



**Isle of Man  
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## **INCOME TAX DIVISION**

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## **PRACTICE NOTE**

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**PN 181/13**

**Date: 22 March 2013**

### **BUDGET 2013**

### **The Introduction of a 10% Rate of Income Tax for Resident and Non-Resident Corporate Taxpayers on Retail Business in the Isle of Man**

**Please note that this guidance is an updated and replacement version of PN 181/13, which was originally published on 19 February 2013**

#### **1. Introduction**

Treasury has introduced a new 10% rate of income tax for corporate taxpayers who:

- carry on retail business in the Isle of Man; **and**
- have a taxable profit of more than the "small company limit" of £500,000 from such business.

All other corporate taxpayers carrying on retail business will continue to be chargeable at the standard zero rate.

The £500,000 limit is reduced proportionately for corporate taxpayers with associated companies which also carry on retail business in the Island, or where the accounting period of the corporate taxpayer is less than 12 months.

#### **2. Retail business in the Isle of Man**

##### **2.1 Retail business**

Retail business for the purposes of the new 10% rate of income tax is defined as follows –

*"the sale of goods for consumption or use, whether or not by the buyer, for purposes unconnected with a trade or business; and any ancillary activity;*

For the purpose of the new rate, "goods" will include all assets, commodities, consumer durables, effects, items, materials, produce, products, stock, supplies, merchandise and things for sale.

However, "goods" does not include any provision of a service.

The sale of licences or rights to use a product, for example software, music or films, is not considered to be a sale of "goods".

Retail business will therefore include, for example, supermarkets, car sales, petrol sales, convenience stores, online sales, mail order, etc.

Profits from wholesale trade, where goods are sold to other businesses, will not be chargeable at the new 10% rate.

What constitutes an "ancillary activity" will be agreed on a case by case basis.

## 2.2 Retail business in the Island

In order for the 10% retail tax to apply, the retailer must carry on that retail business in the Isle of Man. Any business whose customers are all outside the Island is not carrying on retail business in the Island and therefore will not be subject to the 10% rate.

If a retailer has both resident and non-resident customers the Assessor would be pleased to discuss the case in order to determine what proportion of the trade is carried on in the Island.

## 3. **Income from a variety of sources**

If a company receives income from a variety of sources, including from retail business, only the retail element will be chargeable at 10%, and then only if that element of the income exceeds the small company limit of £500,000 (unless the other income is already chargeable at 10% e.g. rental income).

The income tax computation should generally be split in order to show the taxable profits/losses from retail business separately from the company's other taxable income. However, where it is clear that the £500,000 threshold will never be met, there will be no requirement to provide split income tax computations, though any company carrying on retail business may still choose to do so.

### **Example 1**

A Ltd is an Isle of Man resident trading company with retail and manufacturing businesses.

#### Profit & Loss Account for the year ended 5 April 2014

|                     |                |
|---------------------|----------------|
| Turnover:           |                |
| Manufacturing Sales | 200,000        |
| Retail Sales        | 650,000        |
|                     | <b>850,000</b> |

|                     |                |
|---------------------|----------------|
| Less:               |                |
| Purchases           | -100,000       |
| <b>Gross Profit</b> | <b>750,000</b> |
| Less:               |                |
| Revenue Expenses    | -139,500       |
| <b>Net Profit</b>   | <b>610,500</b> |

£60,000 of the company's purchases related solely to the manufacturing business, the other £40,000 related solely to the retail business. All other revenue expenditure was incurred equally in the course of acquiring the income of both trades.

Expenses that relate specifically to one income source can be claimed only against that income source. Expenses that relate to all income sources can be claimed against all income sources, and should be pro-rated in the ratio of the income sources.

Assuming all the expenditure is allowable, A Ltd's tax computation would be split as follows:

General Expense Pro-Rating:

|               |         |   |         |   |         |
|---------------|---------|---|---------|---|---------|
| Retail        | 139,500 | x | 650/850 | = | 106,676 |
| Manufacturing | 139,500 | x | 200/850 | = | 32,824  |

Tax Computation:

|                        | Manufacturing (£) | Retail (£)      |
|------------------------|-------------------|-----------------|
| Income                 | 200,000           | 650,000         |
| Less:                  |                   |                 |
| Purchases              | -60,000           | -40,000         |
| Revenue Expenses Costs | <u>-32,824</u>    | <u>-106,676</u> |
| <b>Taxable Profit</b>  | <b>107,176</b>    | <b>503,324</b>  |

A similar principle will apply to capital expenditure on assets that qualify for capital allowances.

If the asset is used solely in the retail business or solely in another trade, the capital allowances should be claimed against that profit only. If the asset is used in more than one trade, the allowances should be pro-rated against the profits of each trade. However, if it can be proven that pro-rating does not reflect the use of the asset in the trades, the Assessor is prepared to discuss an alternative apportionment.

#### 4. Small company limit

The small company limit is £500,000 and applies to taxable income from retail business. Where, in any accounting period, the taxable income in respect of the retail business does not exceed the limit, the standard rate of 0% will apply in respect of every pound of that taxable income.

##### Example 2

B Ltd is an Isle of Man resident trading company with retail business.

B Ltd's year ended 5 April 2014 taxable profit from retail business was £850,000.

As B Ltd's taxable profit from retail business exceeded the £500,000 limit, the whole of B Ltd's taxable profit will be chargeable at 10%, giving a liability to income tax of £85,000.

### **Example 3**

C Ltd is an Isle of Man resident trading company with retail business.

C Ltd's year ended 5 April 2014 taxable profit from retail business was £350,000.

As C Ltd's taxable profit from retail business does not exceed the £500,000 limit, C Ltd's taxable profit will be chargeable at 0%.

## **5. Small company limit for accounting periods of less than 12 months**

Where a corporate taxpayer has an accounting period of less than 12 months, the small company limit should be determined by the following formula:

$$\frac{\pounds 500,000 \times T}{365}$$

where T is the number of days in the relevant accounting period.

### **Example 4**

D Ltd, a resident retail trading company, incorporated on 1 August 2013, makes up its first accounts to 5 April 2014 (243 days).

D Ltd's taxable profit from retail business in its first accounting period was £375,000.

The small company limit for the accounting period is calculated as follows:

$$\frac{\pounds 500,000 \times 243}{365} = \pounds 332,877$$

As D Ltd's taxable profit exceeded the apportioned retail limit of £332,877, D Ltd's taxable profit will be fully chargeable at 10%, giving a liability of £37,500.

## **6. Small company limit: associated companies**

Where a corporate taxpayer has one or more associated companies which also carry on retail business in the accounting period, the small company limit for each of those associated companies is determined by the following formula:

$$\frac{S}{1 + \text{number of associated companies}}$$

where S is the small company limit determined by the calculation in section 4 above.

When applying the small company limit to any accounting period of a corporate taxpayer, an associated company which has not carried on retail business in the Island at any time in that accounting period is disregarded.

One company is an associated company of another at any given time if one of the two has control over the other, or both are under the control of the same person or persons.

**Example 5**

E Ltd and F Ltd are resident trading companies with retail business, wholly owned and controlled by the same Isle of Man resident taxpayer.

In the year ended 5 April 2014, E Ltd had taxable retail business profits of £150,000 whilst F Ltd had taxable retail business profits of £400,000.

The small company limit for each company is calculated as follows:

$$\frac{\pounds 500,000}{(1+1)} = \pounds 250,000$$

As E Ltd’s taxable profit is less than the apportioned small company limit of £250,000, E Ltd’s taxable profit will be fully chargeable at 0%, giving a liability of nil.

However, as F Ltd’s taxable profit exceeds the apportioned small company limit of £250,000, F Ltd’s taxable profit will be fully chargeable at 10%, giving a liability of £40,000.

**7. Transition**

In the first accounting period ending after 6 April 2013, the small company limit should be determined by the formula:

$$\frac{A \times T}{365}$$

where

- A is the small company limit or, if the corporate taxpayer had any associated companies, the figure for the small company limit as determined by proportionately reducing £500,000 by the number of companies associated with the corporate taxpayer in the whole accounting period, and
- T is the number of days in the accounting period which fall on or after 6 April 2013.

**Example 6**

G Ltd is an Isle of Man resident trading company with retail business in the Island.

G Ltd’s year ended 30 June 2013 taxable profit from retail business was £600,000.

The period from 6 April 2013 to 30 June 2013 is 86 days.

The small company limit for the first accounting period is calculated as follows:

$$\frac{\pounds 500,000 \times 86}{365} = \pounds 117,808$$

The profits which accrued from 6 April 2013 would be calculated as follows:

|                              |            |                   |            |
|------------------------------|------------|-------------------|------------|
| 1 July 2012- 5 April 2013:   | £600,000 x | $\frac{279}{365}$ | = £458,630 |
| 6 April 2013 – 30 June 2013: | £600,000 x | $\frac{86}{365}$  | = £141,370 |

As G Ltd's taxable profit since 6 April 2013 is more than the apportioned small company limit of £117,808, £141,370 will be fully chargeable at 10% giving an income tax liability of £14,137. The profits of £458,630 which accrued prior to the 6 April 2013 are chargeable at 0%.

## 8. Group relief

Group relief under Schedule 2 of the Income Tax Act 1980 is only available from a surrendering company against retail business taxable at the prescribed 10% rate in the claimant company, if the loss to be surrendered is from a trade or business that would be subject to a 10% rate of income tax.

If group relief claimed reduces the taxable income in respect of a corporate taxpayer's retail business to less than the small company retail limit, the corporate taxpayer will be chargeable to income tax at the standard rate of 0%.

If the claimant company has more than one source of income, the group relief must be pro-rated between the income sources and cannot be claimed against only the retail business.

## 9. Losses

A loss may only be offset against retail profit if it is derived from retail business.

A company with losses from another trade will not be permitted to offset these losses against any profit from retail business.

A loss brought forward from a previous year in respect of retail business will be allowed to be offset against the profits of a later year of that same retail business, despite the change in the rates of income tax.

A loss offset against retail business profit could have the effect of reducing the rate of tax from 10% to 0% if it reduces the total income from retail business to below the small company limit of £500,000.

## 10. Non-Retail Business

There are a number of activities and trades that do not fall within the definition of retail and will not be subject to the new 10% retail rate.

Businesses which are either primarily service providers, such as travel agents or hairdressers, or which provide goods for consumption at the point of sale, such as public houses and restaurants, which may have small elements of retail are non-retail businesses.

Businesses that supply gas, oil or telecommunications are, in fact, utilities and are not undertaking retail business so do not fall within the 10% retail tax.

Any business that has any doubt as to whether they fall within the new 10% rate should contact the Income Tax Division.

## **11. Avoidance**

Where the Assessor believes that in any year of assessment arrangements exist or have existed which have reduced or postponed the tax liability of the corporate taxpayer, he may assess the corporate taxpayer and its members, or make adjustments to their assessments, in order to protect the revenue: including assessing the whole of the corporate taxpayer's income at a rate of 10%.

The Assessor must give notice of any such assessment or adjustments in writing to the persons affected, and the corporate taxpayer and each affected person can contest that assessment in accordance with section 87 of the Income Tax Act 1970.

These are some of the arrangements which the Assessor may consider to be avoidance:

- the payment of a management fee, commission or other similar payment where such a payment had not been a feature of the retail business prior to the introduction of the change covered in this guidance;
- an associated company or person selling goods on a wholesale basis to the company carrying on the retail business;
- other arrangements with associated companies or persons, which have been set up so as to minimise the profits from a retail business.

### **M Couch**

#### **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.