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The Taxation Strategy

2012-2016

A Consultation

Issued by:

Income Tax Division
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1. Introduction

The Treasury Minister, Hon. Eddie Teare, MHK, announced in his first budget on 21 February 2012, "I will commit today to publishing a new tax strategy before the end of this year which, if supported by Tynwald, will indicate the areas of the taxation system which I would like to update while I am Treasury Minister."

As part of the preparation of that strategy, Treasury is issuing this consultation document so as to stimulate debate on a key aspect of Government in the Isle of Man; and to seek the views of the Manx community, both private and business, on future changes to our taxation and national insurance systems. To assist anyone who wishes to respond to this consultation, Treasury is also publishing a factual information review today titled 'Consultation Background Information'.

Treasury aims to have in place an income tax and national insurance regime which, so far as possible:

- is fair;
- is simple to comply with;
- is simple to administer; and
- maintains and improves the competitive position of the Island.

Although easy to set out, those aims are far from easy to achieve, especially in view of the Isle of Man's current financial circumstances.

It is assumed in this document that the settled view of Tynwald remains that the Isle of Man should not have capital gains or inheritance/death taxes; and so no further comment will be made about them.

2. Taxation of individuals

The aims of the Treasury, which were set out in the introduction, have the biggest impact on individuals, simply because this is the biggest group of taxpayers by a significant margin. We feel that everyone wants the Isle of Man to have a fair tax system, which is applied impartially. Similarly, no one wants to have a very complicated tax return to deal with every year; then followed by drawn-out discussions with the Income Tax Division. Treasury should demonstrate value for money and ensure that running the system is as efficient and as effective as possible. Finally, having a regime which is based on simplicity and low rates of tax can make the Island more attractive to people who are considering moving here to work.

However, in reviewing these aims, some problems become apparent immediately.

Most, if not all people like the allowances and reliefs which reduce their tax bills. At the same time, it is often these allowances and reliefs which lead directly to complexity and so make it harder for people to manage their tax affairs; because they need to be claimed and because figures and paperwork often need to be provided too. In general, allowances and reliefs tend to be claimed more by and to have more effect on the tax position of the better-off.

We all want to have our tax affairs dealt with in confidence, and some people worry about the Government being able to gather information from third parties, such as the banks, regarding any aspect of their finances without their knowledge. But, if more information could be provided to the Income Tax Division automatically, thousands of people would not need to do a tax return and this would make things easier for them overall.

At present, our tax code system which applies where tax is deducted at source is not as accurate as it could be, and this leads to many people finding either that they either receive a refund or have some tax to pay: often some time after the end of the tax year. In part, this results from the way that allowances and reliefs are given. It can also result from the way that married couples and civil partners can amalgamate their tax affairs: known as joint taxation.

The Government has provided a wide range of internet-based services for the community over the last few years, including online tax services. They have been designed to be easy to use, and at present a significant number of individuals and businesses use them. If the use of online services becomes the norm, it will be much more straightforward for the Income Tax Division to manage the underlying information and thus to reduce its costs.

In relation to the taxation of individuals, Treasury invites comments on the following questions.

Question 1

What changes might make the tax system for individuals fairer?

Question 2

What changes might make the tax system for individuals simpler to deal with?

Question 3

What changes might make the tax system for individuals simpler to administer?

Question 4

Would you think it fair if Treasury simplified the tax system for individuals by removing all allowances and reliefs other than the basic personal tax-free income allowance, but made this cost-neutral in total by increasing the personal allowance level or reducing tax rates?

Question 5

Is it better to support potentially vulnerable groups who currently receive additional tax allowances, such as the elderly, blind, disabled and single parents, through the benefits system rather than the tax system?

Question 6

Is it better to support the less well off who currently receive the personal allowance credit through the benefits system rather than the tax system?

Question 7

Should the current system based on a personal allowance level followed by bands of income taxed at 10% then 20%, with a final tax cap of £120,000 per year be maintained, or should other approaches be considered: e.g. a 'flat tax' rate, or additional rates of tax on different bands of income?

Question 8

Do you think that the Assessor of Income tax should collect details of interest paid to and paid by Manx residents from banks etc. in the Isle of Man so that such information would not need to be entered on tax returns, and if so, would you object if the banks etc. also held tax reference or national insurance numbers?

Question 9

Should there be

- independent taxation for all;
- the freedom to choose to transfer unutilised tax allowances and reliefs between spouses and civil partners; or
- a continuation of joint taxation for married couples and civil partners?

Question 10

Should the use of online tax services by individuals be made compulsory, and if not, how can people be encouraged to use them?

Question 11

Should the current tax return deadline of 6 October be maintained or changed to an earlier or later date; and should the deadline be the same for paper and online return submissions?

3. National insurance

The Isle of Man has had reciprocal social security arrangements with the UK for many years. The practical outcome of these arrangements is that the national insurance and benefits systems in the Isle of Man and the UK are identical for most purposes; and very similar otherwise. With a small number of exceptions, such as the Manx pension supplement, the UK has done all policy and legal development in relation to the social security system. This reciprocity has been viewed as beneficial to the Island over the years, in that the movement of people between the UK and the Isle of Man has been made easier by the transferability of national insurance records and hence entitlement to most benefits.

The reciprocal arrangements are not necessarily all good for the Island, however. Policy and legislation in the UK have been influenced by the size and demographic distribution of its population, which is now estimated to be over 62 million; and by the regular changes in the approach of governments based on their party political manifestos. It is debatable whether such influences meet the needs of a country with a population of 85,000 people and a parliament mainly composed of independent members with no party policy platforms. Matters have become more challenging following the UK election in 2010; as the coalition government has embarked on major changes to the benefits system, including the state retirement pension, and is seeking to bring together the income tax and national insurance systems wherever possible.

The Isle of Man Government which came into office in 2011 has announced that the benefits and national insurance system will be reviewed in detail. Part of this review must involve asking whether we should now have a Manx social security system which is distinct from that in the UK and which meets the current and future needs of the Isle of Man.

Certain aspects of the national insurance system are problematic, and the Isle of Man Government may seek to change them as a consequence.

Currently individuals earning between £107 and £118 per week do not pay any national insurance on their earnings but still build up entitlement to benefits. As dividends and 'benefits in kind' are not subject to national insurance, the rules can be seen as encouraging (legally of course) the setting up of companies from which their owners draw a salary of less than £118 per week and take the remaining

part of their income in the form of dividends or benefits in kind. That this is an anomaly can be seen from considering the national minimum wage of £6.20 per hour; which would give weekly earnings of in the region of £230 and would be subject to national insurance.

As mentioned above, the UK is looking to align income tax and national insurance. The issue driving this move is the same in the Isle of Man: namely that the levying of income tax and national insurance are based on completely different definitions, reference periods, limits, thresholds and rates. This leads to a heavy 'red tape' burden for employers, who are obliged to run what amounts to two distinct systems in parallel. Employed people and self-employed people also face different national insurance rules and rates.

When the national insurance system was introduced, its aim was to oblige people to make contributions to a fund from which, when circumstances dictated, certain benefits would be payable. This 'contributory principle' has been eroded over the years, and now many benefits could be paid without the recipient ever having made national insurance contributions. In addition, employers must pay a form of national insurance which does not affect the benefits entitlement of their employees, and which can, therefore, be seen as little more than a payroll tax. In times when the revenue available to pay for public services is restricted, and when economic growth is of vital importance, both of the points highlighted cannot be ignored.

In relation to national insurance, Treasury invites comments on the following questions.

Question 12

What does the Isle of Man gain from continuing the current reciprocal arrangements with the UK?

Question 13

Does having a Manx national insurance scheme based on the UK scheme help or hinder the Isle of Man when trying to recruit employees and develop the economy?

Question 14

Should income tax and national insurance be more closely aligned in the Isle of Man?

Question 15

Should the scope of national insurance be widened to include other forms of income, for example benefits in kind, dividends from personally owned companies and pensions received before the state retirement age?

Question 16

Should self-employed people pay the same rate of national insurance as employees and be entitled to the same contributory benefits?

4. Taxation of businesses

The taxation of businesses in the Isle of Man takes two basic forms. If the business income is received by a company then it is taxed at a rate of 0%: and if the income is from banking business or is derived from Manx land and property, the rate is 10%. For sole traders and partnerships (i.e. unincorporated businesses), the business profit, once determined and allocated, is subject to the normal individual income tax system.

The Government is committed to retaining a tax-neutral form of business structure in the Isle of Man as a key aspect of our competitiveness. At the same time, it is accepted that the 0% rate, which was preceded by the tax exempt company system, leads to some negative comment internationally and was one of the features of our tax system which the EU Code of Conduct Group reviewed in the 2010-2011 period.

If the Isle of Man is to compete with a 0% tax rate for most forms of business income, then in the main we are reliant upon the taxation of the employees and resident shareholders of those businesses for producing public revenue. However, the taxation of business profits is only one business cost; and the Isle of Man could also compete for economic activity and new employment by looking at other approaches to reducing the costs of doing business here: for example, the rating system, electricity tariffs and employer national insurance.

Other countries with '0/10' regimes similar to our own nevertheless have different approaches. In Jersey, regulated financial services companies are taxed at 10%; not only the banks. In Guernsey, regulated utilities are taxed at 20%.

It is also of interest that some countries operate without income taxes at all, and derive more of their public revenues from, for example, import duties, VAT or equivalent taxes and fees for work permits.

For smaller businesses we need to try to ensure that they have a simple, easy to deal with tax system; as this will also add to our competitiveness.

In relation to the taxation of businesses, Treasury invites comments on the following questions.

Question 17

Should the coverage of the 10% tax rate be widened: and if so to which business sectors?

Question 18

Should capital allowances be retained, and, if so, how could the system be simplified or used to incentivise business investment?

Question 19

Should tax-deductible accounts-based depreciation in some form replace capital allowances?

Question 20

Would increasing the current £15,000 turnover limit for the three line statement system (income, expenses and profit) make the tax system simpler for unincorporated businesses, and if so, by how much should the limit be raised?

Question 21

Would you support the introduction of a further simple system for unincorporated businesses where 'expenses' are allowed as a set percentage of turnover without the need for a claim to be made or records submitted?

Question 22

Should the use of online tax services by companies be made compulsory, and if not, how can they be encouraged to use them?

5. International taxation issues

A report by the Council of Ministers was approved by Tynwald in 2000 titled, "The Organisation for Economic Co-operation and Development – Harmful Tax Competition". The extracts below have formed the policy behind much of our international tax work since then.

"The Isle of Man Government remains committed to preserving the Island's status as a top class financial centre with good regulation and co-operation with other jurisdictions, conducting high-quality, substantial business with transparency and full participation in the work of international regulatory organisations. It is implicit in this principle that the Island will, so far as that is consistent with the pursuit of the economic well-being of its people, endeavour to comply with international standards and norms and it is part of the Island's responsibilities to assess those standards and norms in relation to

taxation, as with other areas, to ensure the Island's practices remain compatible with such standards and norms."

"It would be consistent with the Isle of Man Government's approach to other aspects of the management of the financial services industry if the Island adopted any international standards and norms that evolve in relation to taxation. Clearly, this approach would not commit the Island to acting unilaterally and in advance of the international community, but it would mean adopting policies and practices which were consistent with mainstream international standards."

In December 2000, the Isle of Man Government gave a commitment to the OECD: *"To allow tax information to be exchanged, on a reciprocal basis, with other tax authorities, upon request, and in accordance with tax information exchange agreements to be negotiated."* It should be noted that exchange of tax-related information in respect of a single taxpayer on request remains the current OECD standard. This is not the case with the EU, where the potential for automatic sharing of bulk information in respect of many taxpayers has been envisaged in Directives since the 1970s.

In 2002 the Isle of Man committed to apply the EU Directive on the Taxation of Savings Income in the Form of Interest Payments (EUSD); which meant offering EU-resident investors a choice between a withholding tax deducted at source from their interest payments or automatic sharing with their country of residence of details of the interest earned on their accounts.

In June 2009, the Isle of Man signalled a further change in its position regarding exchange of information for tax purposes, which led to automatic exchange of information under the EUSD being made the only option here from July 2011. This move was perceived by many as keeping the Isle of Man at the forefront of small financial services centres in implementing tax co-operation policies.

Many international taxation issues affect the Isle of Man because of the financial services which we provide to global markets. As markets change, so do the rules associated with them; including in the tax area. Since 2000, for example, the Isle of Man has amended its laws and has signed a large number of tax co-operation agreements with other countries.

A significant change faced by businesses in the Isle of Man and elsewhere is the United States Foreign Account Tax Compliance Act (FATCA). Full compliance with this law will involve the automatic exchange of tax information. The Government will do all that it can to make complying with FATCA a straightforward process for Isle of Man businesses.

The Isle of Man does not have certain co-operation options which are commonly followed by other countries; especially as part of comprehensive double taxation agreements. One of these is assistance in the recovery of the other country's tax debts.

Another potential area of change is the programme promoted by the G20 and other international bodies to bring the countries of the developing world into the tax co-operation community. An instrument which has been updated specifically for this purpose is the multilateral Convention on Mutual Administrative Assistance in Tax Matters.

In relation to international taxation issues, Treasury invites comments on the following questions.

Question 23

Should the Isle of Man seek to stay at the forefront of small financial services centres in implementing tax co-operation policies?

Question 24

Should the Isle of Man do more in the area of international tax co-operation and, if so, what would be appropriate?

Question 25

Should we have an array of tax law which allows us to finalise all aspects of a double taxation agreement, and in particular assistance in the recovery of tax debts?

Question 26

Should the Isle of Man engage more in the movement to assist developing countries, for example by becoming a party to the multilateral convention?

6. Simplification

In relation to simplification of the tax and national insurance systems, Treasury invites comments on the following questions.

Question 27

The income tax instalment payment (ITIP) system operates on a non-cumulative basis, which results in many people needing to pay some tax or receive a refund each year due to incorrect tax codes or changes in jobs or salaries. Should the Isle of Man move to a cumulative tax code system?

Question 28

Should employers be required to submit employee ITIP and national insurance information each month instead of annually ("real time information") as is happening in the UK?

Question 29

We operate a payment on account system for those taxpayers whose income is not subject to ITIP. Are there any alternative methods which would maintain the level of revenue receipts yet be simpler to comply with and to administer?

Question 30

Would it be helpful if all tax legislation was consolidated into a single Act of Tynwald and rewritten in plain English?

7. How to respond to this consultation

Although a number of questions have been included in this consultation document, Treasury also welcomes comments on any issues which can be considered to be part of a national taxation strategy.

The consultation will run until close of business on 7 September 2012. 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.

Comments can be submitted in writing either by post or email at the following addresses:

The Taxation Strategy Consultation
Income Tax Division
The Treasury
Government Office
Douglas IM1 3TX

Email: consultation@itd.treasury.gov.im

In line with the Isle of Man Government Code of Practice on Consultation, we will summarise responses and publish the summary within four weeks of the end of the consultation period.