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# **REVIEWING THE ISLE OF MAN'S BUSINESS TAXATION SYSTEM**

**A Consultation Document**

Issued by:

Income Tax Division  
2<sup>nd</sup> Floor Government Office  
Buck's Road  
Douglas  
IM1 3TX

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## REVIEWING THE ISLE OF MAN'S BUSINESS TAXATION SYSTEM

### Introduction

1. As a small island country with limited natural resources, the Isle of Man needs to attract inward investment and economic activity in order to maintain a healthy economy; which in turn provides employment and revenue of various kinds. That revenue funds public services, and as in any country the Government needs to decide what types of taxation (and at what rates) should generate that revenue. The Isle of Man's tax system has been an aspect of our competitiveness for many years, and as such has contributed to a prolonged unbroken period of economic growth.
2. On 20 October 2009, the Isle of Man's Chief Minister, Hon. Tony Brown MHK, made a statement to Tynwald on changes to the Customs & Excise Agreement revenue sharing arrangements between the Isle of Man and the United Kingdom (UK) and on international developments.
3. As part of his statement, the Chief Minister said:

"We have also been watching the way international sentiments and standards have been moving in response to the global economic crisis, and especially the speed with which such matters have been changing and the potential effect they may have on our economy.

The UK's views on this area have been helpful to us in confirming our own understanding of the situation. This will allow us to develop and position the Island and its future tax regime, so the Island can continue to remain competitive and at the same time be accepted by the international community as responsible and co-operative...

I can confirm that Government will be initiating early discussions with relevant businesses and representative bodies, and other parties, to assess the potential impact of any changes that the international community may be promoting, or may make that could affect the Island.

Government will also be actively looking to identify what new opportunities can be taken to secure further business within the Island with a view to continuing to diversify our economy and increasing our income."

4. Since the Chief Minister's statement, officials of the Isle of Man Government have given a number of briefings to organisations representing Manx businesses and professions, and to other interested parties. The aspects of those briefings related to the business taxation system are reproduced in this paper. The Government wishes to ensure that all interested parties are made fully aware of international trends and are able to contribute their views in relation to the Isle of Man's future position.

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5. The Isle of Man Government has a number of key responsibilities, one of which is to maintain, grow and diversify the economy. At the same time, the Government will continue its long-standing, publicly stated policy of positive engagement with other countries and with international organisations such as the European Union (EU) and the Organisation for Economic Co-operation & Development (OECD), and demonstrating that the Isle of Man is a responsible and co-operative economic partner.
6. It is essential that the Isle of Man Government takes account of international developments and adapts the Isle of Man's taxation regime as necessary to fulfil the key responsibilities outlined above.

### **The EU Code of Conduct for Business Taxation**

7. In the 1990s the EU and the OECD started to consider the difficult question of whether economic competition between countries by way of their tax systems could be harmful. The OECD work is not covered further in this paper, which concentrates on developments in the EU.
8. In December 1997 the EU adopted a Code of Conduct for Business Taxation ("the Code"), and shortly afterwards set up a working group to carry out work related to the Code ("the Code Group"). The Code covers business taxation only, and specifically those measures "which affect, or may affect, in a significant way the location of business activity."
9. The Code Group carried out a review of the Isle of Man's tax system and, in its 1999 report, took the view that six Manx taxation measures were harmful, namely: international business companies; exempt non-resident companies; exempt insurance companies; international loan business; offshore banking business; and, 75% exemption for fund management. In total, the Code Group considered that 66 measures across the EU and the member states' dependent and associated territories were harmful.

### **The Isle of Man's Response**

10. In May 2002, the Isle of Man gave a commitment, via the UK, to abolish the measures found harmful by the Code Group and to introduce a generally-applicable zero-ten system to replace them. In addition, it was indicated that measures would be brought in to preserve the income tax base in respect of individuals.
11. This commitment was then built into reports which were presented to the Code Group by the UK's representative on the Group. In March 2003, in response to these reports, and those of other countries, the Code Group stated, "The Group agreed that none of the proposed revised or replacement measures were harmful." The EU Council of Finance Ministers agreed with that finding in June 2003 and in addition noted that, "...the proposed revised or replacement

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measures are adequate to achieve rollback of all the harmful features of the 66 measures.”

12. The Isle of Man duly abolished the measures considered harmful by the Code Group and introduced the generally applicable zero-ten system in April 2006, on the understanding that it was compliant with international standards and the Code. The new measures to preserve the income tax base in respect of individuals became the distributable profits charge (DPC), and this was itself subject to the Code Group's review. In October 2007 the Code Group found that the DPC was not in conformity with the principles of the Code. The Isle of Man Government had already held friendly and collaborative discussions with UK and EU Commission officials, and immediately announced abolition of the DPC and the introduction of a replacement system to be known as the attribution regime for individuals (ARI). Both measures had been introduced to prevent Manx-resident individuals incorporating their wealth in companies taxed at 0%. The problem with the DPC was that, in the absence of a distribution of profits, the payer of the charge could be the company owned by the resident, and hence that charge could be considered to be a business tax. The ARI seeks tax only from individuals, and the Government considers that it is therefore outside the scope of the Code.

### **The Recent Work of the Code Group**

13. The Isle of Man ARI, being a new measure, was also subject to review by the Code Group, and was considered in 2008 and 2009. During this period, the Isle of Man Government kept in touch with UK officials, and provided explanations and information which enabled the UK to represent the Island's interests in the Code Group.
14. During a meeting in September 2009, senior officials of HM Treasury advised the Isle of Man Government that in the context of the changing international climate and harsher economic and fiscal conditions, opinions in the Code Group in relation to zero-ten regimes had hardened, and that it was now likely that they would be found harmful.

### **The Isle of Man Government's Position**

15. The Isle of Man Government recognises that the global economic and financial crisis has led to a renewed examination both of the nature of international tax standards and how their effectiveness is to be monitored.
16. There is no doubt that the Isle of Man has led the way among the smaller international financial services centres in tax co-operation with other countries. This work has developed from the policy set out in paragraph 5. On 2 April 2009 the OECD acknowledged the Isle of Man's quality in regulation and co-operation by placing it on what many have referred to as the 'white list' of countries which have substantially implemented the internationally agreed tax standard.

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17. It is important that the Isle of Man Government should take account of the views of the EU in relation to the Manx tax system.
18. Similarly, it is important that the Isle of Man should develop rapidly a far more comprehensive understanding of the business tax systems in the EU and the major trends in EU-wide tax policy.
19. The Isle of Man Government wishes to be in a smoothly functioning economic relationship with the EU and its member states, and must, therefore, take seriously the matters set out in this paper. However, changing the tax system of a country is not something to be taken lightly and it is not something that can be done overnight.

### **The Isle of Man Government's Intentions**

20. The Isle of Man Government wishes to gather detailed information so as to be able to consider two questions:
  - i) How should the Isle of Man change its business taxation system?
  - ii) What are the optimal changes?
21. The Government considers that it needs more information in order to develop policy options. The options must be founded on the Isle of Man's business taxation system fulfilling the following key criteria:
  - it meets the requirements of the EU Code of Conduct;
  - it meets the needs of as many domestic businesses as possible;
  - it contributes to competitiveness - allowing existing businesses to continue to grow and attracting new businesses to establish on the Island; and
  - it could potentially increase the attractiveness of the Isle of Man as a location for businesses in economic sectors not currently widely represented, if at all, on the Island.

In addition, the information must be capable of facilitating modelling with sufficient accuracy to allow an economic impact assessment to be drawn up in relation to any policy options. This economic impact assessment will need to take account of the likely economic damage were the Isle of Man's business taxation system found not to be in compliance with the Code.

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22. To gather the necessary information, the Isle of Man Government intends to do the following during the first half of 2010:
- Explore, as far as is possible, with UK and EU interested parties the rationale which will be applied when the Code Group considers business taxation systems, such as those of the EU member states.
  - Review business tax regimes in the EU member states (and regions or dependent territories).
  - Conduct a public consultation to seek views on potential changes to the business taxation system.
  - Engage Deloitte, the business advisory organisation, as external consultants to support the whole exercise.
23. The consultation will run until close of business on Friday 28 May 2010. Written comments and opinions are welcome, and may be submitted to the Assessor of Income Tax in any format determined by the respondent. If it is more convenient, these views can be expressed at a meeting with the Assessor of Income Tax. Submissions from representative bodies, such as professional and business associations, trade unions, voluntary and consumer groups and other organisations should make it clear on whose behalf the submission has been made and the methodology used to obtain members' input into the response.
24. Respondents are asked in particular to comment on the following specific questions:
- i) What difficulties or benefits could arise if the Isle of Man moves away from its current business taxation system?
  - ii) What alternative business taxation systems would you consider to be the most beneficial and least harmful to the economy?
  - iii) What is the minimum timescale in which you consider changes to the Isle of Man business taxation system could be made without compromising the economy?
25. In line with the Isle of Man Government Code of Practice on Consultation, we will summarise responses and publish the summary on our website within four weeks of the close of the consultation period.
26. The Isle of Man Government intends to make public its policy decisions on this vital strategic issue during the second half of 2010, and subsequently to seek Tynwald approval of them as required.