

# Will the Isle of Man be EU tax compliant?

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## The EU Tax Code

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*The code of conduct... concerns  
those measures which affect... in a  
significant way the location of  
business activity in the Community*

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# The 5 criteria

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To assess if an issue is harmful:

1. Are benefits only for non residents in respect of transactions carried out with non residents?
2. Are advantages ring fenced from the domestic market so they don't affect the national tax base?
3. Are advantages granted without any real economic activity taking place within the State?
4. Are rules for calculating taxable profit significantly different from the OECD norm?
5. Do tax measures lack transparency, including at administration level?

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# Where the IoM fell foul

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F059	Free Depreciation and Balancing Charges on Ships
F060	Special Depreciation for Tourist Premises
F061	International Business Companies
F062	Exemption for Non-resident Companies
F063	Exempt Insurance Companies
F064	Tax Holidays for Industrial Undertakings
F065	International Loan Business
F066	Offshore Banking Business
F067	Fund Management
F068	Exempt Public Companies
F069	Film Industry Tax Credits

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# The IoM Exempt Company

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- *F062 Exemption for non-resident companies*

Manx resident companies owned by non-residents and which do not trade in the Isle of Man and do not have any source of income in the island (apart from interest from the IOM Government or bank interest) are exempt from tax, but are subject to an annual fee of £400.

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## The IoM's answer

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A new Tax Strategy was announced in June 2000:

- a reduction in company tax rates
- an undertaking to remove so-called 'harmful tax practices' as specified by OECD and the EU

Modifications to the Tax Strategy were announced in October 2002:

- to comply with the EU Code of Conduct, and
- reduce the mainstream company tax rate to 0%.

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# The IoM Logic

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If tax on all Manx companies = 0% then no one can be advantaged or disadvantaged by

- offshore,
- non resident owned,
- non tax resident, and
- non local trading companies paying 0% tax.

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# Can the IoM afford this?

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The 2005/06 budget is:

Income Source	Estimate £m	Probable £m	Difference £m	%
Value Added Tax	249.0	266.9	17.9	7.2
Resident Income Tax	92.0	95.9	3.9	4.2
Company Tax	35.0	35.0		
Non-Resident Tax	17.5	14.0	(3.5)	(20.0)
Hydrocarbon Oils	26.5	25.8	(0.7)	(2.6)
Tobacco, etc.	19.7	19.5	(0.2)	(1.0)
Other	19.1	19.5	0.4	2.1
	<b>458.8</b>	<b>476.6</b>	<b>17.8</b>	<b>3.9</b>

There is no desire to lose much of that £35 million

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# Current IoM tax rates

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1. For 2005-06 resident persons will be charged to Income Tax as follows:

- (a) individuals:
  - Single - 10% on the first £10,300 of taxable income and 18% on the balance
  - Married - 10% on the first £20,600 of taxable income and 18% on the balance
- (b) companies:
  - Trading profit - 10% on all trading profits up to £100 million
  - Other income - 18% on all other income

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## How to square the circle?

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1. Charge banks to tax at 10%:
  - n Details not yet announced
  - n Will only be those regulated in the IoM
  - n But IoM regulation is tight. This should be acceptable under EU Code
2. Introduce the “distributable profits charge”

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# The Distributable Profits Charge

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From IoM consultation document on this charge:

*“This regime is required in order to discourage corporate taxpayers from retaining profits that have been subjected to tax rates lower than those for individuals, and to maintain the flow of Treasury receipts after the move to a mainstream company tax rate of 0%.”*

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## Who does it apply to?

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*“The regime will operate by calculating a payment in respect of the distributable profits of the company attributable to Manx resident shareholders which will be payable by the company as agent for the resident shareholders on account of the shareholders’ tax liability in respect of their entitlement to a share of those profits.”*

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## How it will be calculated?

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*“Distributable Profit” will be calculated using the normal income tax computation; therefore it will be the same as taxable income calculated within the current regime, except that there will be no longer be a deduction for dividends paid during the year.*

*The current tax computation takes into account capital allowances for capital expenditure, as well as group and loss relief provisions, and this treatment will not change when the new charge is introduced.*

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## How much is it?

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1. Trading income
  - n 18% (higher personal tax rate) of 60% of distributable profit
2. Non trading income:
  - n 18% of 100% of distributable profit

The resulting payment is a credit to these limits in the individual Isle of Man resident recipient's tax calculation.

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## Who pays this?

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The company does.

It has no choice.

It will be legally liable to pay a sum calculated as if it were tax but only if it has loM resident shareholders.

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## So what does 0% now mean?

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In the Isle of Man 0% tax on corporations now means at least 10.8% tax if you have loM resident shareholders

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## What does the IoM think this means?

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*“It is now apparent, from an international initiative perspective, that a zero rate of tax is not harmful as long as it is applied fairly within an economy and does not discriminate between resident and non-resident participators. The approach taken by the island was recently described by The Daily Telegraph as "a neat piece of footwork". “*

Andrew Corlett, Cains, Solicitors, Douglas, IoM April 2005 [http://www.cains.co.im/E-Library/IOMNews/iom\\_news016.htm](http://www.cains.co.im/E-Library/IOMNews/iom_news016.htm)



## What does this actually mean?

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The IoM has:

1. introduced a charge on companies,
2. calculated it as if tax,
3. made a company liable for it,
4. only required this if the shareholders are Isle of Man resident;

As such it is discriminating between participators



## Why has it done this?

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- *To maintain the flow of Treasury receipts after the move to a mainstream company tax rate of 0%.*
- *To discourage corporate taxpayers from retaining profits that have been subjected to tax rates lower than those for individuals.*
- *But only in respect of the distributable profits of the company attributable to Manx resident shareholders.*

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## Does this comply with the Code? (I)

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According to the IoM **Yes** because:

*The profits distribution charge is a personal tax issue and not a business tax issue and therefore is outside the Code*

Malcolm Couch, Head of Income Tax Division, IoM Treasury, in conversation 23 May 2005

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## Does this comply with the Code? (2)

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According to me *No* because:

This is a tax:

1. it's calculated as tax;
2. the company is legally liable to pay it;
3. it's akin to Advance Corporation Tax as seen in some tax imputation systems.

But it only applies to IoM resident owned companies.

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## Does this comply with the Code? (3)

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If this is a tax paid by companies but only with regard to resident tax payers it must fail EU Code test 2:

*Are advantages ring fenced from the domestic market so they don't affect the national tax base?*

In fact, the IoM says that's its intent!

So, it has deliberately recreated the “ring fence”.

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## Does this comply with the Code? (4)

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No, because companies owned by non residents get an advantage. They can accumulate reserves tax free and loM companies cannot to the same degree.

And that's exactly what the loM have said they intend.

So this is a “*measures which affects... in a significant way the location of business activity in the Community*” and so breaches the spirit of the Code

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## Why has this happened?

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1. The loM does not seem to understand Principles; it's used to applying legal form;
2. The loM does not want to ask the EU whether it has complied – it wants to believe it is independent;
3. The loM has not asked the EU as a result.

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## Can the outcome be challenged?

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Yes.

The EU Code allows any State to ask the UK for information on legislation put in place by the IoM to implement the Code.

Any State can challenge that legislation if it believes it contrary to that Code.

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## Is the IoM safe from challenge?

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On 24 May 2005 The Hon Member for Michael (Mr Cannan) asked the Minister for the Treasury in the House of Keys:

(1) Has the Treasury or the Isle of Man Government received written assurance from the United Kingdom Treasury and the European Union Code-of-Conduct Group that the Isle of Man taxation strategy of no tax liability on non-residential shareholders and the 60% compulsory distribution of profits to resident shareholders who are then taxed on the distribution, is acceptable; and, if so

(2) will you provide Members of Tynwald with a copy of the written assurance from both the United Kingdom Treasury and the European Union Code-of-Conduct Group?

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## The IoM response? (1)

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*The Isle of Man is not part of the European Union nor of the United Kingdom although the Honourable Member is aware that we have given certain assurances with respect to the European Union Code of Conduct on business taxation. The code of conduct on business taxation refers only to the taxation of companies and was aimed at preventing jurisdictions having non-standard (i.e. not applying to all companies in that jurisdiction) taxation measures that would distort free competition within the union. **The test to apply when considering the application of the Code of Conduct is whether an aspect of a jurisdiction's company taxation system would give a company benefiting from that aspect an unfair advantage.** As the proposed treatment of non-residents and the distribution of profits charge are neither strictly company tax measures nor can they be seen as benefiting particular classes of company, the Code of Conduct is not applicable.*

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## The IoM response? (2)

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*As part of our constitutional arrangements, the Government of the United Kingdom is always informed regarding Manx legislative bills and I can assure the Honourable Member that such arrangements have been adhered to in respect of the proposed treatment of non-residents and the distributable profits charge. Written assurance that a proposed measure is acceptable is not sought as part of these arrangements and I am sure that the House will support me in the view that there is no need to seek alteration of the arrangements at this time.*

*A R Bell Treasury Minister 24<sup>th</sup> May 2005*

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## So what now for the IoM?

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Think again.

Ask for help.

And begin to believe that Principles are principle based which means “neat footwork” does not work.

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