



Isle of Man
Government

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THE TREASURY

YN TASHTHEY

A REPORT ON

INTERNATIONAL TAXATION STRATEGY

July 2009

INTERNATIONAL TAXATION STRATEGY

BACKGROUND

1. The past eighteen months have seen unprecedented events in the arena of international taxation which have led to an unremitting focus on the legal, regulatory and tax systems of small countries. Tax competition is not in itself a matter of concern, but it is clear that many countries consider certain tax practices to be harmful to the functioning of the global economy. For example, on 31 March 2009 Stephen Timms, the United Kingdom Financial Secretary to the Treasury said in a speech to the 2009 Brussels Tax Forum:

"We strongly support fair tax competition but do not support harmful tax competition. By harmful tax competition, I mean competition for the location of profits rather than fair competition for the location of economic activity. Fair tax competition is a welcome and healthy aspect of the global economy. But harmful tax competition simply leads to a game of beggar-my-neighbour."

2. There has been a sharp increase in the use of the term "tax haven" around the world by politicians, media commentators and non-government organisations. Those countries labelled as tax havens have been accused of causing a range of problems from the collapse of the international banking system to keeping the developing countries of the world in poverty by facilitating the flow of illicit funds arising from corruption, from theft and from profit-shifting by multinational companies. While the Isle of Man Government has not seen a credible definition of what constitutes a tax haven, nevertheless it has to accept that the Island has been called one on many occasions. In the current climate it is self-evident that it is not in our national interest to be associated with the term tax haven.
3. This report aims to set out in non-technical language the key areas of international taxation affecting the Isle of Man and to set out the Government's recommended strategy where one is required. The Isle of Man is recognised increasingly as leading the development of policies in respect of effective collaboration between small international financial services centres (the description of the Isle of Man that the Government favours) and larger economies. By following the strategic course set out in this report, the Government considers that the Isle of Man will be most appropriately placed to move to a position of acceptance by the international community as a competitive, standards-driven financial centre which is integrated fully in a globalised economy. Achieving that position will further increase the confidence that investors have in the Isle of Man, re-emphasise the stability of our economy and foster continuing economic growth.
4. In considering any international taxation strategy, the Isle of Man Government will be mindful of the three over-arching principles which have determined its approach since 2000, namely:
 - fiscal sovereignty;
 - economic stability; and
 - adherence to international standards.

THE EUROPEAN UNION

5. In view of the numerous issues arising in relation to the EUSD, the Treasury set up a working party, reporting to the Treasury Minister, through the Isle of Man Finance Steering Group, comprising private sector representatives from each of the main financial services sectors and chaired by a Deputy Assessor of Income Tax. The working party made a number of observations and recommendations which have informed the Treasury's policies in this area.

EXISTING EUSD

6. In 2002 the Isle of Man gave a commitment to two major European Union ("EU") initiatives: the Code of Conduct for Business Taxation and the Directive on Taxation of Savings Income in the Form of Interest Payments (commonly referred to as the "EUSD"). The Isle of Man is not part of the EU, and so this commitment signalled both our co-operative approach as good neighbours and that our Government was forward-looking and able and willing to adapt to a changing international environment.
7. In fulfilling our commitment to the Code of Conduct, the Isle of Man has completely overhauled its system for the taxation of companies, and has demonstrated understanding and speed of response when part of the replacement system was viewed by the EU as still failing fully to meet the requirements of the Code of Conduct¹.
8. The EUSD has been in operation since 1 July 2005. The Isle of Man Government prepared effectively and professionally for its introduction, and has operated the EUSD without difficulty since 2005.
9. At the heart of the EUSD is a simple concept: that information in respect of interest paid by a bank (or other financial institution) in one EU member state to an individual resident in another EU member state should be exchanged automatically with the tax authorities in the state of residence of the individual.
10. As an alternative to automatic exchange of information, certain countries were permitted to use transitional arrangements, whereby tax could be withheld from the interest payments and then sent to the country of residence of the investor. The level of this tax was set at 15% from 2005-2008, 20% from 2008 to 2011 and 35% from 2011 onwards. Within the EU, Austria, Belgium and Luxembourg apply the transitional arrangements. A number of countries outside the EU agreed to apply the principles of the EUSD, and many of them, including the Isle of Man, also apply the transitional arrangements. The EUSD contains provisions that would bring the transitional arrangements to an end², although as the conditions have not yet been satisfied, the end date cannot be predicted with any accuracy. The Isle of Man would be obliged to end its application of the transitional arrangements should these conditions be satisfied.
11. The increased attention being paid to international taxation issues mentioned earlier in this report has called into question the future of the EUSD transitional arrangements and thus the withholding tax option available to the banks' customers. In part, the

¹ The distributable profits charge regime, designed to prevent the deferral of taxation by resident individuals through the use of company structures, was repealed and replaced in 2007.

² The transitional period shall end at the end of the first full fiscal year following the date of entry into force of an agreement with respect to interest payments between the EU, and the last of Switzerland, Liechtenstein, San Marino, Monaco and Andorra, providing for the exchange of information upon request as defined in the OECD 2002 Model Agreement on Exchange of Information on Tax Matters.

transitional arrangements were necessary because of banking secrecy rules in certain of the countries introducing the EUSD; although that was not the case in the Isle of Man. Very few countries now appear willing to make a stand in relation to banking secrecy. A number of observers have questioned what type of customer would be willing to suffer a 35% deduction of tax from their savings income that they cannot then recover. In addition, Belgium has announced that it will abandon the EUSD transitional arrangements from 1 January 2010.

12. In relation to the existing EUSD, the Treasury believes that it is in the long term best interests of the Isle of Man that an early announcement be made of the actions it intends to take when the next phase of the transitional arrangements come into effect on 1 July 2011. This will provide certainty to the banking industry and to depositors and will enable an orderly implementation of the necessary administrative changes.
13. The Treasury proposes that the Isle of Man should inform the EU and its member states that it will end the EUSD transitional arrangements on 1 July 2011, with the effect that the withholding tax option will no longer be available to EU residents who invest in Isle of Man banks and that automatic exchange of information will be the only option available to EU residents who invest in Isle of Man banks.
14. The financial impact for the Isle of Man is that the withholding tax currently retained by the Isle of Man and totalling £4.5 million will be foregone and that public finances will need to be adjusted accordingly. The Treasury is of the view that this is the necessary financial consequence of implementing a required policy.

The Treasury recommends that the Isle of Man Government formally informs the European Union and its member states that it will end the European Union Savings Directive transitional arrangements on 1 July 2011.

PROPOSED NEW EUSD

15. In November 2008 the EU issued proposals to introduce a new EUSD with the aim of "closing existing loopholes and eliminating tax evasion."
16. It has been known since before the EUSD became operational that planning around it was straightforward. For example, an individual resident in an EU member state could:
 - arrange to have interest income paid to an intermediate entity (e.g. a company or trust) that they had set up;
 - convert their interest into a different type of income by investing in another form of financial product (e.g. a fund or insurance product); or
 - simply open a bank account in a country not covered by the EUSD, such as Dubai or Singapore.
17. Clearly, a person who knowingly fails to declare such income in their tax return is committing tax evasion; which is a criminal offence in most countries.
18. The EU's proposals for a new EUSD seek to address the first of the two planning approaches above in the following ways.
19. If a bank in the EU makes a payment of interest to an "entity or legal arrangement" established outside the EU, it is proposed that the bank should apply a "look-through" approach if it knows, under anti-money laundering provisions, that the ultimate beneficial owner of the interest is an individual resident in the EU. This means that the EUSD would apply as if the interest were paid directly to the individual. The entities covered by the proposal are listed in its Annex I. In relation to the Crown

Dependencies, they are: Guernsey trusts and zero tax companies; Isle of Man trusts; and Jersey trusts. The proposal claims that Annex I lists entities in “jurisdictions which do not ensure appropriate and effective taxation of income obtained by such entities.”

20. Where an “entity or legal arrangement” established in the EU receives interest from any source and its ultimate beneficial owner is an individual resident in the EU, it is proposed that the entity itself will need to apply the EUSD.
21. Income from collective investment funds which are in effect similar to bank deposits (i.e. where the capital is protected and the return on investment is pre-defined) will be subject to the EUSD, and so the fund manager will need to apply the EUSD.
22. Income from life insurance contracts which provide no significant risk cover will be subject to the EUSD, and so the insurance company will need to apply the EUSD.
23. All advice that the Government has received indicates that a new EUSD is likely to be introduced. Unfortunately, it is not clear when a new Directive might become an approved piece of EU law and, even when that has happened, when it might come into operation. However, it is possible that the EU could approve a new EUSD as early as December 2009, and so the matter is urgent. If a new EUSD is introduced in the form proposed, it will have a significant effect on businesses in the Isle of Man: principally corporate service providers/trust companies, insurance companies and certain fund managers.

The EUSD is an important aspect of the Isle of Man’s international co-operation, and as the EUSD evolves, so must our strategy. It is in the Island’s interests that its views are represented as fully as possible.

It is recommended that the Isle of Man Government should seek to engage in constructive dialogue with the EU in relation to the proposed new EUSD.

INTERNATIONAL STANDARDS

24. In October 2003 Tynwald approved a Treasury report on taxation strategy and exchange of information. One of the statements in that report was: “As to the future, the published taxation strategy already 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.”
25. The G20 Summit in London on 2 April 2009 considered among many topics international tax standards and co-operation. Part of the preparatory work for the summit had been carried out by the Organisation for Economic Co-operation and Development (“OECD”). In the Leaders’ Statement published at the end of the summit, it was agreed:

“... to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information.”

26. Also on 2 April 2009, the OECD published "a progress report on the jurisdictions surveyed by the OECD Global Forum in implementing the internationally agreed tax standard." The standard referred to is quoted directly in the next paragraph.
27. "The internationally agreed tax standard, which was developed by the OECD in co-operation with non-OECD countries and which was endorsed by G20 Finance Ministers at their Berlin Meeting in 2004 and by the UN Committee of Experts on International Cooperation in Tax Matters at its October 2008 Meeting, requires exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged."
28. In the 2 April 2009 progress report, the Isle of Man was listed as one of the "jurisdictions that have substantially implemented the internationally agreed tax standard." As is clear from other parts of the report, the OECD does not consider the Isle of Man to be a tax haven because of the Island's implementation of the standard.
29. While many countries made commitments and declarations in the periods immediately preceding and following the G20 Summit in London, the Isle of Man had no need to take such urgent action. The Isle of Man committed to the standard in 2000, and since then has been working as a member of the OECD Global Forum on Taxation and some of its sub-groups. We have also been conducting negotiations with many countries aimed at concluding co-operation agreements with them at the required standard. At the date of the summit the Isle of Man had signed 14 agreements, of which 12 were with member countries of the OECD.
30. Once tax co-operation agreements have been signed, the Isle of Man Government's track record is to present them rapidly to Tynwald for ratification, to make strong links with the relevant authorities in the other country and then to operate the agreements in a highly professional manner. The Isle of Man's approach to international tax co-operation is widely known and widely respected.
31. To qualify for inclusion in the list of countries (which many have insisted on describing as the "white list") that have substantially implemented the internationally agreed tax standard, the OECD required 12 agreements of the appropriate standard to have been concluded. The Isle of Man Government considers that this threshold will be kept under review by the OECD and that it is almost certain to be raised to a higher level in the future.
32. As long ago as December 2006, Jeffrey Owens, Director of the OECD Centre for Taxation Policy and Administration wrote an article for the journal *European Taxation*, in which he said:

"The author is convinced that some offshore financial centres will have a secure future, not as "concealment" centres, but as "service" centres that have carved out niche markets in which activities can thrive in a lightly regulated, tax-neutral environment. Those that continue in the old way of offering themselves up as places in which home taxes can be avoided will, however, in the author's opinion, face extinction."
33. Mr Owens' comment that tax-neutral service centres operating in niche markets is very much of the moment. Whether any financial centres will "face extinction" is not for the Isle of Man Government to predict. Our principal role is to ensure that the Isle of Man has a secure future and that its economy thrives.

34. The Isle of Man needs not fear explaining its system of taxation, and how the revenues generated by that system are applied to the well-being of the Island's people, businesses and environment. It is interesting to note that in a paper published by the OECD's Economics Department in July 2008 titled "Tax and Economic Growth", the following comments were made:

"This paper investigates the design of tax structures to promote economic growth. It suggests a "tax and growth" ranking of taxes, confirming results from earlier literature but providing a more detailed disaggregation of taxes. Corporate taxes are found to be most harmful for growth, followed by personal income taxes, and then consumption taxes. Recurrent taxes on immovable property appear to have the least impact. A revenue neutral growth-oriented tax reform would, therefore, be to shift part of the revenue base from income taxes to less distortive taxes such as recurrent taxes on immovable property or consumption ... high top marginal rates of personal income tax can reduce productivity growth by reducing entrepreneurial activity. While the paper focuses on how taxes affect growth, it recognises that practical tax reform requires a balance between the aims of efficiency, equity, simplicity and revenue raising."

35. Thus the Isle of Man's standard 0% rate of tax for companies and our tax cap for individual taxation are in accordance with a thoroughly mainstream view of how to stimulate economic growth.
36. The Treasury believes that the appropriate strategy is to continue to develop a programme of tax agreements, based on the policy agreed in October 2003 and as part of that programme intends to contact proactively those member countries of the OECD or EU with which the Isle of Man does not already have tax co-operation agreements, indicating our willingness to enter into negotiations aimed at concluding such agreements.

Therefore it is recommended that the Isle of Man Government seeks to extend its network of tax co-operation agreements by continuing to engage constructively with other countries, based upon the policy agreed by Tynwald in October 2003.

DEVELOPING COUNTRIES

37. The Isle of Man has a prosperous, growing and developed economy. Many countries do not have the same benefits, and so may be held back from improving the well-being of their people, businesses and environment. International taxation is increasingly being seen as a factor in both the difficulties that developing economies face and in potential solutions that may assist them.
38. Our focus to date in the sphere of tax co-operation has been on member countries of the OECD and EU. This has been an appropriate policy, and has been to a large extent reactive, in that in most cases other countries have approached the Isle of Man Government seeking to negotiate tax co-operation agreements. The time is now right to make a change in this policy and to become more proactive in the future.
39. The Isle of Man can ensure that it assists developing countries in tackling tax evasion by negotiating appropriate tax co-operation agreements with them.
40. The Isle of Man can also assist developing countries by providing direct assistance to help them build their administrative capabilities. As an example of this direct assistance, the Treasury Minister announced at a meeting in Washington in October 2008 that the Isle of Man was becoming the first Associate Member of the Small States

Network for Economic Development, sponsored by the World Bank. In addition, the Isle of Man will co-fund an education programme run by Oxford University's Saïd Business School for officials from small states which will enable them to improve their ability to manage their financial sectors and engage more effectively with the global financial system.

It is recommended that the Isle of Man Government be willing to discuss tax co-operation, either at multilateral or bilateral level, with developing countries.

OTHER MATTERS

41. The Isle of Man will face more international taxation issues over the coming years than those covered in detail in this report. In the short term, taxation is likely to feature in some way in the independent review of British offshore financial centres (often referred to as the "Foot Review"), which was set up by the United Kingdom Treasury and which expects to report in the fourth quarter of 2009. Similarly, taxation could be covered in the latest assessment of the Isle of Man's regulatory arrangements by the International Monetary Fund, which is expected to be published during the summer of this year.
42. In the short and medium terms, the Isle of Man must monitor and engage with developments in the OECD and also in the United States of America; as changes in OECD standards or changes in United States legislation (such as the proposed, or a variant of, the "Stop Tax Haven Abuses Act") could have an effect on our international taxation strategy and potentially the Island's economy.
43. Finally, the Isle of Man must stand ready to deal effectively with those issues which at this time cannot be predicted. This requires the Government to have the appropriate skills and resources at its disposal at all times. Expertise in international taxation is a rare skill. Attracting, retaining and developing people with that skill is vital to our future.
44. The Isle of Man Government has shown that it is strategic and that it is able to adapt rapidly to changing circumstances. In the field of international taxation our reputation has improved and is getting better. The Government's willingness and effectiveness in engaging with the businesses that make up our varied and growing economy has few rivals anywhere in the world. This report aims to set out a course that will maintain our strong position into the future, and thus protect the Island, its people and economy.

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July 2009