



PRACTICE NOTE

PN 174/12

Date: 22 June 2012

REMOVAL OF CONCESSIONS - DISTRIBUTIONS

Please note that this guidance is an updated and replacement version of PN 174/12, which was originally published on 21 February 2012.

It should be read in conjunction with GN49 – Taxation of Distributions from Corporate Taxpayers

Introduction

This guidance is relevant to all Isle of Man resident companies, their members and agents. It explains a revision to the Assessor's practice in respect of the tax treatment of company distributions.

The Assessor has for a number of years been prepared to relax the strict application of the law in defined circumstances and to treat certain distributions as if they were capital in the hands of the company's shareholders. The Assessor considers that this concessionary treatment is no longer appropriate.

The conditions set out in Practice Note 156/09, whereby 100% of the profit of the most recently ended accounting period must be distributed in order to take advantage of the concessionary treatment, continue to apply for distributions made up to 21 February 2012.

The overarching principle in the Isle of Man that income tax is imposed on income and not on capital gains, is and will remain unchanged.

It is accepted that the new approach set out in this guidance will lead to an increase in the compliance burden for corporate taxpayers. Careful attention to good record-keeping by corporate taxpayers in particular will ease this burden.

General Principles

The general principles to be followed are that:

1. distributions by a corporate taxpayer of its accumulated income profits should be taxed when they are received by individual members;
2. distributions by a corporate taxpayer of its accumulated capital profits should not be taxed when they are received by individual members;
3. repayment of the par value of share capital and any share premium reserve of a corporate taxpayer should not be taxable distributions when received by individual members;
4. economic double taxation should in general not occur in the Isle of Man.

The Assessor will not accept claims to relate distributions to earlier accounting periods, or to vary the treatment of distributions made in respect of an earlier accounting period which have already been reported and settled. However, in cases of genuine uncertainty, the Assessor will be prepared to offer an opinion to the company or member; provided that all relevant facts are disclosed.

Company Winding Up or Dissolution

Under the Isle of Man Companies Acts there are a number of ways that a company can be wound up or dissolved; including winding up by a Court, voluntary winding up, dissolution by an officer or member or striking off by the Registrar.

Where a winding up, dissolution or striking off of a corporate taxpayer which commences after 21 February 2012 leads to a distribution, then the accumulated income profit element of this distribution will be subject to income tax.

Distributions of Capital Profits

Whilst capital profits may be distributed on a tax-free basis it is not appropriate that tax relief should effectively be given for capital losses. It is also essential to the fairness of the tax system that only genuine capital profits (i.e. gains on the disposal of assets that are capital assets for tax purposes) can be distributed on a tax-free basis.

Where a corporate taxpayer has an accumulated profit from disposals of its capital assets, these capital profits can be received by the members free of tax when distributed; but for tax purposes a distribution will be treated as made out of capital profits only if all income profits have been distributed first.

Tax Credits etc.

From the 2006/07 tax year onwards, economic double taxation on dividends received from Isle of Man corporate taxpayers' profits which have been subject to Manx income tax at 10%, or which have been subject to the distributable profits charge (DPC), is avoided via statutory tax credits.

Economic double taxation on dividends received from Isle of Man corporate taxpayers' profits which have been attributed to members under the provisions of the attribution regime for individuals (ARI) is avoided because distributions from that profit are not, statutorily, subject to further taxation.

Economic double taxation on dividends received from Isle of Man corporate taxpayers' profits accumulated in periods prior to 6 April 2006 will be avoided by providing a concessionary treatment that section 25A (3), Income Tax Act 1970, shall not apply, if agreed with the Assessor: and the tax credits resulting from this concessionary treatment will not be refundable.

Economic double taxation can also arise on distributions from corporate taxpayers where the underlying profit has suffered tax in other jurisdictions. If a full credit were to be given for the foreign tax, in most scenarios no Manx tax would then be payable on the distribution. The unilateral granting of a tax credit by the Isle of Man for tax paid in another jurisdiction has an effect on local tax revenue, and this issue will be subject to further consultation. In the interim, distributions made by Isle of Man resident corporate taxpayers from profits taxed in another jurisdiction at a rate of 20% or higher (or, for periods prior to 6 April 2010, 18% or higher) will, by concession, not be subject to further taxation. Note that such distributions will be included in the income of the recipient for the purposes of the personal allowance credit.

Ordering

Three forms of profit can be distributed at any time and without reference to the ordering system set out below. These are:

- profits certified as attributed in accordance with ARI;
- profits subject to DPC; and
- profits which have been subject to Manx income tax at the 10% rate.

In order to benefit from the concessionary treatment set out in this guidance, distributions will be treated as being made from accumulated profits in the following order.

For the purpose of the ordering process, profit reserves will be allocated to "boxes". A distribution will only be treated as being paid out of a box of a higher number if all of the lower numbered boxes are empty.

Box 1 Accumulated income profits which have not been taxed, attributed or subject to DPC.

Box 2 Accumulated income profits for the period of account forming the basis of the income tax assessment for 2005/06 or earlier, less any agreed capital profits and distributions already made from this reserve.

Box 3 Accumulated income profits of a resident corporate taxpayer which have suffered foreign tax at a rate of at least the Isle of Man individual higher rate applying in the period during which the profits arose.

Box 4 Accumulated capital profits.

Corporate taxpayers will be expected to provide a schedule setting out reserves and distributions (see also the 'Monitoring' section below) and failure to do this will result in distributions being treated as made from Box 1.

Published Guidance

The Income Tax Division's Guidance Notes relating to DPC, the pay and file regime for companies and ARI (numbers 36, 38 and 41, respectively) will be updated to take account of the changes outlined in this Practice Note. These updates will cover the treatment of losses, estates, trusts and foundations.

Monitoring and Protecting the Isle of Man Revenue

The Assessor has been charged with monitoring the flow of revenue carefully during the transition period following the repeal of ARI, and for this reason, corporate taxpayers will be asked to provide additional information with their tax returns. This information will comprise a declaration of certain reserves at the beginning and end of the accounting period, distributions made and the reserves from which the distributions have been made. Further details will be made available in due course; although it is expected that this information will be in respect of the profits mentioned in the 'Ordering' section above.

If for any reason the pattern of revenue collection changes more than had been estimated in relation to the abolition of ARI, Treasury may take further action.

In cases where, in the opinion of the Assessor, artificial arrangements have been used to avoid or reduce the liability of any person to income tax, the Assessor will consider counteracting those arrangements through the application of Schedule 1 of the Income Tax Act 1980.

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Assessor of Income Tax

This Practice Note is intended as 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.

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