

Isle of Man Economic Substance

The Isle of Man has passed legislation requiring certain legal entities which carry on 'Relevant Activities' to demonstrate that they have adequate economic substance in the Isle of Man.

Any company that is registered or incorporated in the Isle of Man should be aware of this legislation and consider whether it is affected.

The Income Tax (Substance Requirements) Order, 2018 was approved by the Tynwald on 11 December 2018 and takes effect for accounting periods starting on or after 1 January 2019. The introduction of this legislation demonstrates the Isle of Man's continued commitment to international best practice, including the Isle of Man's implementation of the OECD's Base Erosion and Profit Shifting (BEPS) framework and related EU initiatives.

This approach closely follows that taken to address the same issue in other international financial centres.

Which entities need to demonstrate economic substance in the Isle of Man?

The legislation imposes economic substance requirements on Isle of Man companies which carry on a 'Relevant Activity'. Other non-resident entities which are regarded as tax resident in the Isle of Man are also required to meet the requirements.

Entities which do not carry on a Relevant Activity are not subject to the economic substance requirements, but may still be subject to certain reporting obligations (see 'What are the reporting obligations?' below).

The legislation primarily affects companies which are undertaking any of the following activities:

- ✦ Banking;
- ✦ Insurance;
- ✦ Shipping;
- ✦ Fund management;
- ✦ Financing and leasing;
- ✦ Headquartering;
- ✦ Operation of a holding company;
- ✦ Holding of intangible property;
- ✦ Distribution and service centres.

Some of the activities are widely described in the legislation which results in companies being brought into the substance requirements, where it is not immediately apparent that they otherwise should. For example, if a company receives as little as £1 of loan interest alongside income from their other activities, it would fall into the category of financing and leasing.

What will entities that carry on Relevant Activities need to do?

If a company falls into one of the categories mentioned overleaf, an analysis will need to be carried out to assess whether an entity is conducting any Relevant Activity, and any affected entities will need to consider their position and take appropriate action.

The officers will be required to provide additional information to the local tax authorities on their tax returns to include confirmation of the following information: -

- 1) That the company is directed and managed in the jurisdiction (determined in accordance with specific criteria),
- 2) Whether the core income generating activities are undertaken in the jurisdiction,
- 3) The number of qualified full time employee equivalents in the jurisdiction,
- 4) The premises for the company in the jurisdiction, and
- 5) The expenditure incurred in relation to core income generating activities carried out in the Jurisdiction.

Intellectual property businesses have a higher level of substance that needs to be achieved in order to satisfy the economic substance requirements.

What are the reporting obligations?

Going forward there will be new disclosure requirements contained in Isle of Man Tax Returns whereby affected companies will be required to determine and confirm the above on an annual basis.

Directors will need to consider whether they have sufficient substance in the Isle of Man to prevent:

- 1) Sanctions applying to the company, including substantial financial penalties,
- 2) Reporting of information to tax authorities in EU Member States where there is a direct or indirect owning company or ultimate beneficial owner, and
- 3) Potential strike-off of the company from the register of companies.

If there is determined to be insufficient substance in the Jurisdiction (according to the legislative tests), then consideration will be needed to be given quickly as to the actions required to demonstrate sufficient levels of substance in order to validly claim to be tax resident in the Isle of Man.

The legislation provides for penalties for non compliance, and these are listed below so that you are aware of the significant financial costs of not complying with the legislation.

Penalties for Noncompliance

- ✦ First year of noncompliance, maximum penalty of £10,000
- ✦ Second year of noncompliance, maximum penalty of £50,000
- ✦ Subsequent years of noncompliance, maximum penalty of £100,000 and possible strike off.

For further information please contact:

Anna Mazzilli,
Managing Director

T +44 1624 670951

E anna.mazzilli@praxisifm.com