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## PRACTICE NOTE

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PN 134/06

Date: 5 May 2006

### ELECTION TO PAY CORPORATE INCOME TAX AT A RATE OF 10%

#### Introduction

The Income Tax (Amendment) Act 2006 will shortly receive Royal Assent.

This Act introduces the standard rate of corporate income tax of 0% with effect from 6 April 2006, together with the 10% rate chargeable on profits arising from land and property situated in the Isle of Man or from banking business.

Certain corporate taxpayers chargeable at the standard 0% rate of income tax can elect to pay tax at the 10% rate. This Practice Note sets out the criteria for making an election and the effect that the election will have on the company's income tax responsibilities.

#### Background

Corporate taxpayers who are trading<sup>1</sup> and liable to the standard 0% rate may wish to retain profits for reinvestment within the business, e.g. for purchasing new premises or production machinery. However, the retention of profits in this way may bring the company within the scope of the Distributable Profits Charge ('DPC') provisions<sup>2</sup>.

The need for a provision permitting a company to retain profits for capital investment purposes, whilst not being required to account for the DPC, was recognised during consultation regarding the DPC. Allowing a trading company to elect to pay income tax at the 10% rate answers this concern, and is being introduced by Statutory Document SD224/06 – Income Tax (Rates of Income Tax) (Resident and Non Resident Corporate Taxpayers) Order 2006<sup>3</sup>.

Under this provision a trading company which elects to pay tax at 10% on its profits will be classified as a distributing company<sup>4</sup> and will not have to account for the charge.

The remaining sections of this Practice Note set out how companies can make an election, and describe the tax treatment of company distributions made from profits subject to the 10% rate.

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<sup>1</sup> Trading corporate taxpayer is defined in SD 224/06 Income Tax (Rates of Income Tax) (Resident and Non Resident Corporate Taxpayers) Order 2006 and means a corporate taxpayer whose business consists wholly or mainly of the carrying on of a trade or trades.

<sup>2</sup> The DPC Provisions were introduced via Part 3 of the Income Tax (Amendment) Act 2006 and are considered in detail within the public guide GN36 "Distributable Profits Charge". A copy of the guide can be downloaded from the Division's website or issued on request.

<sup>3</sup> Orders and Regulations relating to Income Tax can be downloaded from the Income Tax Division's website.

<sup>4</sup> Companies are classified as distributing companies in accordance with SD 218/06 Income Tax (Distributable Profits Charge) (Distributing Company) Regulations 2006.

## **Elections**

An election must be made in writing using the attached form and sent to the Assessor on or before the statutory filing date for the return of profits to which the election first relates.

### Example

A company with a 30 April year end wishes to elect for the 10% rate of tax to apply to its 2006/2007 preceding year basis assessment.

Accounts to 30 April 2005 form the basis of the tax return to 5 April 2006, which must be filed by 6 October 2006.

The election must also be made by 6 October 2006.

The election will apply for a five year period and is not revocable once made.

Where an election is already in place, a corporate taxpayer may make a further five-year election before the filing date of the return of profits for the last year of assessment covered by the previous election.

If, in any year covered by an election, the corporate taxpayer ceases to trade, the election shall not apply for that year or subsequent years.

## **Distributions**

For the 2006/2007 year of assessment only, the existing income tax rules will apply and companies may deduct dividends when computing their taxable profit. Dividends paid to Manx residents are paid gross, without deduction of income tax, and dividends paid to persons who are resident outside the Isle of Man are subject to a 10% withholding tax<sup>5</sup>. These rules are not affected by the election to be taxed at 10%.

For 2007/2008 and subsequent years of assessment, new rules introduced by the Income Tax (Corporate Taxpayers) Bill 2006 will mean that companies will not be able to deduct dividends when computing taxable profits. A dividend paid by a company taxed at the 10% rate (for whatever reason) will carry a 10% tax credit that will be refundable if paid to a Manx resident individual. The 10% tax credit will not be refundable if the recipient is non-resident or is a corporate entity.

## **Future Changes**

Income Tax Division will be introducing an accounting period basis of assessment for companies for accounting periods ending on, or after, 6 April 2007. If an election to be taxed at 10% is made prior to 6 April 2007, it will continue to apply for each accounting period until the end of the fifth consecutive year of assessment / accounting period. A company will not have to make a new election if one is in place on 6 April 2007.

The normal re-election process would apply at the end of the fifth year / period.

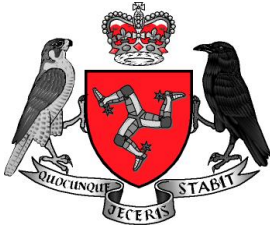
**M Couch**  
**Assessor of Income Tax**

This Practice Note is intended only as a general guide 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.

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<sup>5</sup> Withholding Tax on payments to non-residents was covered in Practice Note PN 127/06 "Taxation of Companies in the Isle of Man from 6 April 2006".



**CORPORATE TAXPAYER'S  
ELECTION TO PAY  
INCOME TAX AT THE  
10% RATE**

**The Treasury**  
*Yn Tashtey*

**Income Tax Division**  
Government Office, Douglas  
Isle of Man, British Isles  
IM1 3TX

Telephone (01624) 685400

Company Name

Company Registered Office

Tax reference number:  Tel No

The company elects to pay income tax at the rate of 10% on all profits arising in the accounting period ending on \_\_\_\_ / \_\_\_\_ / 20 \_\_\_\_

When making the election it is understood that:

- Only trading corporate taxpayers are eligible to make an election.
- The 10% rate will apply in any year of assessment in which the accounts form the basis of assessment.
- The election will continue for five consecutive years (and/or accounting periods).
- Once made, a company cannot revoke the election.
- A further election may be made at the end of the five consecutive years of assessment and/or accounting periods.
- This election must be signed by an authorised company signatory.

**Signed for the company:**

**In the capacity of:**

**Date:**