DISTRIBUTIONS TO MANX SHAREHOLDERS - THE NEW REGIME

The Manx Income Tax Division issued a Practice Note (PN174/12) on 21 February 2012 dealing with the treatment of distributions by a company from its accumulated reserves after that date.

The Practice Note introduces some important changes that need to be considered by the company's directors and shareholders when distributions/dividends are being declared each year. This applies to all companies. It also sets out some general principles which are:

1. Distributions by companies of accumulated income profits should be taxed when they are received by its members;
2. Distributions by companies of capital profits should not be taxed when received by its members;
3. Repayment of share capital and share premium should not be taxed when a company is wound up;
4. There should be no economic double taxation in the Isle of Man.

The Practice Note sets out how distributions are taxed from 21 February 2012 and requires very careful record keeping and thought. It also introduces a classification system for different types of profit and puts them into ordered "boxes". Certain accumulated profits can be distributed at any time but others can only be distributed if profits from the preceding boxes have been paid out first.

Ordering

Three forms of profit can be distributed at any time without reference to the ordering system of the boxes. These are:

1. Profits that have been attributed under the ARI regime, which potentially means profits up to 5 April 2012;
2. Profits subject to the previous regime, DPC;
3. Profits which have already been subject to Manx income tax at 10%.

The Boxes

Distributions of other accumulated profits are treated as being made in the following order of boxes, and a distribution will only be treated as being paid out of a box of a higher number if all the lower numbered boxes are empty:

1. Accumulated income profits that have not been taxed, attributed under ARI or subject to the DPC regime;
2. Accumulated income profits of tax year 2005/2006 or earlier;
3. Accumulated income profits which have suffered foreign tax at 20% or more, or the income profits of Manx investment companies of 2005/06 or earlier (which would have suffered tax at the highest Manx rate)
4. Accumulated capital profits.

As can be seen, capital profits, which are tax free, can only be distributed after all income profits have been paid out.

Company Winding ups

Another consequence of the new practice is that when a company is wound up or dissolved the accumulated income profit element of any distribution will be subject to income tax.

Further Guidance

In March 2013 the Income Tax Division issued guidance on the application of PN 174/12 in the form of Guidance Note GN 49. This gives numerous examples of how distributions will be treated in various circumstances and explains further how the box ordering system works.

However, altogether this new approach to the taxation treatment of company distributions is complex, onerous and, in some respects, unfair. If you are in any doubt about the tax treatment of any proposed dividend please ask us for advice first and remember it is vital that complete and accurate records are maintained of a company's reserves and that all distributions are minuted at the time of voting or payment.

If you would like to know more then please contact
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