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PRACTICE NOTE

PN 156/09 **Date: 6 April 2009**

UPDATED– THIS PRACTICE NOTE IS WITHDRAWN WITH EFFECT FROM 21 FEBRUARY 2012. PLEASE REFER TO PN174/12

REVISION TO THE ASSESSOR'S PRACTICE IN RESPECT OF DISTRIBUTIONS FROM COMPANY RESERVES

This Practice Note is relevant to all Manx resident companies, their shareholders and agents. It explains a significant revision to the Assessor's practice in respect of the tax treatment of company distributions; which will come into effect today (6 April 2009).

Introduction

In law, distributions made by a company to its shareholders from its profits constitute income in the hands of those shareholders. The Assessor has for a number of years, however, been prepared to relax the strict application of the law in certain circumstances and treat distributions as if they were capital in the hands of the company's shareholders. This practice was generous, but took account of issues which arose during the period when individual and, in particular, corporate income tax rates were reduced rapidly; and so it was also pragmatic.

The Assessor has reviewed this practice and considers that it is giving rise to an unintended level of deferral or loss of revenue. The revisions to the Assessor's approach described in this Practice Note will introduce a system which is more appropriate to current circumstances.

Background

It was announced in Guidance Note 41 'Attribution Regime for Individuals' (ARI) that, from 6 April 2008, a distribution of trading profits in respect of a company's accounting period which formed the basis of its income tax assessment for 2005/06 or earlier would be treated as if it were a distribution of capital. This extended significantly the Assessor's existing practice, which was to treat a distribution from trading profits assessed for 2000/01 or earlier as if it were a distribution of capital. Such distributions became commonly known as "distributions from reserves". Non-refundable tax credits of 12% and 10% became obsolete with this more beneficial treatment for shareholders.

The earlier Guidance Note 36 'Distributable Profits Charge' (DPC) stated that where a distribution exceeded 55% of a company's trading distributable profit, the excess could be treated as if it were a distribution of capital. This was an alternative to that excess distribution increasing the company's averaged profits.

Change in treatment

For the purposes of this Practice Note:

- "distributable profit" means that profit defined in Section 13 (A) (8) Income Tax Act 1970 and in paragraph 4 (3) of Statutory Document 928/07;
- "trading distributable profit" means distributable profit derived from a trade or trades; and
- "distribution from reserves" means distribution of taxed profits from periods of account forming the basis of the income tax assessment for 2005/06 or earlier, which is treated as a distribution of capital in the hands of shareholders as described earlier.

In all cases, tax returns must clearly state the actual payment dates of all distributions made and the names and addresses of the recipients.

Accounting periods ending after 5 April 2009

For accounting periods ending after 5 April 2009, the option to treat the whole of a distribution as a distribution from reserves, with no part of it meeting the ARI/DPC distribution requirement, will no longer be available for any company.

The option to treat the part of a distribution exceeding 55% of trading distributable profit as a distribution from reserves will also no longer be available; and the whole of a distribution of up to 100% of the trading distributable profit of an accounting period will be included for averaging purposes.

Only that part of a distribution which exceeds 100% of the distributable profit of an accounting period will be treated as a distribution from reserves.

This revised practice will also apply to corporate income taxable at 10% (including cases where an election to be taxed at 10% has been made). In this case, the whole of the taxable profit must be distributed with tax credit vouchers before any distribution from reserves can be claimed.

The ARI will apply to all accounting periods ending after 5 April 2009. Please see Guidance Note 41 for details of how the ARI operates.

Accounting periods ending between 5 April 2008 and 5 April 2009

A distribution which is paid within 12 months of the end of an accounting period can be 'referred back' to that accounting period to meet the ARI/DPC distribution requirement.

For these accounting periods, the date on which a distribution is made will determine whether it can be claimed as a distribution from reserves.

In respect of accounting periods ending between 6 April 2008 and 5 April 2009 only, where a company can demonstrate that it has declared and paid more than 55% of its trading distributable profit before 6 April 2009, the amount exceeding 55% can be claimed as a distribution from reserves under the previous practice.

Example A

Accounting period ended 30 September 2008 - Distributable Profit £100,000
Dividend paid 31 December 2008 - £45,000
Dividend paid 31 March 2009 - £30,000

£10,000 of the £30,000 paid on 31 March completes the 55% distribution requirement, and the balance can be claimed as a distribution from reserves under the previous practice.

Distributions paid on or after 6 April 2009 but within the 12 months of the end of an accounting period can still be referred back to that accounting period to meet the ARI/DPC distribution requirement of 55%, but the new practice will apply and only the amount exceeding 100% of the distributable profit can be claimed as a distribution from reserves.

Example B

Accounting period ended 30 September 2008 - Distributable Profit £100,000
Dividend paid 31 March 2009 - £45,000
Dividend paid 30 April 2009 - £30,000

The dividend of £30,000 can be related back to meet the 55% distribution requirement, resulting in a total distribution of 75%, but the excess over 55% cannot be claimed as a distribution from reserves.

If the whole of a company's profits are subject to tax at 10%, a distribution which was paid before 6 April 2009 can be claimed as a distribution from reserves. For distributions paid on or after 6 April 2009, only the amount exceeding 100% of taxable profit can be claimed as a distribution from reserves.

Where a company has profits subject to tax at both 10% and 0%, the relevant parts of this practice will apply individually to each portion of profits.

Updating of published guidance

Published Guidance Notes relating to DPC, the Pay and File Regime for Companies and ARI (numbers 36, 38 and 41, respectively) will be updated shortly to take account of the changes outlined in this Practice Note.

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Assessor of Income Tax

This is a general guide only 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.