



Isle of Man
Government

Reilhtys Ellan Vannin

The Treasury *Yn Tashtey*

Assessor
I Q Kelly

Telephone: (01624) 685400
Fax: (01624) 685351
E-mail: incometax@itd.gov.im
Website: www.gov.im/incometax

INCOME TAX DIVISION

Government Office, Douglas
Isle of Man, British Isles
IM1 3TX

PRACTICE NOTE

PN 94/02

Date: 4th December 2002

Capital Distributions

Introduction

UPDATED – THIS PRACTICE NOTE IS WITHDRAWN WITH EFFECT FROM 21 FEBRUARY 2012. PLEASE REFER TO PN174/12

Following the reduction in the rate of income tax for trading companies, a number of requests have been made for the Division to clarify the position with regard to "capital distributions". This Practice Note outlines the Divisions current practice.

Statutory Position

The statutory position for granting relief and charging income tax on a distribution of income from an association is contained in Sections 25 and 25A of the Income Tax Act 1970 (as Amended). By virtue of Section 25 Income Tax Act 1970 "an association shall not be liable on so much of its income as shall be distributed among its shareholders or stakeholders, members or associates, by way of a dividend bonus interest or share in profit". The recipient of the distribution will usually be charged to income tax on a preceding year basis.

Where the Division is satisfied that the distribution being paid is not an income distribution but one of a purely capital nature i.e. the disposal of a long held fixed asset of the company, Sections 25 and 25A do not apply. The association will be able to make the distribution without a claim for relief and it will not be charged to income tax in the hands of the recipient.

Concessional Practice

Where a company has chosen not to distribute any part of its income or profits for a number of years and it has added to its reserves, the Division has concessionally allowed these taxed income reserves to be distributed in the same manner as a capital distribution, **provided that there was no income tax advantage to either party**. This concessional practice has been subject to a clearance procedure via the Division.

Due to the differential in the rates of individual and company taxation it is important that this clearance procedure is not now abused. The Division will continue the concessional

treatment where there is no tax advantage to either party and therefore reserves accumulated up to and including accounting periods ending in the 1999/2000 tax year will be granted clearance. However, where taxed reserves are distributed which have been accumulated in accounting periods ending after 5th April 2000 the Division will adopt a strict statutory position and treat them in accordance with the provisions under Sections 25 and 25A of the Income Tax Act 1970.

Clearance may still be granted where a company has profits/ income, which are wholly charged to tax in another country and which makes a distribution to an Isle of Man resident in sole ownership.

The Division may also, by concession, grant clearance where a company can demonstrate a good business reason for the dividend to be treated as though it was of a capital nature.

Example 1

A company has taxed reserves carried forward from the accounting period ending on 30.6.1999 of £50,000 and has made a net profit for the accounting period ending on 30.6.2000 of £50,000.

In 2000/2001 the company has paid a dividend of £30,000 and has requested clearance for a "capital distribution" from taxed reserves of £60,000.

In this case the Division will give clearance for £50,000 being the taxed reserves carried forward, however clearance for the £10,000 balance will not be given the concessional treatment and will be treated as a normal dividend.

The £50,000 for which approval is granted will not be relieved on the company and will equally not be charged in the hands of the recipient. The remaining payment of £40,000 i.e. £10,000 plus £30,000 will be relieved as a dividend and will be taxed on the recipient.

Example 2

An Isle of Man investment holding company whose only income is UK rents has requested clearance for a "capital distribution".

Clearance will be granted in the following circumstances: -

- All of the rents are charged to tax in the UK and the company has been granted double tax relief.
- The distribution is made to the Isle of Man resident beneficial owner in control of the company.
- If the income of the company was charged on the individual using the "look through" principle no further tax liability would arise.

Clearance Procedure:

Requests for clearance should be made in advance of the proposed capital distribution and should be addressed to the Head of Assessing.

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.