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## **PRACTICE NOTE**

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**PN 162/10**

**Date: 9 April 2010**

### **TAXATION OF NON-EXECUTIVE DIRECTORS' FEES**

Some uncertainty has built up in relation to the treatment of non-executive directors' fees paid by Isle of Man companies to Manx-resident directors for income tax instalment payments ("ITIP") and National Insurance contributions ("NICs") purposes. This guidance seeks to clarify the position.

#### **Statutory Position**

Company directors are in law office holders. Furthermore, non-executive directors must have a degree of independence from the executive management of the company in order to exercise their governance responsibilities. However, for the purposes of ITIP and NICs directors are deemed to be employees.

Section 2 (c) (2) of the Income Tax Act 1970 states that remuneration from any office or employment held by an individual is income assessable to tax.

The definitions in section 1 (1) of the Income Tax (Instalment Payments) Act 1974 provide that an employee is any person receiving remuneration, and an employer is any person paying remuneration. This section also states that remuneration means the income defined in section 2 (c) (2) of the Income Tax Act 1970.

Similarly, section 2 (1) (a) of the Social Security Contributions and Benefits Act 1992 (a United Kingdom Act having effect in the Isle of Man) states that an employed earner for the purposes of NICs is a person employed under a contract of service or in an office. Earnings for the purposes of section 3 of the Act just mentioned specifically include 'any payment by a company to or for the benefit of any of its directors', by virtue of regulation 22 of the Social Security (Contributions) Regulations 2001.

It follows that, in normal circumstances, fees paid to a director should be subject both to ITIP and NICs. Exceptions to this rule will be detailed later in this guidance.

#### **Multiple Directorships**

Where a person is a director of more than one company, ITIP and NICs should be deducted by each company in respect of their fees from that company.

The mere holding of multiple directorships by a person does not create self-employment status for taxation and National Insurance purposes.

## **Directors' Fees Paid to Partnerships and Companies**

Where directors' fees are paid by a company in respect of a directorship held by a member of a Manx professional partnership they should, in strictness, be subject to ITIP and NICs. However, the fees may be treated as income of the partnership, and will not therefore be subject to deduction of ITIP and NICs provided that:

- (a) the directorship is a normal incident of the profession and of the particular practice concerned;
- (b) the directors' fees form only a small part of the partnership income; and
- (c) under the partnership agreement, the fees are pooled for division among the partners.

Similarly, directors' fees paid by an Isle of Man company to another Manx company can be treated as income of the other company in certain circumstances, and will not therefore be subject to deduction of ITIP and NICs. The requirements are that a company has the right to appoint a director to the board of another company by virtue of its shareholdings in, or a formal agreement with, the other company and that the director is required to, and does, hand over to the first company any fees or other earnings received in respect of his directorship.

If a formal agreement is not in place between the companies for the director's services, then both ITIP and NICs should be deducted. The agreement must be such that the appointing company can appoint any agreed individual as a director, and not a specific named person. If the agreement provides for a specific person to be a director, then that person will be in receipt of remuneration as an office holder and the fees will be subject to deduction of ITIP and NICs.

The exceptions described above are provided by regulation 27 of the Social Security (Contributions) Regulations 2001, and for income tax purposes by concession.

The practice described above will be extended to include a situation where the first company has no formal right to appoint the director to the board but the director is nevertheless required to (and does) hand over his fees to that company, provided it is:

- (a) a company that is resident in the Isle of Man for income tax purposes or, if non-resident, is trading through a branch or agency in the Isle of Man so that its income is chargeable to income tax in the Island and the fees form part of that income; and
- (b) not a company over which the director has control (for this purpose 'control' has the meaning given to it by section 119A of the Income Tax Act 1970, but in determining whether the company is controlled by the director the rights and powers of his spouse, his children and their spouses and his parents will also be taken into account).

## **Directors' Fees Paid to a Non-resident**

Due to the reciprocal agreement on National Insurance between the Isle of Man and the United Kingdom, a company should deduct NICs from payments it makes to United Kingdom-resident directors unless the exceptions described above apply. The withholding of income tax will not be required provided that the fees are in the scope of the extra-statutory concession set out in Government Circular No 26/06 issued by the Income Tax Division.

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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.