



Isle of Man
Government

Reilhtys Ellan Vannin

The Treasury *Yn Tashtey*

Assessor
I Q Kelly

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

INCOME TAX DIVISION

Government Office, Douglas
Isle of Man, British Isles
IM1 3TX

PRACTICE NOTE

PN 73/99

Date: 16th February 1999

Budget 1999 - New Tax Band For Companies

Introduction

The purpose of this Practice Note is to provide further details on the proposed new tax band for Companies announced by the Treasury Minister in his Budget speech. It is to be introduced by way of a Temporary Taxation Order, a copy of the draft proposals is set out at Appendix A. The temporary taxation provisions are contained in section 15 of the Income Tax Act 1995. Under those provisions an Order approved by Tynwald has the force of law for 24 months provided that within the next 12 months a Bill confirming the Order receives its second reading before the House of Keys. The intention is to have a Bill ready in time for the new legislative sitting commencing in October 1999.

Consultation Period

It was announced that a short period of consultation would be given to enable the industry to comment on any aspect which caused concern or required clarification. The cut off date for comments is the 31st March 1999. This will allow enough time for the responses to be analysed and the legislative processes to be completed in time for the Temporary Taxation Order to be placed on the Tynwald Agenda for the 18th May 1999.

Interpretation

The Order should be read in conjunction with the following definitions -

Company - includes Manx incorporations and foreign incorporations which have been registered under Part XI of the Companies Act 1931 or have changed their domicile to the Island but investment companies are to be excluded.

Associated Company - a company is to be treated as an "associated company" of another at a given time if, at that time, one of the two has control of the other or both are under the control of the same person or persons.

In applying the definition to any income tax year -

a) an associated company shall be counted even if it is an associated company for only part of that year, and two or more associated companies shall be counted even if they are associated companies for different parts of the year;

b) an associated company which has not carried on any trade at any time in that year shall be disregarded.

Control (Section 119A Income Tax Act 1970) - in relation to a body corporate means the power of a person to secure -

by means of the holding of shares or the possession of voting power in, or in relation to, that or any other body corporate; or

by virtue of any powers conferred by the articles of association or other document regulating that or any other body corporate,

that the affairs of the 'first mentioned body corporate' are conducted in accordance with the wishes of that person.....

Investment company (Section 120 Income Tax Act 1970)- means an association incorporated in the Isle of Man, or a body corporate resident though not incorporated in the Isle of Man, the sole or principal object of business of which is the investment of money, and which does not bona fide engage to a substantial extent in any business, industrial or commercial undertaking other than the investment of money, and for the purpose of this definition the expression "the investment of money" shall include the sale and purchase of investments or securities or the under-writing of investments".

The Order In Detail

Commencement and Interpretation - Articles 1 and 2

1) The new rate of 15% is to apply for the income tax year commencing 6 April 1999. This means that it will be applied to assessments falling to be made in respect of that year irrespective of the basis of assessment.

2) The interpretations which are to apply have already been commented upon.

New rate of tax - Article 3

3) The rate applies to a company which derives the whole of its trading profits from a trade carried on in the Isle of Man. Companies which are either resident or non-resident for tax purposes come within the definition, but branch operations are excluded.

4) The limit of £100,000 applies to the taxable income which will be the amount after capital allowances, distributions and any loss/group relief.

5) For the purposes of the new rate calculation, incidental investment income of a trading company of £10,000 or less will be treated as part of the trading profits.

6) Where the investment income exceeds £10,000 the computation of taxable investment income will be subject to the same calculation as applied to Investment Holding Companies. (see Practice Note PN68/97). In the absence of a separate computation the full amount of investment income will be assessed to 20% without any deduction.

7) A holding company which is an "associated company" will not qualify for the new rate unless it is carrying on a separate and substantial trading activity. For it to be substantial at least 75% of its total income must arise directly from that trading activity.

8) The Division will continue its current practice of accepting a company as carrying on a trading activity where it is in receipt of significant income from the letting of commercial property. Evidence may be called for to substantiate that the business both needs to be organised and is being organised in the same manner as a trade.

9) The new rate will apply in addition to the present concessional treatment for fund managers and international loans.

Commencements and cessations - Article 4

Where a company commences or ceases its trade, the limit is apportioned to reflect the period of trading carried on in the year. It is calculated on a monthly basis with any part months being left out of account.

Associated Companies - Article 5

The purpose of this article is to alleviate the avoidance of a tax liability by the simple process of dividing activities through one or more other companies. The principle of disaggregation is not new and extensive measures are taken to avoid it happening for VAT purposes. In this instance the formula counters it by dividing the £100,000 limit between all active associated trading companies. Having regard to the definition of "control", comments are invited on the form of certification that should be put in place to determine associated company relationships.

Assessment of undistributed profit - Article 6

Although less likely, it will be possible for an individual to avoid a personal tax liability by the accumulation of profits within a company. In the exceptional case that it is believed that the profits are being accumulated to bring about a reduction in the tax liability of an individual(s), the Assessor will be able to apply the provisions of sections 12 and 13 of the Income Tax Act 1970 to deem that in effect a distribution has taken place. The subsequent actual distribution would then be treated as a payment of capital and not income.

Comments

Anyone wishing to provide comment on any aspect of this Practice Note should do so in writing addressed to the Secretary to the Tax Liaison Committee at the above address. Comments should be received no later than Wednesday 31st March 1999.

Appendix A

Draft Of Temporary Taxation Order

Citation and commencement

1. (1) This Order may be cited as (.....) and, subject to section 15(2) of the Act, shall come into operation on 6 April 1999.

(2) This Order shall apply in respect of the income tax year commencing 6 April 1999 and subsequent years.

Interpretation

2. In this Order -

"the Act" means the Income Tax Act 1995;

"the 1970 Act" means the Income Tax Act 1970;

"company" means -

(a) a company formed and registered under the Companies Act 1931;

(b) a company registered under Part XI of that Act;

(c) a body corporate in respect of which a certificate has been issued under paragraph 3(4)(a) of Schedule 3A to the Insurance Act 1986; and

(d) a body corporate in respect of which a certificate has been issued under section 4(2) of the Companies (Transfer of Domicile) Act 1998, but shall not include an investment company within the meaning given in section 120 of the 1970 Act; "control" shall be construed in accordance with section 119A of the 1970 Act.

New rate of tax: companies

3. (1) A company which derives the whole of its trading profits from a trade carried on in the Island shall, in respect of the income tax year commencing on 6 April 1999 and every subsequent income tax year, pay income tax -

(a) in respect of every pound of taxable income up to and including £100,000, at a rate of 15%; and

(b) in respect of every further pound of taxable income, at the higher rate determined under section 1(2A) of the 1970 Act.

(2) Section 1(2)(b) of the 1970 Act shall not apply in respect of a company to which paragraph (1) applies

Commencements and cessations

4. (1) Where the provisions of sections 3(1), 4(1), 5(1) or 6(1) of the 1970 Act fall to be applied to the taxable income derived from the trade of the company, the amount specified in article 3(1)(a) shall be reduced to an amount determined by the formula

$$£100,000 \times T / 12$$

where -

T is the number of complete months in the relevant income tax year during which the company was carrying on its trade in the Island.

2) For the purposes of paragraph (1), a month is the period from the beginning of the 6th day of any month to the end of the 5th day of the following month.

Associated Companies

5. (1) Where in any income tax year a company has one or more associated companies, the amount specified in article 3(1)(a) [or as the case may be, the reduced amount determined in accordance with article 4(1)] shall be determined by the following formula -

$$A / N+1$$

where

-A is the amount specified in article 3(1)(a) [or as the case may be, the reduced amount determined in accordance with article 4(1) 1]; N is the number of companies associated with the company.

(2) For the purposes of this article a company is to be treated as an "associated company" of another at a given time if, at that time, one of the two has control of the other or both are under the control of the same person or persons.

(3) In applying paragraph (2) to any income tax year -

(a) an associated company shall be counted even if it is an associated company for only part of that year, and two or more associated companies shall be counted even if they are associated companies for different parts of the year;

(b) an associated company which has not carried on any trade at any time in that year shall be disregarded.

Assessment of undistributed profit

6. Without prejudice to the generality of sections 12 and 13 of the 1970 Act, where it appears to the Assessor that in any year of assessment arrangements relating to the distribution or non distribution of profits of any company exist or have existed, the main purpose of which or one of the purposes of which, is to reduce the tax liability of one or more individuals, the powers conferred on the Assessor by sections 12 and 13 of the 1970 Act may be exercised in relation to the company and its members, and for this purpose -

(a) any reference in those sections to an investment company shall be construed as a reference to a company; and

(b) in section 12(1), the words " from such investment" shall be omitted.