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## PRACTICE NOTE

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### **Introduction of a Current Year Basis of Assessment and Payment on Account of Income Tax for persons other than corporate taxpayers**

#### **Introduction**

Following the issue of a Feasibility Study in October 2000 the Treasury made the commitment to move to a current year basis of assessment for all income arising or accruing to non-corporate taxpayers (non-corporates). This includes individuals, partnerships, trusts and settlements.

The Income Tax (Amendment) Act 2004 (the 2004 Act) was granted Royal Assent in June 2004 and contains the legislation required to introduce a Current Year Basis of assessment for all income of non-corporates.

The 2004 act also:

- Defines corporate taxpayers, thereby identifying all other taxpayers as non-corporates.
- Provides transitional provisions.
- Introduces a new Payment on Account (POA) procedure for non-corporates.
- Updates interest and repayment supplement provisions.

These provisions reflect significant reform and simplification of the income tax system. The Income Tax Division (the Division) recognises the importance of providing clear guidance on the new rules, to explain the new system and to ensure that everyone affected understands their obligations under the revised legislation.

This Practice Note deals specifically with non-corporates and details changes to the basis of assessment and the introduction of the POA system. Further guidance and Practice Notes that detail other changes introduced by the 2004 Act will be available in due course. The topics will include:

- The basis of assessment of trading income
- Returns and Returns Compliance (including Provisional Requests)
- Anti-avoidance, Differential Tax Rates

## Index of sections

	Page Number
<b>1. Basis of Assessment:</b>	
1.0. The new rules	2
2.0. Commencement and cessation provisions	3
3.0. The Year of Transition – 2003/2004	3
<b>2. Due and Payable Date for Income Tax</b>	<b>4</b>
<b>3. Payment on Account of Income Tax:</b>	<b>4</b>
1.0. Introduction	4
2.0. The New Rules	4
3.0. Changes which affect the POA	4
4.0. Appeals	5
5.0. Collection of outstanding POA liabilities	5
<b>4. Impact on Interest Charging Provisions</b>	<b>5</b>
<b>5. Impact on Repayment Supplement Rules</b>	<b>5</b>
<b>6. Definitions</b>	<b>6</b>
<b>Appendix – Examples</b>	<b>7</b>

### **1. Basis of Assessment:**

#### **1.0. The New Rules**

The 2004 Act introduced new provisions to provide that, with effect from 6 April 2004, all income will be assessed on a current year basis. Sources affected by these changes include:

- UK and foreign pensions
- Rent
- Trading income
- Dividends
- Other investment income

Section 1 of the 2004 Act introduced a new section 81A and provided for consequential amendments to the 1970 Act.

The new section 81A applies a current year basis of assessment to income received by non-corporates:

*“Subject to section 2C of this Act, the Assessor shall, in respect of each year of assessment assess the income of every non-corporate taxpayer chargeable with income tax on the amount of income received or accrued in that year or in any part of that year.”*

Consequential amendments are made to the existing Section 81 that ensure that the previous year basis of assessment will continue to apply in respect of corporates.

The new rules took effect on the 6 April 2004, and ensure that the current year basis of assessment will apply to all years of assessment commencing with 2004/2005 and, by the application of transitional provisions, apply a deemed cessation and therefore a current year basis of assessment to 2003/2004.

## 2.0. Commencement and cessation provisions

Section 6 of the 2004 Act amends the commencement and cessation provisions in sections 3, 4, 5, 6 and 7 of the 1970 Act for non-corporates.

The commencement and cessation provisions will continue to have effect for years of assessment up to 5 April 2004. Further guidance regarding the application of these provisions may still be found in Guidance Note GN3 – Basis of Assessment (pre 6/4/03 version).

The provisions contained in sections 4(2) and 6(2), dealing with the raising of an assessment on the executor or administrator, and the apportionment of allowances and deductions on cessation of residence are still required for non-corporates. New sections 7A and 7B have therefore been inserted into the 1970 Act.

### Section 7A:

*“Where a non-corporate taxpayer ceases to be regarded as resident in the Isle of Man during the year of assessment, the Assessor shall allow only a proportion of all allowances and deductions in respect of that taxpayer corresponding to the proportion which the period during which the taxpayer was resident in the Isle of Man in the year of assessment bears to that year.”*

### Section 7B:

*“In the case of the death of an individual, the income tax which is, or would have become, chargeable under the Income Tax Acts in respect of any year shall be assessed and charged upon his executors or administrators, and shall be a debt due from and payable out of his estate.”*

## 3.0. The Year of Transition – 2003/2004

The 2004 Act directs that transition will be achieved by the application of the cessation provisions that are contained within 1970 Act.

Section 7 of the 2004 Act contains provisions to treat all income sources assessed on a previous year basis as having ceased at midnight on the 5 April 2004. All income from such sources during the 2003/2004 year will be subject to the cessation provisions.

Normally, when a cessation of a source of income takes place the Assessor also has the power (Section 4(1)(b) Income Tax Act 1970) to make adjustments in appropriate cases to increase the preceding year's liability (which in this case would be the liability for the tax year 2002/2003). Treasury has directed the Assessor that in those cases where he is satisfied that the liabilities are not subject to tax avoidance he should not exercise that power. There will therefore be no amendment of 2002/2003 liabilities unless tax avoidance is identified.

Having applied the cessation provisions section 7 of the 2004 Act provides for the same income sources to recommence at midnight on the 5 April 2004.

The effect of this deemed cessation and re-commencement, together with introduction of the new section 81A, brings all income of non-corporates into charge on a current year basis for the 2003/2004 year and future years.

Where an individual has died, ceased residence or ceased to receive a source of income before midnight on 5 April 2004, then the concessional treatment to the penultimate year will not apply.

## 2. Due and Payable Date for Income Tax

The move to a current year basis and the introduction of a POA (see Payment on Account below) required a change to the due and payable date for income tax for non-corporates.

Section 2 of the 2004 Act inserted the new section 96A into the 1970 Act. This moves the due date of payment for income tax for a year from the 1 January **during** the year of assessment to the 6 January **following** the year of assessment for the 2004/2005 year and subsequent years.

Where as a result of cessation of residence or death any assessment is raised late, the due and payable date is 30 days after the date of the assessment.

## 3. Payment on Account of Income Tax

### 1.0. Introduction

A key issue to be resolved was how to introduce the current year basis of assessment and, at the same time maintain Treasury receipts. The issue was considered within paragraph 5 of the Current Year Basis Feasibility Study (October 2000). Following consultation Treasury agreed to adopt a Payment on Account (POA) system.

The POA notice reflects the figure that we request is paid on account. This does not try to estimate or take account of any other changes which may affect the client's tax position.

### 2.0. The New Rules

The POA of income tax will be determined by sections 96B and 96C of the 1970 Act.

A POA notice will be issued to any non-corporate who had a tax liability during the previous year that was not settled by either ITIP or subcontractors deductions.

The POA is calculated by multiplying the previous year's liability to income tax (less tax deducted at source, e.g. ITIP or subcontractor deductions) by a fixed percentage (the factor).

The POA Factor for 2004/2005 has been set by Treasury at 105%. This factor in future years will be reviewed annually and may be varied by Tynwald resolution depending on a number of economic trends, e.g. inflation.

Where the non-corporate was not liable to pay income tax in respect of income for the whole of the year of assessment immediately preceding the year to which the payment applies, e.g. a new resident, the Assessor has the power to estimate (to the best of his judgement) the required POA.

There may be other circumstances which need special consideration, for example an employee becoming self employed or a self employed person retiring. In some cases it may not be appropriate to issue a POA request, however each case will be looked at to ensure the full details of the person's circumstance are taken into account.

### 3.0. Changes which affect the POA

If the POA is believed to be too high, for example due to a change in circumstances, a request can be made for the excess to be held over. However **it is extremely important to note** that if a holdover is requested and it is established that a greater amount should have been paid, interest will be due on the POA balance, chargeable from the POA due date to the date the balance is paid. The POA notice is accompanied by an explanatory note which covers this important point and includes a tear off form requesting the balance to be held over. This should be completed and signed then submitted to the Division.

Where an agent is acting, a composite written request listing clients for whom a holdover is required, together with the amounts to be held over, will be accepted.

If the POA appears too low there is no obligation to pay more; under normal circumstances any additional amount payable will be due on the 6 January following the year of assessment.

#### **4.0. Appeals**

A formal appeal against a POA notice can only be made where the amount has been estimated under Section 96B(6) of the 1970 Act.

An appeal must be made in writing to the Assessor setting out the grounds for the appeal within 30 days of the date of service of the POA notice. The provisions within the 1970 Act in respect of contested assessments shall apply in respect of POA notices.

#### **5.0. Collection of outstanding POA liabilities**

Section 96C(4) directs that “the provisions of the Income Tax Acts as to the recovery of income tax shall apply to an amount falling to be paid on account of tax in the same manner as they apply to an amount of tax”.

### **4. Impact on Interest Charging Provisions**

The interest provisions in the 1970 Act have been amended to take account of the introduction of the POA and the change to the payment date for income tax. The main changes are that:

- Interest on an unpaid POA is charged from the due and payable date of the POA until the balance is paid.
- If a holdover is requested and it is established that a greater amount should have been paid, interest will be due on the POA balance, chargeable from the POA due date to the date the balance is paid.
- If the POA was paid in full and, on assessment, further income tax was due, interest will be chargeable on the additional income tax if the additional liability is paid late. In such cases the period of interest charge will run from the due and payable date of the assessment to the date the balance is paid.
- Interest on an unpaid assessment is charged from the due and payable date of the assessment until the balance is paid.
- Illustrations of interest charges are contained in the Appendix to this Practice Note.

The 2004 Act includes a new surcharge rate of interest that is linked to late submission of an income tax return, which will be introduced in 2005. A Guidance Note on Returns and Returns Compliance will be available in due course.

### **5. Impact on Repayment Supplement Rules**

The 2004 Act inserts a new section 107B into the 1970 Act which amends the manner in which repayment supplement (RPS) is both calculated and paid to non-corporates in certain circumstances. The 2004 Act also includes consequential amendments to section 107A which ensure that, in the main, existing provisions continue to have effect for corporates.

One significant benefit of the new provision is the removal of the time delay between Treasury receiving payments and RPS starting.

Prior to the introduction of section 107B, RPS was only paid where a repayment occurred more than one full year after the end of the year of assessment to which it relates. Section 107B provides for RPS to run from the date on which the POA became due or, if later, the date the POA was actually paid.

The new provisions will apply in all cases, subject to a de minimis refund limit of £100. This will benefit a wide range of people where a repayment of overpaid tax is made.

All ITIP and subcontractor deductions that are accounted for throughout the year will be treated as though they were paid on the 6 January in the year of assessment. Therefore any deductions that, on assessment, are overpaid will carry RPS from the 6 January in the year of assessment to the date on which the refund is issued.

RPS will be calculated on a daily basis for non-corporate taxpayers (previously RPS was calculated on a monthly basis).

Whilst these provisions reflect a significant benefit to the non-corporate taxpayer, section 107B(10) precludes the payment of RPS in cases of non-compliance where the income tax return is filed more than 12 months after the issue date or where a default assessment has been issued in the absence of a return.

## 6. Definitions

Current Year Basis	means income arising or accruing in the year is included in the assessment for the same year.
Previous Year Basis	means the income arising or accruing in one year is included in the assessment for the following year.
1970 Act	means the Income Tax Act 1970.
2004 Act	means the Income Tax (Amendment) Act 2004.
ITIP	means Income Tax Instalment Payments.
RPS	means Repayment Supplement.

### **The 1970 Act (as amended) includes the following statutory definitions within section 120:**

Non-corporate taxpayer	means a person that is not a corporate taxpayer.
Corporate taxpayer	means an association that is – (a) a limited liability company; (b) any other body corporate created by or under a statutory provision or charter (other than a corporation sole, a Scottish firm or a limited liability partnership); (c) an investment club; (d) a members' club; (e) the Isle of Man Agricultural Marketing Society; or (f) such person or class of persons as may be specified in an order made by the Treasury for the purpose of this definition and such an order shall not come into operation unless it is approved by Tynwald,  and includes a receiver or liquidator of an association referred to in paragraphs (a) to (f) when exercising that office in respect of the association in question.

**I Q Kelly**

**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.

**Examples** (Applicable to 2004/2005 Assessment year onwards)**No. 1 Payment on Account**

Total Liability for the preceding year	£1000.00
<u>Less</u>	
Tax deducted at source (e.g. ITIP)	£250.00
	£750.00
Multiplied by the POA Factor	105%
<b>Payment on Account</b>	<b>£787.50</b>

- The payment on account is due and payable on 6 January during the year of assessment or within 30 days where the notice is issued late.

**No. 2 Payment on Account (request to pay lower amount)**

Payment on Account request issued	£2000.00
Client indicates final liability should be	£1500.00
Assessment liability	£1500.00

- £1500 is due and payable on the 6 January during the year of assessment or within 30 days where the notice is issued late.
- £500 is held over pending the issue of the income tax assessment.
- As the final assessment equals the POA actually paid, no interest would be due in respect of the £500 not paid.

**No. 3 Payment on Account (interest charge)**

Payment on Account	£2000.00
POA actually paid	Nil
Assessment liability	£2500.00

Final liability fully paid within 30 days of the date of issue of the assessment.

- Collection procedures will apply against the unpaid POA. Therefore the client can expect to receive reminders and, ultimately, referral to the Coroner to serve a warrant in respect of the amount due.
- Having paid the full amount of the assessment, an interest charge will arise in respect of the £2000 POA which was unpaid. The interest charge period will run from the due and payable date of the POA to the day before the date of payment.
- No interest would be due in respect of the £500 liability that was included on the assessment, but not on the POA notice.
- Had the final assessment liability been £1500, then the interest charge would run for the same period but would be based upon the £1500 final liability and not the POA amount.

**No. 4 Payment on Account (interest charge and request to pay lower amount)**

Payment on Account	£2000.00
Client requests holdover and pays only	£1500.00
Assessment liability	£2750.00

Final liability fully paid within 30 days of the date of issue of the assessment.

- Collection procedures in respect of the £500 unpaid POA will be held over pending issue of the final assessment.
- An interest charge has accrued in this example as the unpaid element of the POA has, on assessment, become due. Interest will be due in respect of the £500 unpaid POA and the charge period will run from the due and payable date of the POA to the day before the date of payment.
- No interest would be due in respect of the £750 liability that was included on the assessment but not on the POA notice.
- Where a request to pay a lower amount has been made and, as time moves on, information is received that suggests that a higher (or full) amount of POA should be paid, the taxpayer should not wait for the final assessment to make that payment. Interest charges can be minimised if additional payments are made in advance of the assessment.

**No. 5 Payment on Account (RPS)**

Payment on Account	£2000.00
Client requests holdover and pays only	£1500.00
Assessment liability	£1000.00
Refund due	£500.00

- Having paid an amount of POA that is in excess of the assessment liability the client qualifies for a repayment supplement.
- The amount of the supplement will be based upon the £500 refund and will be due in respect of the period beginning on the day the POA was paid (or on the 6<sup>th</sup> January during the year of assessment if later) and ending on the day the refund was issued.