boxes.

In practice the maximum distribution that may carry a statutory 10% tax credit for an accounting period is restricted to profit per the accounts BEFORE tax from the 10% activity **less** the amount of the 10% income tax charge for that accounting period. (The accounting provision for tax for the accounting period is not used.)

**Example 12**

The following computation shows the maximum distribution and associated statutory 10% tax credit for the accounting period to 30 September 2009.

The company’s only source of income is rents from a residential property in Ramsey.

Net rents per accounts	30,000	
Taxable Rents	<u>20,000</u>	After adjustment to disallow capital expenditure and relief for excess brought forward
Tax @ 10%	2,000	

The maximum distribution for the period which can carry a statutory 10% tax credit is 30,000 less 2,000 = £28,000

Net Dividend	28,000	X 100/90 =	Gross Dividend	31,111
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The statutory 10% tax credit is £31,111 x 10% = **£3,111.10**

If a dividend exceeds the maximum available for distribution for an accounting period, the excess will be offset against the later accounting periods. (See FIFO Offset below.)

**N.B. If a company has a reserve of profits with statutory 10% credits, it can choose to distribute with statutory 10% credits from this reserve in preference to any reserves it has in Boxes 1 to 4, or after offsetting distributions from Boxes 1 to 4.**

**4.6.1 Common Questions relating to the calculation of statutory 10% tax credits**

**Why isn’t the tax credit with a distribution just the amount of tax paid?**

- If you limit the credit to the tax paid, you remove the benefit of losses and capital allowances by passing the tax charge on to the individual (i.e. the rate of credit is less than 10% of the total distribution).

A company has the following results:

Accounting Profit for Rents	152,500
Adjusted Rent before CAs	150,000
Less: CA's	(25,000)
Taxable Rents	125,000
Tax paid at 10%	12,500
Max Dividend with Credit = Accounting profit of 152,500 Less tax paid of 12,500	140,000

If the Tax Credit is Capped to Tax Paid:

<b>Net Dividend</b>	<b>Tax Credit</b>	<b>Gross Amount for Assessment</b>	<b>Effective rate of Credit</b>	<b>Comments</b>
140,000	12,500	152,500	8.2%	The recipient of the dividend will be required to pay the additional 1.8% (£2,750)

- If you give credit for the full amount of the tax paid (i.e. the rate of credit is more than 10% of the total distribution), you will give tax relief for non-allowable expenditure because the higher rate of credit will reduce the tax payable by the individual.

A company has the following results:

Accounting Profit for Rents	150,000
Taxable Rent	165,000
Tax paid at 10%	16,500
Max Dividend with Credit = Accounting profit of 150,000 Less tax paid of £16,500	133,500

If a Tax Credit Given for all of the Tax Paid:

<b>Dividend</b>	<b>Tax Credit</b>	<b>Gross Amount for Assessment</b>	<b>Effective rate of Credit</b>	<b>Comments</b>
133,500	16,500	150,000	11%	The recipient of the dividend will get an extra 1% tax credit (£1,500), which is in relation to disallowed expenses of £15,000.

**Is the corporate charge treated as tax paid?**

No - the corporate charge paid in the form of an increased annual return filing fee has already been deducted in arriving at the accounting profit.

It shouldn't also to be treated as tax paid. It is not deducted again from the accounting profit in arriving at the maximum distribution which can carry a 10% tax credit.

**Example – Single Income Source, with Corporate Charge**

The following computation shows the maximum distribution and associated statutory 10% tax credit for the accounting period to 30 September 2007.

The company's only source of income is rents from a residential property in Ramsey. It has paid the additional £250 filing fee to the Companies Registry and is entitled to a reduction in its tax liability of the same amount.

Net rents per accounts	30,000 (Figure net of corporate charge paid)
Taxable Rents	30,000
Tax @ 10%	3,000
Corporate Charge Relief	-250
Tax Payable	2,750

The maximum distribution for this accounting period which can carry a statutory 10% tax credit is the:

Net accounting profit of 30,000 **less the tax paid** of 2,750 = £27,250

Max Net Dividend 27,250 x 100/90 Max Gross Dividend 30,278

The maximum statutory 10% tax credit is £30,278 x 10% = **£3,028**

If the corporate charge was also treated as tax paid, the resulting double deduction would mean that the dividend carrying the tax credit would be £250 less than the cash in the company's reserves after tax, and this amount would not qualify for any tax credit.

For example:

Net accounting profit of 30,000 **less the tax paid** of 2,750, **less the corporate charge paid** of 250 = £27,000

Max Net Dividend 27,000 x 100/90 Max Gross Dividend 30,000

The maximum statutory 10% tax credit is £30,000 x 10% = **£3,000**

This company had £30,000 accounting profit after paying the £250 corporate charge, and £27,250 after paying the income tax for the period. It has £27,250 cash available to distribute but the 10% tax credit would only be given on £27,000. The £250 would be paid gross with no tax credit.

### **What if there is an accounting loss for the period?**

If there is an accounting loss for the period, this will reduce the profits the company has available for distribution from the income subject to tax at 10% (i.e. the accounting reserve). Accordingly, accounting losses will also reduce the pool of reserves on which a 10% tax credit can be given.

<b>Period</b>	<b>Accounting Profit before tax</b>	<b>Tax Paid</b>	<b>Net 10% Reserve</b>	<b>Statutory Tax Credit</b>	<b>Gross 10% Reserve</b>
31/01/2010	170,021	-17,002	153,019	17,002	170,021
31/01/2011	-55,450	0	-55,450	-6,161	-61,611
31/01/2012	178,804	-17,880	160,924	17,880	178,804
<b>Total net c/f at 1/2/2012</b>	<b>293,375</b>	<b>34,882</b>	<b>258,493</b>	<b>28,721</b>	<b>287,214</b>

## 5 Applying for the concession

Unless the concession is applied for, any income distribution made after 21 February 2012 will be taxed in accordance with the primary law.

In order to claim the concession in relation to a distribution, a company will be required to provide a schedule of its income and capital reserves with the tax return.

Simply stating on the computation that the company wishes to claim the concession is not sufficient, a schedule of reserves is also required to be provided.

The schedule must be computed in accordance with this Guidance Note and should be clearly noted if the company is an **investment holding company** or if Box 2 has been computed using the flat 10% tax credit set out in section 4.2.1 above.

Examples of different lay outs of reserves schedules are provided at **Appendix 1**. These do not include columns to reconcile the taxable/distributable profits for each period back to the accounting profit (e.g. if there was any capital expenditure not allowed) but these can be included if it assists in your calculations.

### 5.1 Tax return requirements

Once a company has applied for the concession, a schedule detailing income and capital reserves and the offset of any distributions made will be required with each subsequent tax return in order for distributions to be considered under the concession.

If this is not provided with each return, the concession will not apply and all income distributions will be taxable in full with no concessional tax credits.



## 5.2 Transitional provisions

In order to spread the workload for those involved in the preparation of company income tax returns, the Assessor proposes a phased approach to submission of the first schedules.

- Any company that made a distribution between 21 February 2012 and the date of publication of the initial version of this Guidance Note on 14 March 2013 and wishes to claim the concession in respect of that distribution:

A schedule should be provided with the income tax return for the accounting period during which the distribution was made.

If the return has already been filed, the schedule should be submitted no later than the filing date of the return for the next accounting period.

- All other companies wishing to have the concession apply to future distributions:

A schedule should be provided with the income tax return for the accounting period ending between 6 April 2014 and 5 April 2015.

If a distribution was made during an earlier accounting period, the schedule should be included with the income tax return for that accounting period if the concession is to apply in respect of that distribution.

N.B. The ability to put "old reserves" subject to Isle of Man income tax in Box 2 or Box 3 **will not continue** beyond this date, so all claims to establish these reserves must be made with the income tax return for the accounting period ending between 6 April 2014 and 5 April 2015.

A company that has not made a distribution may, of course, submit its schedule of income and capital reserves earlier than these dates.

If an existing company does not make an election with the return for an accounting period in line with the dates specified above, the ability to allocate profits accumulated up to that date to any of the boxes will be lost.

There will, however, be provisions for new companies which do not exist at 5 April 2015 to apply for the concession in the future. (See 5.3 for details.)

There will also be provisions for companies receiving new income sources after those dates.

### 5.2.1 Claims for New Income Sources after 2015

Where a company would only have profits in Box 1, it is not strictly necessary to claim the concession by the final date stated above. All distributions will then be taxed in accordance with section 2PA Income Tax Act 1970.

If such a company's circumstances then change and it receives a new source of income - such as overseas taxed profits or it makes a capital gain- it will be possible for the company to claim the concession in respect of that new source when it is first received.

The claim should be made with the income tax return for the accounting period in which the new source is first received. If the income tax return for this period is not filed by the due date (i.e. it is late), the claim may not be accepted.

In order to do this, the company will also have to compute the value of Box 1 reserves arising since incorporation in line with section 4.1 of this guide.

N.B. If the company also had "old reserves" which would have been put in to Box 2 or Box 3 had a claim been made by the dates set out in section 5.2, it **will not be possible** to do this when making a claim in relation to a new income source in the future. The reserves which could have been allocated to Box 2 or Box 3 will be allocated to Box 1.

#### Example 13

2008 Trading Limited was incorporated on 6 April 2008 and makes accounts up to 30 June each year. The company's only source of income up to 30 June 2015 is profits from its trade as a wholesaler, and it has always met the ARI distribution requirements.

In the year to 30 June 2016 the company sells one of its warehouses in the Isle of Man, making a profit on disposal of £25,000.

It also opens a shop in Rochdale and commences to trade as a retailer in the UK in the same accounting period. UK taxable profits for the period are £50,000 and the applicable tax rate is 20%.

The company can make a claim with its income tax return to 30 June 2016 to establish Box 3 reserves of £40,000 (net of UK tax) and Box 4 reserves of £25,000.

2008 Trading Limited's Box 1 reserves from 30 June 2009 to 30 June 2016 are:

Accounting Period	Isle of Man Taxable Profit	Less: Dividend Paid	Box 1 Reserves
30 June 2009	485,000	(300,000)	185,000
30 June 2010	425,000	(300,000)	125,000
30 June 2011	410,000	(250,000)	160,000
30 June 2012	310,000	(200,000)	110,000
30 June 2013	475,000	(310,000)	165,000
30 June 2014	385,000	(200,000)	185,000
30 June 2015	415,000	(250,000)	165,000
30 June 2016	240,000	-	240,000
		Total	1,335,000

The profit and loss reserve at 30 June 2016 before dividend is £850,000. A dividend of £750,000 is paid on 30 June 2016.

The dividend will be offset against the boxes starting with the lowest number first:

	Total B/F	Less Dividend	Total C/F
Box 1	1,335,000	(750,000)	585,000
Box 3	40,000	0	40,000
Box 4	25,000	0	25,000

Once the initial schedule has been provided companies must provide revised schedules on an annual basis with their income tax return showing how the current year's profits and any distributions have been allocated and deducted from the boxes.

### 5.3 New companies

New companies – new incorporations, foreign registrations, transfers of domicile or companies incorporated elsewhere commencing residence in the Isle of Man – should provide a schedule with the income tax return for the first accounting period.

If a company is commencing residence or transferring domicile from another jurisdiction, its reserves up to the date of commencement or transfer will need to go into the box that reflect the nature of those reserves.

#### Example 14:

Control Ltd is incorporated in the UK, is in receipt of rental income taxed at the UK corporate rates and has an accounting period end of 5 April.

The directors move to the Isle of Man on 6 April 2012 and begin to exercise management and control from the Island on that date. The Assessor is advised that Control Ltd has commenced residence in the Island on 6 April 2012.

All income up to 5 April 2012 has been subject to tax in the UK at a rate at least equal to the higher rate in the Isle of Man, so the reserves will go into Box 3.

However, if the company does not provide the schedule or does not inform the Assessor that it has commenced Isle of Man residence then no concession will apply and all income distributions will be taxable in full.

#### **5.4 Existing Company - Commencement of Resident Ownership on or before 5 April 2015**

The previous concessions relating to distributions did not require a company which was wholly owned by non-residents for an accounting period to provide specific details regarding reserves and distributions made.

As long as the company remains wholly owned by non-residents this remains the case for the purposes of the revised concession published in PN 174/12, so these companies are not required to claim the concession in respect of dividends paid.

However, if an Isle of Man resident becomes a member, or if an existing member becomes Isle of Man resident, on or before 5 April 2015 and the company has reserves at that date which would qualify to go into Boxes 2, 3 and 4, then the company will be required to apply for the concession contained in PN 174/12 in order to establish these boxes.

##### **5.4.1 Treatment of Earlier Distributions**

When applying for the concession, the reserves schedule will need to take account of all distributions made whilst the company was wholly owned by non-residents. (See section 4 and its subsections for details on how to offset previous distributions for each box.)

At the time the distribution was made the company would not have been required to specify which profits the distribution was made from, so the reserves schedule should be prepared treating the distributions **how they would have been treated under the concession in effect at that time.**

A brief summary of the concessions in operation between 6 April 2006 and 21 February 2012 is provided for reference in Appendix 2, and full details can be found in GN38 – The Pay and File Income Tax System for Companies.

**Example 15**

Changing Owners Limited is a resident company which was wholly owned by non-residents until 30 June 2012. On that date, the shares in the company were purchased by an Isle of Man resident.

The company was incorporated on 1 June 2002 and commenced to trade on the Island immediately.

Dividends of £50,000 were paid each year on 31 May 2007 to 2011; £150,000 was paid on 31 January 2012.

The company's accumulated profit and loss reserve at 31 May 2004 was £200,000.

When claiming the concession with the company's income tax return to 31 May 2013, the company's reserve schedule would offset the earlier dividends paid as follows:

<b>Profit for Period</b>		Box 1	Net Box 1	Box 2	Net Box 2
31-May-04	Less: Div May-07 May-08 Jan-12 Balance			200,000 -50,000 -50,000 -15,000	85,000
31-May-05	Less: Div Balance	150,000 -			
			150,000		
31-May-06	Less: Div Balance	200,000 -			
			200,000		
31-May-07	Less Div: Balance	130,000 -			
			130,000		
31-May-08	Less Div: Balance	145,000 -			
			145,000		
31-May-09	Less Div: Balance	210,000 -50,000			
			160,000		
31-May-10	Less Div: Balance	215,000 -50,000			
			165,000		

31-May-11	Less Div:	185,000		
	Balance	-50,000	135,000	
31-May-12	Less Div:	135,000		
	Balance	-135,000	0	
	<b>Cumulative Balance</b>		<b>1,085,000</b>	<b>85,000</b>

When claiming the concession a company will not be permitted to choose to offset all previous distributions from lower numbered boxes, leaving only reserves in higher numbered boxes for distribution to the new resident members.

### 5.5 Existing Company - Commencement of Resident Ownership after 5 April 2015

The previous concessions relating to distributions did not require a company which was wholly owned by non-residents for an accounting period to provide specific details regarding reserves and distributions made.

As long as the company remained wholly owned by non-residents up to 5 April 2015 this remains the case, so these companies are not required to claim the concession in respect of dividends paid.

However, if an Isle of Man resident becomes a member after 5 April 2015 and the company has reserves at that date which would qualify to go into boxes 2, 3 and 4, then the company will be required to apply for the concession contained in PN 174/12 in order to establish these boxes.

This claim must be made with the income tax return for the accounting period in which an Isle of Man resident became a member.

### 5.6 Previous Distributions

If any distributions made to Isle of Man residents in previous years have been taxed as gross distributions without any reference to the previous concessions which could have applied, those distributions should be deducted from Box 1 preserving the balances in Boxes 2 and 3 for the offset of future distributions.

If offsetting these distributions results in the Box 1 total being a negative figure (i.e. the dividends exceed the taxable profits) the next distribution paid can first be offset from Box 2 and higher until those balances are exhausted.

## Important Note

If, whilst reviewing a reserves schedule, the Assessor discovers that dividends deducted from the various boxes have not been declared or charged to income tax correctly in the hands of the recipient, appropriate steps will be taken to correct the position and preserve the revenue. The appropriate steps will depend on the specific circumstances of the case.

In the most serious cases steps may include the charging of penalties and interest in relation to the lost tax due on the dividend. In other cases the appropriate steps may simply be the adjustment of Box 1 to include the amount of dividend not taxed correctly.

## 6 Practical application of the concession

Once a company makes a distribution and applies for the concession, the computations of income and distributions should be performed in the following order:

1. undertake the normal income tax computations for the accounting period
2. fill the reserve boxes for that accounting period
3. offset the distributions made during the accounting period.

### Example 16:

A company has the following reserves up to 30 June 2012:

ARI	0
DPC	0
10% tax	0
Box 1	450,000
Box 2	230,000
Box 3	0
Box 4	125,000

### Results for the accounting period ended 30 June 2013:

Taxable profit	35,000
Net gain on sale of investments	175,000
Dividend paid	25,000

***Step 1 - fill the boxes***

<b>Box 1</b>	
Balance b/f	450,000
Reserve for year	35,000
<b>Balance c/f</b>	<b>485,000</b>

<b>Box 2</b>	
Balance b/f	230,000
<b>Balance c/f</b>	<b>230,000</b>

<b>Box 4</b>	
Balance b/f	125,000
Net gain for year	175,000
<b>Balance c/f</b>	<b>300,000</b>

***Step 2 - offset the distributions, lowest number box first***

<b>Box 1</b>	
Balance b/f	450,000
Reserve for year	35,000
Balance	485,000
Less: distributions made	-25,000
<b>Balance c/f</b>	<b>460,000</b>

<b>Box 2</b>	
Balance b/f	230,000
Distributions made	0
<b>Balance c/f</b>	<b>230,000</b>

<b>Box 4</b>	
Balance b/f	125,000
Net gain for year	175,000
Distributions made	0
<b>Balance c/f</b>	<b>300,000</b>



Only distributions made within an accounting period will be considered in the reserves and box computations for that accounting period. After the ARI ended there is no longer any requirement for a 12 month period to refer distributions back to an accounting period.

However, during the transition from the ARI, if a distribution is being made within the permitted 12 months to meet the 55% requirement, it will only be used for that purpose and will not also be deducted from the Box 1 reserve for the accounting period in which it was paid.

**Note:**

Where a company makes distributions on different dates in an accounting period, these will be combined and the total distribution offset from the boxes from 1 to 4.

Distributions paid to each shareholder (whether on the same or different dates) will be pro-rated across the boxes in the same way as the total distribution.

A company will still be required to provide the following details of the recipients of distributions paid:

- name
- address
- date and amount of each payment
- associated tax credits.

As the non-refundable credit from box 2 is given by relaxing section 25A(3) Income Tax Act 1970, a distribution voucher should be issued when a distribution from these reserves is made.

The consolidated distribution voucher provided in Guidance Note GN 38 can be used for this purpose, and also for detailing any other distributions.

## **7 Winding up and liquidation**

As stated earlier, any distribution made on liquidation or winding up of a company is taxable in the same way as a distribution made during the normal life of a company. Therefore, in order for the concession to apply to a distribution made on liquidation or winding up it must be applied for.

The Assessor appreciates that there was a period of uncertainty between 21 February 2012 and the publication of the revised version of PN 174/12 on 22 June 2012, and wishes to clarify the position regarding distributions made on liquidation or winding up commenced but not completed during that period.

It should be noted that, for the purposes of the previous practice, the Assessor only considered a winding up, dissolution or liquidation, to have commenced when the initial documentation was filed in the Companies Registry.

Any distribution made before the filing of the application was, and continues to be, treated as a normal distribution.

## **7.1 Declaration of dissolution**

- **Application for dissolution made before 21 February 2012**

The primary legislation and concessional treatment set out in PN 174/12 will not apply, and distributions will be taxed in accordance with the previous practice, regardless of whether they are paid before or after 21 February 2012.

Note – this only applies to applications for dissolution made before 21 February 2012 where the winding up was completed without unnecessary delay after that date. If the completion of winding up was unnecessarily delayed (e.g. due to failure to submit information requested by the Assessor or to pay outstanding tax liabilities) the concessional treatment in PN 174/12 will apply.

- **Application for dissolution after 21 February 2012**

The distributions will be taxed in accordance with PN 174/12 and this Guidance Note, or in accordance with primary law if no application for the concession is made.

## **7.2 Liquidation**

- **Liquidator appointed before 21 February 2012**

The primary law and concessional treatment set out in PN 174/12 will not apply, and distributions will be taxed in accordance with the previous practice regardless of whether they are paid before or after 21 February 2012.

- **Liquidator appointed after 21 February 2012**

The distributions will be taxed in accordance with PN 174/12 and this Guidance Note or in accordance with primary law if no application for the concession is made.

## **7.3 Return of share capital**

PN 174/12 states that a repayment of par value of share capital and any share premium should not, in general, be taxable distributions when received by individual members. There are, however, certain scenarios where this is not the case.

Where a company buys back the shares from the member, this is defined as an income distribution in section 2PA Income Tax Act 1970. It should be noted that only any amount in excess of the amount paid for the share will be considered to be an income distribution.

For example, if the consideration paid for the share was £1 and the company buys it back from the shareholder for £15, the income distribution is £14 (£15 - £1).

On winding up the company will return its surplus assets to its shareholders. The maximum that can be treated as an income distribution for the purposes of section 2PA is the balance of the profit and loss reserve. Any distribution up to this amount – whether it is made in cash or in specie – will be an income distribution that can be considered in accordance with the concession.

Any distribution over and above the profit and loss reserve made on winding up will be considered to be a return of share capital and will not be an income distribution.

## 8 Groups

If a company is a member of a group for tax purposes (i.e. at least 75% of the share capital of the subsidiary is owned by the parent) each company will have its own reserves but, in recognition of the group arrangement, the Assessor will allow distributions made to parent companies to retain the personality of the reserve in the subsidiary company.

### Example 17:

Company A owns 100% of the share capital of Company B for the accounting period ended 30 June 2013.

Before taking into account any distributions from the current year's profit, Company A has the following reserves at 30 June 2013:

Box 1	£200,000
Box 2	£150,000
Box 3	£ 0
Box 4	£ 0

Before taking into account any distributions from the current year's profit, Company B has the following reserves at 30 June 2013:

Box 1	£ 0
Box 2	£ 0
Box 3	£ 350,000
Box 4	£ 100,000

Company B makes a distribution of £400,000 to Company A on 30 June 2013, and that distribution is reflected in the reserves of each company as follows:

**Company B – deduct the distribution**

<b>Box 1</b>	
Balance b/f	0
Balance c/f	0

<b>Box 2</b>	
Balance b/f	0
Balance c/f	0

<b>Box 3</b>	
Balance b/f	350,000
Less: distribution	(350,000)
Balance c/f	0

<b>Box 4</b>	
Balance b/f	100,000
Less: distribution	(50,000)
Balance c/f	50,000

**Company A – add the distribution to the boxes**

<b>Box 1</b>	
Balance b/f	200,000
Balance c/f	0

<b>Box 2</b>	
Balance b/f	150,000
Balance c/f	0

<b>Box 3</b>	
Balance b/f	0
Add: distribution	350,000
Balance c/f	350,000

<b>Box 4</b>	
Balance b/f	0
Add: distribution	50,000
Balance c/f	50,000

This concessionary practice only applies to how that income is recorded in the parent company's reserves. The income element of any intra-group distribution will still need to be declared as income by the parent company for inclusion in its income tax assessment.

If the company is **not** a member of a group for tax purposes, income distributions will not retain the personality of the reserve in the paying company in all cases.

- Any income distributions carrying non-refundable tax credits will be added to the Box 1 reserve of the recipient company.
- Distributions carrying a 10% credit will go into the income taxed at 10% reserve because they are, in statute, also subject to tax at 10%.
- Distributions from Box 3 will not be subject to further taxation in the hands of the recipient company, they will remain in Box 3 of the recipient company.
- Distributions of capital will be considered to be capital in the hands of the recipient company and, after netting off any capital losses for the period, will go into Box 4.

## 8.1 Group relief

The reserves for an accounting period for a company receiving group relief will be computed in the same way as for any other company utilising a loss i.e. the taxable income for the year to go into the respective boxes will be reduced by the group relief. This is outlined in section 4.1.1 Trading losses.

## 9 Foundations

An Isle of Man foundation is specifically designated as a corporate taxpayer, so is required to pay tax at the same rate as a company and also to file income tax returns on the same dates.

As a corporate taxpayer, any distributions made by a foundation will need to be considered in the light of the PN 174/12 concession and reserves schedules may be required. If the foundation holds shares in a company that is wound up, any distribution will be treated as income in the hands of the foundation but will be subject to the zero rate of income tax for corporate taxpayers.

It should be noted that the look through principle does not apply to foundations because in law a foundation is a corporate taxpayer. Any profits of a foundation that are agreed to be capital profits can be distributed to an Isle of Man resident free of income tax in the usual way.

## **10 Distributions paid to trusts and estates**

Any income distributions paid to a trust will be considered to be income in the hands of the trustees.

The taxation of income distributions paid to trustees will follow the practice outlined in the two published practice notes – PN 141/07 “The Taxation of Trusts in the Isle of Man” and PN 160/09 “Taxation of Trusts in the Isle of Man – Additional Guidance”.

Income distributions from a company which has applied for this concession made to the trustees of a discretionary trust, if subject to tax under the provisions of PN 141/07 and PN 160/09, will be taxed in the hands of the trustees in accordance with section 11 of this Guidance Note.

Income distributions paid to the executors (or equivalent) of an estate are also considered to be taxable income. Generally the income received by an estate is taxed in the hands of the beneficiaries as if they had received it personally, but if a trust is created then the income will be taxed in accordance with the taxation of trusts in the Isle of Man.

## **11 Assessment of income distributions**

The following sections set out how distributions from various reserves will be treated in the individual recipient’s income tax assessments.

### **11.1 DPC and 10% reserves**

The assessment of income distributions from reserves subject to DPC is covered in section 12.1 of Guidance Note GN 38 and the assessment of dividends carrying a 10% tax credit is covered in section 11 of GN 38.

### **11.2 ARI reserves**

Distributions from reserves subject to the ARI will not be taxed again in the hands of the recipient. See Guidance Note GN 41 “Attribution Regime for Individuals” for more details.

**11.3 Box 1**

Income distributions from box 1 will be included in the recipient’s assessment as a dividend with no tax credit. The amount treated as taxable income will be the amount of the distribution paid.

**11.4 Box 2**

Income distributions from box 2 will carry a non-refundable tax credit computed as set out in section 4.2.1.

As the non-refundable credit is given by relaxing section 25A(3) Income Tax Act 1970, a distribution voucher should be issued when a distribution from reserves is made.

Verified tax credits are allocated to the year of assessment by way of a “Company Credit” adjustment between the “Total Liability” and “Total Tax” lines of the assessment.

This treatment ensures the amount of the credit covers the income tax due but does not generate a refund of the credit if it is more than the liability.

**Example 18:**

A company distributes £50,000 from reserves in May 2012, which is offset against its Box 2 reserves on a first in, first out (FIFO) basis and grossed up as follows:

<b>Tax year</b>	<b>Amount distributed</b>	<b>x</b>	<b>100/100-Rate (R)</b>	<b>= Gross</b>
2001/2002	23,849		100/88	27,101
2002/2003	7,650		100/90	8,500
2003/2004	8,640		100/90	9,600
2004/2005	2,250		100/90	2,500
2005/2006	7,611		100/90	8,457

The non-refundable tax credits are calculated as follows:

<b>Tax year</b>	<b>Gross distribution</b>	<b>x</b>	<b>R/100</b>	<b>Non-refundable credit</b>
2001/2002	27,101		12/100	3,252
2002/2003	8,500		10/100	850
2003/2004	9,600		10/100	960
2004/2005	2,500		10/100	250
2005/2006	8,457		10/100	846

The shareholder will be required to declare:

- £56,158 gross distribution with a non-refundable tax credit of £6,158.

If the shareholder is a Manx resident individual, the 2012/2013 assessment would be as follows:

Employment	35,000		
Distribution from reserves	56,158		
<b>Total income</b>	<b>91,158</b>		
Less: personal allowance	(9,300)		
<b>Taxable income</b>	<b>81,858</b>		
	10,500	@ 10%	1,050
	71,358	@ 20%	14,272
<b>Total liability</b>			<b>15,322</b>
Less: company credit			(6,158)
<b>Total tax</b>			<b>9,164</b>
Less: ITIP			(4,090)
<b>Tax payable</b>			<b>5,074</b>

### 11.5 Box 3

If the concession has been applied for, income distributions from Box 3 are not subject to further taxation in the hands of the recipient and so they will not feature in their income tax assessment.

They are, however, considered to be income for personal allowance credit purposes and should be declared in the recipient's income tax return form as an income distribution from Box 3.

#### Example 19:

Following on from Example 8, Old IHC Ltd makes a distribution of £600,000 to the company's resident owner Mr Smith on 30 June 2012.

Old IHC Ltd decides to pay out its DPC and ARI pools in full and takes the balance under the PN 174/12 concession from its boxes as shown below:

DPC Pool		ARI Pool	
Balance b/f	266,500	Balance b/f	150,000
CY profits	-	CY profits	91,803
Distribution	(266,500)	Distribution	(241,803)
Balance c/f	<b>Nil</b>	Balance c/f	<b>Nil</b>



<b>Box 1 Pool</b>	
Balance b/f	-
CY profits	28,197
Distribution	(28,197)
Balance c/f	<b>Nil</b>

<b>Box 2 Pool</b>	
Balance b/f	-
CY profits	-
Distribution	
Balance c/f	<b>Nil</b>

<b>Box 3 Pool</b>	
Balance b/f	225,000
CY profits	40,000
Distribution	(63,500)
Balance c/f	<b>201,500</b>

<b>Box 4 Pool</b>	
Balance b/f	750,000
CY profits	-
Distribution	-
Balance c/f	<b>750,000</b>

Mr Smith's assessment, payment on account and personal allowance credit computations would be as follows:

<b>Income Tax Assessment</b>				
<b>Income</b>				
Dividends	28,197			
Dividends with DPC credit	325,000			
<b>TOTAL INCOME</b>				353,197
<b>Allowance</b>				
Personal allowance	(9,300)			
<b>TAXABLE INCOME</b>				343,897
		10,500	@ 10%	1,050.00
		333,397	@ 20%	66,679.40
<b>TOTAL LIABILITY</b>				67,729.40
			DPC Credit	(58,500.00)
<b>BALANCE</b>				<b>9,229.40</b>

<b>Payment on account</b>				
TOTAL LIABILITY		67,729.40		
<u>Less:</u>	Third party payments	(58,500.00)		
		9,229.40	@ 105%	<b>9,690.87</b>
<b>Personal Allowance Credit</b>				
Gross income		416,697		
Upper income point		9,300		
Excess income		407,397		<b>No PAC Due</b>

### 11.6 Box 4

If the concession has been applied for, distributions from Box 4 are capital and not subject to income tax in the hands of the recipient and so they will not feature in their income tax assessment.

## 12 Protected cell companies

A protected cell company (PCC) is, in corporate law, a single legal entity and Practice Note PN 107/04 "Protected Cell Companies" confirms that the company itself is the taxpayer and that the cells cannot be assessed separately.

However, the Assessor recognises that the cells are separate from each other, with ownership, profits and losses of each cell segregated from the others, and has established a practice of treating each cell separately for the purposes of computing taxable profits and applying the DPC and ARI regimes. The PCC files a single tax return, with accounts and a tax computation for each cell, and a single assessment is issued showing the taxable profit for each cell.

For the purposes of PN 174/12 each cell will have its own boxes, and distributions made from each cell will be considered in relation to its own boxes and other reserves.

### **13 Contact information**

If you require any further information about anything contained in this Guidance Note please contact:

The Treasury  
Income Tax Division  
Second Floor  
Government Office  
Buck's Road  
Douglas  
Isle of Man  
IM1 3TX

Telephone: (01624) 685400  
Fax: (01624) 685351  
E-mail: [incometax@itd.treasury.gov.im](mailto:incometax@itd.treasury.gov.im)  
Website: [www.gov.im/incometax](http://www.gov.im/incometax)

#### **Opening hours:**

Monday to Thursday	9.15 am – 5.00 pm
Friday	9.15 am – 4.30 pm



**14 Appendix 1 – Example Layouts for Reserves Schedule**

Tax Year	Year end	Regime	Taxable / Distributable Profits	Box 1	Box 2 Net	Box 2 Concessional Tax Credit	Box 3	Box 4	DPC Gross	DPC Credit	ARI	Statutory 10% Net
2005/06	31/03/2005	Taxed	P&L Reserve		100,000	11,111						
2006/07	31/03/2006	DPC	income divs	50,000 -25,000								8,000
2007/08	31/03/2007	DPC	income divs	65,000 -30,000								8,000
2007/08	31/03/2008	DPC	income divs	60,000 -25,000				5,000				8,500
2008/09	31/03/2009	DPC	income divs	70,000 -35,000								9,000
2009/10	31/03/2010	ARI	income divs	75,000 -40,000				2,500				10,000 -15,000
2010/11	31/03/2011	ARI	income divs	70,000 -40,000								9,000
2011/12	31/03/2012	ARI	income divs	72,000 -45,000								9,000
2012/13	31/03/2013	Final ARI	income divs	80,000 -40,000								5,000
2013/14	31/03/2014		income divs	75,000 -35,000				-1,000				10,000 -20,000
<b>Totals</b>				<b>302,000</b>	<b>100,000</b>	<b>11,111</b>	<b>0</b>	<b>6,500</b>	<b>0</b>		<b>0</b>	<b>17,000</b>

Taxation of Distributions from Corporate Taxpayers

Year end			Box 1	Box 2 Net	Box 2 Concessional Tax Credit (10%)	Box 3	Box 4	Statutory 10% Net	DPC Gross	DPC Credit	ARI
30/06/2005	P&L Reserve Divs paid old concessions	21,000									
		0									
		21,000		21,000	2,333						
			0	21,405	2,378	0	0	0			
30/06/2006	Distributable Profits divs	150,000									
		-100,000									
		50,000	50,000								
			50,000	0	0	0	0	0			
30/06/2007	Distributable Profits divs	165,000									
		-125,000									
		40,000	40,000								
			40,000	0	0	0	0	0			
30/06/2008	Distributable Profits divs	230,000									
		-140,000									
		90,000	90,000								
			90,000	0	0	0	0	0			
30/06/2009	Distributable Profits divs	210,000									
		-120,000									
		90,000	90,000								
			90,000	0	0	0	0	0			
30/06/2010	Distributable Profits divs	92,000									
		-80,000									
		12,000	12,000								
			12,000	0	0	0	0	0			
30/06/2011	Distributable Profits divs	215,000									
		-160,000									
		55,000	55,000								
			55,000	0	0	0	0	0			
30/06/2012	Distributable Profits divs	39,000									
		-80,000									
		-41,000	-41,000								
	Net Rent	18,647									
	Tax	-1,865									
Net 10%	16,782						16,782				
			-41,000	0	0	0	0	16,782			
		<b>Box Totals:</b>	<b>296,000</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>16,782</b>	<b>0</b>	<b>0</b>	<b>0</b>



## **15 Appendix 2 – Summary of Previous Distribution Concessions**

### **Distributions from Reserves Paid before 6 April 2008**

Distributions paid before 6 April 2008 are treated as made from “taxed reserves” which are taxed profits from periods of account forming the basis of the income tax assessment for 2005/06 or earlier.

Distributions can be made from taxed reserves in preference to meeting the distribution requirement of DPC, or after 55% is allocated to meet that requirement.

*Note: For a wholly non-resident owned company there would have been no requirement to meet the 55% distribution requirement, so it will be assumed that any distribution made whilst this concession operated was from “taxed reserves” (i.e. offset from Box 2)*

### **Distributions from Reserves Paid between 6 April 2008 and 5 April 2009**

Distributions paid since 6 April 2008 are treated as made from the accounting reserves at the balance sheet date of the accounts forming the basis of the income tax assessment for 2005/06.

Non-refundable tax credits are no longer required and all distributions from those reserves are treated as capital and no income tax is payable by shareholders. This change to practice was announced in GN41 Attribution Regime for Individuals.

The option to make distributions from reserves in preference to meeting the distribution requirement of DPC / ARI, or after 55% has been allocated to meet that requirement is only available for distributions made from accounting periods ended before 6 April 2009.

*Note: For a wholly non-resident owned company there would have been no requirement to meet the 55% distribution requirement, so it will be assumed that any distribution made whilst this concession operated was from “taxed reserves” (i.e. offset from Box 2).*

### **Distributions from Reserves Paid after 5 April 2009 and accounting periods ended after 5 April 2009**

All distributions from accounting reserves at the balance sheet date of the accounts forming the basis of the income tax assessment for 2005/06 are classed as capital distributions (i.e. they were taxed as if they were capital, despite having been made from accumulated income profits).



The whole of the distributable profit of an accounting period must be distributed before an excess can be treated as a distribution from reserves under the Assessor's revised practice.

*Note: The requirement to distribute the whole of the profit for an accounting period before a distribution could be taken from older reserves applied equally to wholly non-resident owned companies as it did to those with resident ownership.*

## 16 Appendix 3 - Preparing Reserves Schedules – Which Figures to Use

### ARI

1. Use the **distributable profit** for the period
  - This amount will have been attributed and charged on the resident shareholders
  - If the company had any non-resident shareholders for the period, their share goes in Box 1 as it is not attributed

### DPC

1. Start with **the distributable profit** for the period
2. Use this as the gross reserve figure
3. The net reserve figure is the gross reserve, less the DPC charge for the period
  - If the company had any non-resident shareholders for the period, their share of profit goes in Box 1 as it was not subject to DPC

### Statutory 10% Tax Credits

1. Start with the **net profit for the period** (the “profit before tax” in the P&L if the company only has one income source) **BEFORE** relief for losses/excess brought forward or capital allowances.
2. Deduct the actual tax paid for the period, NOT the provision for tax in the accounts
3. The resulting figure is the net statutory 10% credit reserve for the period
  - If the company has 10% and 0% income, the net profit for the period will need to be split between the two reserves.
  - Use the taxable/distributable profit for the other income source and put it into the relevant reserve.

**Box 1**

1. Use the **taxable/distributable profit** for the period.
  - There is only one Box 1 - you don't split Box 1 between resident and non-resident owners.

**Box 2 Non-Refundable Credits**

1. Start with **the accumulated profit and loss account reserve balance** in the accounts forming the basis of the 2005/2006.
2. If the company is claiming tax credits of more than the flat 10%, you will need to work out how much of that reserve gets each tax credit.
  - Take the **net accounting profit for the period** (i.e. 31/1/2001 for 01/02), use the bottom line on the P&L **AFTER** tax, dividends and everything paid out for the year.
  - This is the net reserve figure for the year, which will carry the non-refundable tax credit at the tax rate charged for the year.
  - If more than one tax rate was charged because of the trading company lower rate band, the accounting profit will need to be pro-rated in line with the taxable profit to determine how much gets each rate of tax credit.

Like this:

Taxable Profit	£200,000
Taxed at 10%	£150,000 (150/200)
Taxed at 20%	£ 50,000 (50/200)
Accounting Profit	£175,000
Credit Rate 10%	£131,250 (175 x 150/200)
Credit Rate 20%	£43,750 (175 x 50/200)