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Replacing the Distributable Profits Charge

A Proposal Document

Issued by:

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1 INTRODUCTION

In his March 2007 Budget the Treasury Minister announced that he had asked the Assessor to review the operation of the Distributable Profits Charge (DPC), which was introduced as part of a package of taxation changes in April 2006. The Minister said: "Although I am content that the Distributable Profits Charge system is appropriate and fair, I am aware of concerns expressed about it. As such, it is only right that we take a careful look again at the Distributable Profits Charge and deal with any resulting issues."

Concerns had been raised locally about the complexity of the DPC regime. Treasury also became aware that, notwithstanding the expert opinions sought by Treasury prior to its introduction, the DPC would be subject to critical scrutiny by the EU Code of Conduct for Business Taxation review group (the EU Code Group) in the latter part of 2007. The Isle of Man has given a commitment to the EU that its business taxation system will conform to the principles of the Code of Conduct.

The EU Code Group met on 16 October 2007, and considered the DPC. It considered the DPC only and not the Isle of Man's '0/10' taxation system for companies which conforms to the principles of the Code of Conduct. The DPC, however, was found by the EU Code Group not to conform to the principles of the Code of Conduct.

We therefore propose to replace the DPC regime. Treasury is also taking into account the concerns raised about the complexity of the DPC and intends that its replacement will be a simpler but equally effective method of minimising tax deferral by Manx resident individuals and trusts.

We have worked with the authorities in the UK and with the EU Commission, and based on those discussions we are confident that the new system proposed does not relate to business taxation and is therefore outside the mandate of the EU Code Group.

This document sets out an outline of the new regime and allows interested parties to consider the proposal and to raise any concerns before the relevant legislation goes to Tynwald. It is intended that the new system will come into operation in April 2008. The earliest date that the related legislation could go to Tynwald is December 2007.

2 BACKGROUND

The introduction by the Isle of Man of a standard corporate income tax rate of 0% in 2006 could have led to broader loss of revenue. Manx resident individuals and the trustees of certain trusts (all referred to for convenience as individuals)

owning companies taxed at the standard rate could have chosen to leave profits in the company rather than paying them out as distributions which would be taxable as part of their personal income. The DPC was introduced at the same time as the 0% corporate tax rate specifically to limit the impact of this sort of planning. Although the DPC is operationally complex, it has achieved its aim.

We understand that as the DPC is paid by companies on behalf of their Manx resident shareholders only, it is viewed by the EU Code Group as differentiating between resident and non-resident owned companies and therefore 'ring fencing' the latter group from parts of the tax system. Ring fencing is considered harmful in the context of the Code of Conduct.

3 REPEAL OF THE DPC

It is intended that the DPC will be repealed for accounting periods commencing after 6 April 2008. The company taxation system will not be changed.

4 THE NEW REGIME

A charging provision will be introduced that will, in certain circumstances, attribute the profit of a company to its Isle of Man resident owners. This attributed profit will be taxed as the income of the owners. The working title for the new system is the Attribution Regime for Individuals (ARI).

It is not intended that there will be any overlap with the DPC regime; therefore, the only profits capable of attribution under the ARI should be those arising in accounting periods beginning after 6 April 2008.

Examples illustrating the operation of the ARI and comparing it with the DPC regime are given in the appendix.

4.1 Introduction to the ARI

The ARI will apply to Isle of Man resident individuals with an interest (in effect a shareholding) in a "relevant company". Such individuals will be taxed on their appropriate share of the distributable profits of the company (the "attributed profits"). Distributions out of such attributed profits when subsequently received by resident individuals will be tax-exempt.

Isle of Man resident individuals will generally be treated for income tax purposes as receiving any attributed profits 12 months after the end of the accounting period of the relevant company.

4.2 Relevant companies

All Isle of Man companies will be relevant companies for the purposes of ARI other than those listed below:

- Charitable, religious and crown companies
- Friendly societies
- Boards and local authorities
- Approved pension schemes
- Licensed banks
- Companies limited by guarantee
- Members clubs and associations
- Companies listed on a recognised stock exchange
- Trading companies that have distributed 55% of their distributable profits
- Companies that pay tax at the 10% rate on the whole of their distributable profits.

Isle of Man resident individuals with interests in companies that are not relevant companies will continue to be taxed as they are today, i.e. distributions from such companies will remain subject to income tax and the ARI will not apply.

4.3 Distributable profits

Distributable profits are in effect the company's profits adjusted for tax purposes, and will be defined in the same way as for the DPC regime.

4.4 Trading companies

Under the ARI an Isle of Man resident individual with a shareholding in a trading company will be liable to income tax on his/her share of that company's distributable profits unless the company in question is not a relevant company. A trading company that has distributed at least 55% of its distributable profits or paid tax at the 10% rate on the whole of its profit (whether by election or otherwise) will not be a relevant company.

4.5 Trading companies with investment income

In order to reduce complexity for ARI purposes there will generally be no differentiation between the trading and investment income of a company where

Replacing the Distributable Profits Charge – A Proposal Document

it receives both. Rather, a company will either be a trading company or it will be a non-trading company. For maximum simplicity, unless the Assessor is of the view that a company's activities have been structured to avoid the ARI, it is proposed that all companies having more than 50% of their gross income derived from a trading activity will be treated as trading companies.

5 Further Information

If you have any questions or concerns or would like any further information please contact:

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Appendix

ARI AND DPC COMPARISONS

The examples below compare the amount of tax that would be paid under DPC with the amount that would be paid under ARI. In each example two simplified scenarios are shown which assume that income in the hands of the individual taxpayer who owns all of the shares in the company is taxed in full at the 18% or 10% rate. The intention is that as far as possible ARI is comparable to DPC in terms of tax payable.

The examples are for illustration only and take no account of tax allowances or tax rate bands. It is not possible to cover all conceivable circumstances in this short introduction to ARI.

Example 1 - Trading company that distributes in full

Profit £30,000

DPC				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	5,400	0	0	5,400
10%	3,000	0	0	3,000

ARI				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	5,400	0	0	5,400
10%	3,000	0	0	3,000

Example 2 - Trading company that does not distribute

Profit £30,000

DPC				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	0	0-2,430	2,970*	2,970-5,400
10%	0	0-30	2,970*	2,970-3,000

* DPC is credited against individual future tax

Replacing the Distributable Profits Charge – A Proposal Document

ARI				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	5,400	0	0	5,400
10%	3,000	0	0	3,000

Example 3 - Trading company that distributes 55%

Profit £30,000

DPC				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	2,970	0-2,430	0	2,970-5,400
10%	1,650	0-1,350	0	1,650-3,000

ARI				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	2,970	0-2,430	0	2,970-5,400
10%	1,650	0-1,350	0	1,650-3,000

Example 4 - Non-trading company that distributes in full

Profit £30,000

DPC				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	5,400	0	0	5,400
10%	3,000	0	0	3,000

ARI				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	5,400	0	0	5,400
10%	3,000	0	0	3,000

Replacing the Distributable Profits Charge – A Proposal Document

Example 5 - Non-trading company that does not distribute

Profit £30,000

DPC				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	0	0-5,400	5,400*	5,400
10%	0	0-3,000	3,000*	3,000

* DPC is credited against individual future tax

ARI				
Rate	Individual initial tax	Individual future tax	Company	Total
18%	5,400	0	0	5,400
10%	3,000	0	0	3,000