

Income Tax (Substance Requirements) Order 2018

Economic substance legislation came into force for companies resident in the Isle of Man in late 2018. The legislation is effective in respect of accounting periods commencing on or after 1 January 2019. This note serves as an overview of these rules, and should not be regarded as advice. Should you require professional advice, please contact us and we will be pleased to assist.

Background

Following pressure from the OECD, several non-EU jurisdictions implemented Economic Substance legislation, including the Isle of Man ("IOM").

The Income Tax (Substance Requirements) Order 2018, ("the Order"), applies to all companies that are tax resident in the Isle of Man which derive income from a relevant sector. Such companies must have adequate substance in the IOM.

The Order requires IOM companies to have regard to guidance issued by the IOM Income Tax Division, and although guidance was issued in April 2019, this is incomplete and we await updated guidance.

Relevant Sectors

The relevant sectors specified in the legislation are:

1. Banking
2. Insurance
3. Shipping
4. Fund Management
5. Finance and leasing
6. Headquartering
7. Operation of a holding company
8. Holding intangible property, and
9. Distribution and service centre businesses

It should be noted that following our analysis, we have determined that yacht owning companies and those providing crew management services to yacht owning companies do not fall within the shipping sector.

The finance and leasing sector applies to companies providing credit facilities for consideration. This is a broad definition and can apply to any IOM resident company that receives interest on a loan made by it.

Headquartering means provision of services to foreign group entities where those services are material for decision making in the group.

The distribution and service centre sector only applies where the IOM company acquires goods from or provides services to a non-IOM company within the same corporate group.

Meeting substance requirements

An IOM resident company receiving income from a relevant sector must have adequate substance in the IOM, in relation to the generation of relevant income, for the accounting period in which the income is derived.

There are five fundamental tests in demonstrating adequate substance:-

1. The company must be directed and managed in the IOM
2. There must be an adequate number of qualified employees in the IOM
3. The company must have adequate expenditure proportionate to the level of activity carried on in the IOM
4. The company must have adequate physical presence in the IOM
5. The company conducts core income generating activities ("CIGA") relating to the relevant section in the IOM

These tests must be reviewed on a case by case basis and the CIGA will vary depending on the relevant sector. We will be advising our clients of the impact of this legislation. Where substance requirements are not currently met, our clients can instruct our consultancy team to advise on the options available.

Reporting

Reporting is required in respect of income and related expenses for each relevant sector. Where a company derives income from more than one relevant sector, a detailed analysis of income, expenditure and the substance requirements for each sector must be reported to the Income Tax Division. Fees for the preparation and submission of tax returns will be varied depending on the level of analysis and reporting required.

For companies with a 31 December year end, the first report in respect of 2019 is due by 31 December 2020. Companies with a 31 March year end will be required to make their first report in respect of the year to 31 March 2020; the deadline being 31 March 2021. Substance reporting is dealt with annually via the company tax return.

Sanctions

There are significant financial penalties for failure to meet the substance requirements, ranging from initial financial penalties of £10,000, (£50,000 for IP companies) rising to £100,000. These are imposed on the IOM company. It is also possible that a non-compliant company can ultimately be struck off.

Reviews

All IOM companies we administer are in the process of being reviewed in order to ensure compliance. Our fee for the initial review undertaken this year is £250 plus VAT and this charge will be included within our 2020 invoice.

All companies are required to be reviewed on an annual basis in order to determine whether or not the company continues to meet the relevant substance requirements. All companies will be required to make a declaration on the tax return as to whether it has income from a relevant sector and if so, whether the relevant requirements have been met. We will undertake an annual economic substance review and for this we will charge an annual fee of £250 plus VAT.

Our consultancy team will be in contact with clients where further work or restructuring is recommended in consequence of the substance requirements.

Mann Made Corporate Services Limited
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