TAXATION STRATEGY – EXCHANGE OF INFORMATION

RESPONSE TO THE EU TAX PACKAGE

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1. At the EU's Council of Economics and Finance Ministers' meeting in Brussels on 3 June 2003 all Member States finally agreed to adopt the tax package consisting of the Directive on taxation of savings ("the Savings Directive"), the Directive on Interest and Royalties and the Report by the Code of Conduct Group (Business Taxation) ("the Code").

2. The Isle of Man is not part of the EU and the provisions of the EC Treaty relating to taxation do not extend to the Isle of Man. During the EU negotiations, the UK resolved to promote, within the framework of its constitutional arrangements, the adoption of the measures set out in the Savings Directive and the Code by the relevant dependent or associated territories.

3. From the outset the Isle of Man has been concerned as to the consequences of a Tax Package determined outwith the Island and in respect of which it has not been able to make any direct input. The Isle of Man firmly believes in the process of constructive engagement, as demonstrated by its response to the OECD initiative on harmful taxation. The key principles of fiscal sovereignty, economic stability and adherence to international standards remain fundamental to the Isle of Man's consideration of any taxation initiative. That was the basis on which the Island responded to the OECD initiative on harmful taxation and it remains the basis of its response to the Tax Package and in particular the issues of exchange of information in direct taxation matters.

Code of Conduct (Business Taxation)

4. In October 2002, Tynwald approved modifications to the Island's Taxation Strategy. The modifications were designed to achieve a uniform tax system for the whole business sector. The strategy currently provides for a new standard zero rate of corporate tax combined with a higher rate of 10% levied on defined regulated businesses, principally banks.

5. The 10% rate was achieved in April of this year and a move towards a zero rate has already begun. Subject to economic conditions, it remains the Treasury's intention to introduce the zero rate generally by 2006. Following its introduction the exempt and international tax regimes perceived by the Code to be "harmful" will be abolished. This will provide a seamless transition into a uniform system of business taxation. The Isle of Man notes the confirmation that these proposals meet the stringent conditions set down by the Code of Conduct Group (Business Taxation). This will provide the future certainty for which the industry has been looking.

Directive on the taxation of savings

6. The Isle of Man will have to study the final text of the Directive but it appears clear in accordance with article 17 of the Savings Directive that the Council of the European Union will be looking for the relevant dependent or associated territories of the United Kingdom to apply either:

* automatic exchange of information from 1 January 2005; or
* a withholding tax on the same terms and for the same transitional period as Austria, Belgium and Luxembourg.

7. It is important to set out the context in which the Isle of Man has considered its response to the Savings Directive:

   - the Island is acknowledged as a progressive international finance centre, with a sound and well regarded regulatory framework, which is committed to seeking to prevent its financial systems being used for criminal activities such as money laundering and the financing of terrorism. Co-operation in fighting such matters is neither unique nor new. For many years assistance has been provided to other countries through both the Island's criminal justice provisions and its comprehensive network of mutual assistance arrangements on indirect taxation issues;
   - through its constructive engagement with international organisations, such as the IMF, its active participation in the creation of the OECD Model Tax Information Exchange Agreement, its tax information agreement with the United States and its longstanding double taxation agreement with the UK, the Isle of Man already embraces widely accepted standards for the exchange of information on direct taxation issues.

8. Conscious of the UK's commitment to its EU colleagues, an extensive and inclusive consultation process has been conducted with the relevant financial concerns on the Island. That process has shown that the Island's financial institutions acknowledge and accept that exchange of information is the emerging standard. Fundamental to this is the need for a levelplaying field delivered in relation to competitors both within Europe and other parts of the world. The decision of the Island's fellow Crown Dependencies is another relevant factor, particularly in the context of the stated desire of the Island's financial institutions to see consistency of approach between the Crown Dependencies. Finally, account has been taken of the international standard favoured by the OECD, which is exchange of information upon request and in particular the manner in which it has been referred to in Article 10 of the Savings Directive.

9. Taking account of all these factors, the Isle of Man Government has decided that, in keeping with the three principles outlined in paragraph 3, the economic well being of its people will be best served by adopting a withholding tax on the same terms as Austria, Belgium and Luxembourg and for a transitional period in compliance with the terms and conditions set out in article 10 of the Savings Directive.

10. This means the Island will impose withholding tax on interest (as defined) payable to EU resident individuals only. Such EU individuals may opt out of the withholding tax by agreeing to the exchange of information to their EU country of residence. Twenty five percent of any withholding tax levied will be retained, with seventy five percent being remitted to the depositor's country of residence.

Exchange of Information – Way Forward

11. There can be little doubt that the Savings Directive has seriously impacted upon the work of the OECD relating to exchange of information. It is not for the Isle of Man to predict what may come out of the OECD negotiations between participating partners scheduled for later this year but the OECD Model, providing for exchange of information upon request, does currently represent a widely accepted standard for exchange of information. This point appears to be readily accepted within the Savings Directive insofar as Switzerland, Liechtenstein, San Marino, Monaco,

Andorra and the United States of America are required to move to information on request at some indeterminate future date.

12. As to the future, the published taxation strategy approved by Tynwald clearly states that the Treasury is prepared to enter into bi-lateral negotiations with any country about a double taxation agreement or a tax information agreement which provides mutual economic benefit. Such are the actions of a mature and responsible financial centre which, given the opportunity, stands willing to participate actively in a constructive and inclusive international debate on the development of new standards.

Next Steps

13. This document sets out the Island's position on the EU tax package within the context of its overall taxation strategy. Much remains to be done to convert the EU proposals into reality both on the part of the EU states and within the Island. As the Island is not a member of the EU, and so not bound directly by the Savings Directive, these steps include the negotiation of bilateral agreements between the Island and EU member states in order to implement the tax withholding obligations. The Isle of Man Government's decision still requires the approval of Tynwald later this year and any subsequent enabling legislation will be subject to the normal parliamentary debate should it be approved for introduction in the next parliamentary session.

14. In keeping with the Island's commitment in relation to the Savings Directive, the proposal will not be implemented in advance of the adoption of the same or equivalent measures by all EU member states, all relevant dependent or associated territories and named third countries, performance of such obligations being currently scheduled for 1 January 2005.

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Notes

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