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PRACTICE NOTE

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BUDGET 2006 – BANKING BUSINESS

Introduction

This Practice Note is relevant to companies holding a banking license in the Isle of Man within the meaning of the Banking Act 1998 (hereinafter referred to as 'banks'). It expands upon the announcements in today's Budget Statement made by the Minister for the Treasury, the Hon AR Bell MHK; covering both the application of the general 0% rate of corporate income tax and the 10% rate in respect of the profits of banks.

The information in this Practice Note has application from 6 April 2006 unless otherwise stated.

The International Loan Concession available to banks in the Isle of Man is withdrawn with effect from 1 January 2006 as part of our commitment to the European Union Code of Conduct on Business Taxation. The last accounting period to which the concession might apply therefore, is that ending on or before 31 December 2005.

Background

Banks receive income from a number of discrete business lines, some of which would be taxed at the general rate of 0% were they to be in separate companies. Treasury has made it clear, however, that at present direct taxation revenue from the banking sector is a necessary fiscal measure and that a tax rate of 10% will apply to some of the banks' profits. Whilst primary legislation and related orders or regulations will shortly provide the framework for the taxation of companies in the Isle of Man, detailed consultation with the Association of Licensed Banks has shown the need for immediate technical guidance so as to provide certainty for the banks currently operating here and information for those that may consider basing operations here in the future.

An underlying principle is that any company having more than one class of income chargeable to tax at more than one rate will compute its tax liability accordingly.

Income from deposit taking

Deposit taking and its related activities represents the primary business line covered by the Banking Act. All income arising from the re-investment or utilisation of client deposits will be subject to tax at 10% irrespective of how that income is earned. The phrase "client deposits" should be construed as including current, call, omnibus, notice, and fixed deposit accounts, certificates of deposit, bonds, structured products and other similar investment products.

Ancillary income arising from deposit taking activities will also be charged at the 10% rate; e.g. income from the issuing of cheque books, transaction fees, account management and servicing fees, foreign exchange charges, debit and credit card fees, money transmission fees (BACS/CHAPS/SWIFT) etc.

Income from capital and reserves

One of the Financial Supervision Commission's regulatory conditions attached to the holding of a banking licence is for a minimum amount of capital to be held (a combination of share capital and such other reserves as are required for risk asset ratio purposes). As this minimum regulatory capital is related to banking business, income arising from it will be taxed at the 10% rate. Income arising from capital surplus to regulatory requirements from 1 January 2006 will be chargeable at the general corporate income tax rate of 0%.

Income arising other than from client deposits

Income arising from sources of funding other than client deposits, such as group funded lending, is not banking business as defined and will therefore be chargeable at the general 0% rate. Similarly where group funds or funds other than client deposits are used for activities such as leasing and hire purchase, participation in syndicated loan business, sub-participation lending and asset securitisation, income arising will be chargeable at the general 0% rate.

Fiduciary deposits

Fiduciary deposits are a financial product primarily developed in Switzerland and involve the specific commissioning by a client of their own bank to invest their assets with a third party bank. As the interest is paid by the third party bank to the client bank, subject to the Assessor being satisfied that an Isle of Man bank is acting in a third party fiduciary capacity it is accepted that the funds involved will be inter-bank placements and not client deposits and that income earned from them will be chargeable at the general 0% rate.

Other non-banking business

It is recognised that many banks will provide services and generate income from activities such as assurance, insurance, custody, trust and corporate services. As all such activities would be charged at 0% rate of tax if undertaken by any other company, it follows that the 0% rate will apply to such income received by banks. Where a bank is in receipt of other income (e.g. from land or property in the Isle of Man) which is taxed for all companies at the 10% rate, the bank will be taxed on that income at 10%.

Centres of excellence

When groups restructure or create centres of excellence, new business activities may be undertaken by a pre-existing bank and initially might appear to be ancillary income arising from banking business within the terms of this Practice Note and therefore taxable at 10% (e.g. proprietary dealing as compared to a group treasury function). Subject to review by the Assessor, where banking group functions are being centralised, income arising from group functions will be recognised as not being ancillary to the taking of deposits and therefore will be subject to the general 0% rate.

Tax computation

Administration and general expenses should be allocated on a pro rata basis to the gross profits chargeable at the 0% or 10% rates of tax. This method of attribution will also apply to claims for capital allowances. The Income Tax Division will review this initial guidance once the new regime has bedded in.

Where a bank has income from land and property, it should submit a tax computation specific to that income source showing specific expenses.

Group/loss relief and brought forward losses

Group and loss reliefs will continue to be permitted; however they will be restricted to profits chargeable at the same rate of tax; i.e. losses arising on activities subject to the general rate of 0% will not be relievable against profits taxed at 10%.

Where losses are brought forward from 2005/06, unless the agreed taxation computations for that year provided specific loss allocation, the losses will be relieved against the 2006/07 and future years' profits on a pro rata basis to the profits chargeable at the 0% or 10% rates of tax.

M Couch

Assessor of Income Tax

This practice note 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.

Comments and suggestions for improvements of issued Practice Notes and suggestions for future Practice Notes are always welcome.