

Taxation of Income Derived from Land and Property in the Isle of Man

Consultation Document

Issued By:

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



Date of Issue: 3 October 2005

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

1 INTRODUCTION 1

2 A SCHEDULAR SYSTEM..... 1

3 INCOME DERIVED FROM LAND AND PROPERTY 2

 3.1 Rental Income 2

 3.2 Property Development Income..... 2

 3.3 Other Income 3

4 OTHER PROPOSED CHANGES TO THE CLAUSES OF THE FIRST 2005 BILL..... 4

 4.1 Exemptions 4

 4.2 Disposal of land by a non-resident 4

 4.3 Development Levy 4

 4.4 The Rate of Tax..... 4

5 THE TAXATION OF LAND TRANSACTIONS IN OTHER JURISDICTIONS..... 5

 5.1 Jersey 5

 5.2 Guernsey 5

 5.3 United Kingdom..... 6

 5.4 Ireland..... 6

 5.5 Gibraltar 6

6 SUBMISSIONS..... 6

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

1 INTRODUCTION

For many years concern has been expressed that land is a national asset that should be protected and should not be exploited for the benefit of a small number of people.

The buying, selling and development of land and property and the effect that these may have on prices is of genuine concern to the Isle of Man Government. Treasury and the Income Tax Division are also concerned that there should be certainty in respect of the taxability of transactions in land and property. Many land transactions result in a capital profit and Treasury has no intention of taxing them. Certain transactions however, are of an income nature and may be escaping tax.

With the move to a general 0% rate of income tax for companies, non-resident owners could potentially extract profits from land transactions or Manx property rental income without paying Manx income tax. Treasury feels that this is not appropriate and therefore proposes the introduction of a schedular tax system for income¹ derived from land and property in the Isle of Man. When using the term 'schedular', we mean that the Taxes Acts would define a class of income and how that class of income would be taxed separately from the rules applying to general income.

Treasury proposes that the relevant legislation will be presented as a stand-alone Bill incorporating revised clauses that had originally been presented in the first Income Tax (Amendment) Bill 2005. The introduction of this legislation in the House of Keys will come after the new company tax legislation.

2 A SCHEDULAR SYSTEM

Within our current legislation rental income is taxed as a separate source subject to its own discrete rules.

We propose treating all income derived from land and property in a similar way, which would mean that:

- Income derived from land and property (as defined below) will be subject to a specific rate of tax. This rate could vary between types of taxpayer if necessary. As a rate will be charged on the type of income, it will apply even if the income is received by a company that would otherwise be taxed on its income at 0%. There will however still be no tax charge for bodies that are exempt from income tax, such as pension schemes
- The current taxation of rental income will remain largely unchanged, with Sections 58 and 59 of the Income Tax Act 1970 continuing to apply

¹ Throughout the document, the term 'income' should be taken to include profit in the context of the business of traders, whether incorporated or unincorporated.

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

- Losses will be relievably against income from sources within the schedule and against general income in the same way that trading losses are relieved. The carrying forward of excess property-related expenditure against rental income and pooling will therefore continue

3 INCOME DERIVED FROM LAND AND PROPERTY

The schedule of income derived from land and property will include:

- Rental income
- Property development income
- Other income sources as may be defined in the Bill e.g. mineral extraction

3.1 Rental Income

The concept of rental income is well understood and we do not propose to cover it in detail in this document.

3.2 Property Development Income

It is proposed that a widened definition of property development income (including profits from trading in land and property) will be a source of income charged to tax under this schedule.

Part 3 of the first Income Tax (Amendment) Bill 2005 proposed taxing the income arising from various types of disposal of land or property. The Bill included five 'cases' where an income tax charge would occur².

We feel that there is a general recognition in the Isle of Man that large tax-free profits are being made by certain individuals and groups through the buying and selling of property other than their private residence. Consultation has shown that whilst there is general agreement that certainty in legislation in relation to the taxation of such transactions is desirable, the same level of agreement does not exist in relation to the proposed scope of that legislation.

² CASE A - was a charge on a profit arising from a disposal of land which was not an individual's only or main residence for 18 months before the disposal and which he did not own for the whole of the 5 years preceding the disposal.

CASE B - was a charge where there was a profit arising from a disposal of land by any person, other than an individual, who did not carry on the trade of property developer during the previous 7 years and which he did not own for 5 years before disposal.

CASE C - was a charge on the disposal by a property developer and taxed the profit on any disposal that was not already chargeable as trading income, resulting from the sale of property owned for a period not exceeding 7 years.

CASE D - was a charge on the disposal of land or property which was the only or main residence of an individual for eighteen months but in circumstances that indicated that he did not have the means to meet personal day to day living expenses. This case sought to charge those individuals who make a living from renovating properties and then selling.

CASE E - enabled Treasury by order to specify further circumstances which would be chargeable to income tax.

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

Negative views were expressed to varying degrees about most of the cases presented in the first Bill, with a principal concern being that people could find themselves being taxed when they sold their own home within eighteen months of moving into it.

We must aim to provide a set of rules which distinguishes clearly between transactions in land and property giving rise to a taxable profit and those giving rise to a tax-free capital gain.

It is proposed that the charging provisions are simplified and based on a single definition of property development income³. Part of this definition will tax the profit on a disposal of land or property where it has not been owned for at least five years⁴.

In order that the sale of a person's home does not become taxable, we propose an exemption where the disposal is that of a dwelling house⁵ which has been the person's only or main residence⁶ throughout the period of ownership. Where a person has two or more residences, whether owned in their own name or by a related party, they may nominate which is to be treated as their main residence.

This change in what we propose removes the 'tax trap' that could have caught someone who moved to the Island, bought a house and moved again within 18 months. It also removes the 'tax trap' where an individual moves house before being able to sell their main residence. The new proposal reduces the number of exemptions that were originally proposed relating to the disposal of a person's only or main residence.

We will seek to charge the profit from the sale of a second property where that property has been owned by an individual or a related party for less than five years. For all other persons we will seek to charge the profit from any sale where the land or property has been owned for less than five years.

3.3 Other Income

We would propose that income derived from the exploitation of materials found beneath the soil overburden (minerals, aggregates etc.) is included within the schedule of income derived from land and property.

³ The Division may challenge other cases where considered appropriate under normal principles.

⁴ "At least five years" – a period of five calendar years will run from the date that ownership of the land or property is transferred to the person. Where land has been in ownership for more than five years and is later developed, the five year period will start from the date of the completion certificate for the property.

⁵ "Dwelling House" - A dwelling house will include gardens or grounds of up to half a hectare in area, or such larger area as the Assessor may determine as being required for the reasonable enjoyment of the residence.

⁶ "Only or main residence" - An individual can at any time have only one main residence. A man and wife living together can have only one main residence between them. If an individual has more than one residence they can elect which one is their main residence. Someone who owns two houses is not by that fact alone able to elect that one is their main residence. For the election to be valid, it is necessary to demonstrate that the house is a residence, and this requires occupation of the property with some degree of continuity or permanence, or the expectation of it.

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

4 OTHER PROPOSED CHANGES TO THE CLAUSES OF THE FIRST 2005 BILL**4.1 Exemptions**

Part 2 of the first 2005 Bill included an extensive list of exemptions from the charge to income tax. Whilst some exemptions remain necessary (e.g. the sale of an individual's only or main residence) those exemptions provided in the first Bill in respect of leaving the Island and circumstances outside the individual's control can be removed.

4.2 Disposal of land by a non-resident

Part 2 of the first 2005 Bill included supplementary provisions (within Paragraph 18) dealing with the situation where a person selling land or property is resident outside the Isle of Man. Advocates acting on behalf of the person making the disposal would have been required to withhold income tax and to remit that tax within 14 days of making the deduction. An advance clearance procedure was envisaged, where the Assessor could rule that a disposal by a non-resident was exempt from charge and that deduction of tax was not required.

This part of the Bill came in for particular criticism from the Isle of Man Law Society. They felt very strongly that it was an unfair imposition in an area of work which already has obligations in relation to land registration. They also considered that provisions could encourage non-residents to sell property on the Island without using advocates.

It is proposed that this part of the first Bill is not re-introduced and that we should review the payment of tax by non-residents. Tax due from non-residents is difficult to pursue and requires a more proactive enforcement regime. Should we proceed on this basis, therefore, an expected reduction in the burden on our compliance activities will not be delivered in the short-term. If there appears to be vulnerability in this area, amendments could be introduced in a later income tax bill and after further consultation.

4.3 Development Levy

Another option for consideration is a charge similar to that proposed in the Jersey Fiscal Strategy document, which could be triggered where land is reclassified from a low value use to a higher value (e.g. agricultural to residential use). By rezoning land for development, Government increases the value of that land. Any profit arising on the development or sale of the land within, say five years, could be classed as property development income as covered earlier in this paper.

4.4 The Rate of Tax

Within the proposed Bill we can set a single rate of tax applying to all income derived from land and property, whether it is received by a company, trust or individual and regardless of the taxable status of that taxpayer in terms of other sources of income. It will also be possible, should Treasury wish, to charge different entities at different rates of tax on the same type of income.

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

Alternatively, Part 5 of the Income Tax (Amendment) (No.2) Bill 2005 currently before the House of Keys will give Treasury the power, by Order, to introduce rates of tax specific to certain types of income.

Both approaches would ensure that all persons continue to pay tax on income from land and property, even after the introduction of the 0% rate of tax for companies. As the Minister has made clear that we will implement our "0/10" strategy with effect from April 2006, it is proposed that Treasury follows the route of making an Order so that the scheduling of income from land and property has effect from April 2006 also. The proposed land and property Bill can then consolidate the Order and provide greater definition, especially in the area of property development income.

It is proposed that a rate of 10% should apply to income from land and property. This rate should be acceptable to business and the general population alike, being the same as the current lower rate of personal income tax and the current rate of corporate income tax. The 10% rate would also continue Treasury's practice in respect of commercial letting income, which is, by concession, taxed at a rate of 10% despite being investment income that would otherwise be taxable at a rate of 18%.

This consultancy document is underpinned by the concept of land being a precious national asset; the final proposal is in respect of what is essentially the rate of tax applying to income from land and property. Should Treasury decide to introduce a cap on the tax liabilities of individuals, it is proposed that income from land and property received by an individual (including dividend income from companies deriving their income from Manx land and property) should be excluded from the tax cap regime.

5 THE TAXATION OF LAND TRANSACTIONS IN OTHER JURISDICTIONS**5.1 Jersey**

Jersey currently has a sliding scale of stamp duty charge on the transfer and purchase of property. There is no charge to tax on land transactions unless a trading motive can be proved. However within the recently issued Fiscal Strategy, Jersey has proposed the introduction of a development levy. This would charge development gains when land is reclassified from a lower value use (e.g. agricultural) to a higher value use (e.g. housing). As the increase in value is due to a decision of government rather than through the efforts or risk of the landowner, taxes are advocated as a means of capturing some of the substantial gain through a development levy. It is suggested within the strategy document that the rate of this levy could be set as high as 50% of the gain.

5.2 Guernsey

Guernsey has had a dwellings profit tax since 1975 which is very similar to the land speculation tax that the Isle of Man introduced a year earlier and repealed in 1985. Income tax is charged on the profits arising from the disposal of land and property, including profits on the sale of the only or main residence of an individual for the first twelve months of ownership.

Taxation of Income Derived from Land and Property in the Isle of Man – Consultation Document

5.3 United Kingdom

The United Kingdom charges all gains on the sale of land and property to capital gains tax, and offers a number of exemptions and reliefs (including principal private residence relief). Stamp duty is charged on the value of the property on sale where the residential property is sold for more than £120,000. The rate of duty varies, ranging from 1% on property sold for between £120,001 and £250,000 to 4% on property sold for more than £500,000.

5.4 Ireland

Ireland is in a similar position to the United Kingdom in that they charge capital gains tax and stamp duty on the sale of land and property.

5.5 Gibraltar

Gibraltar has stamp duty which is currently charged at a rate of 1.26% on the consideration shown in the deed of conveyance, provided that the consideration is at fair value. In addition, if the property is purchased with the assistance of a mortgage, stamp duty is charged at the rate of 0.13% on the sum borrowed.

6 SUBMISSIONS

Anyone wishing to submit their views in relation to the topics in this document is invited to do so, in writing, to:

Chris Barber ATT
Legislation Officer
Income Tax Division
2nd Floor Government Office
Buck's Road
Douglas
IM1 3TX

Email: consultation@itd.treasury.gov.im