

Isle of Man Economic Substance Requirements

You will be aware from earlier communications that legislation introducing economic substance requirements for companies in the Crown Dependencies (amongst other jurisdictions) was approved in December 2018. For Isle of Man companies, the legislation applies to all companies resident in the Island for tax purposes and which have income (gross income) from a relevant sector in any accounting period commencing on or after 1st January 2019.

Guidance on the scope and application of the economic substance legislation has since been published on certain aspects by the Crown Dependency governments. It is necessary to initially categorise companies into the various relevant sectors that are caught by the new legislation.

The relevant sectors are:

- Banking*
- Insurance*
- Shipping
- Fund Management*
- Finance and Leasing
- Headquartering
- Distribution and Service Centres
- Operation of a Holding Company
- Holding Intangible Property (Intellectual Property).

The Income Tax (Substance Requirements) Order 2018 (the “Order”) includes definitions of the activity that falls within each of these sectors. A note of these definitions is detailed below together with the associated published guidance that applies to that relevant sector.

** These sectors are not included in our summary*

Adequate Substance

All companies with activities and income in a relevant sector in an accounting period will be required to demonstrate that they have adequate substance on the Island. Such requirements will generally require that a company:

- is directed and managed in the Island
- has an adequate number of qualified employees proportionate to the level of activity carried on in the Island
- has an adequate physical presence in the Island; and
- conducts core income generating activity in the Island.



Further details as to how your company will be affected specifically and how this may be addressed will be provided once the relevant sector that applies to the company has been agreed and confirmed.

Reporting of Information

Companies carrying on relevant activities will need to report certain information as part of the income tax filing process.

Sanctions

If a company in a relevant sector cannot demonstrate it has adequate substance in the Island in an accounting period, it will be subject to sanctions, e.g. exchange of information with competent authorities in other jurisdictions, financial penalties and, ultimately, striking off the companies register.

Relevant Sectors – Detailed Definitions and Guidance

Shipping

Means the operation of ships in international traffic for income for the transport of passengers or cargo and includes any of the following activities where the relevant activity is directly connected with, or ancillary to, such operation:

- the rental on a charter basis of a ship
- the sale of tickets or similar documents and the provision of services connected with the sale of tickets or similar documents, either for the enterprise itself or any other enterprise
- the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise; and
- the management of the crew of a ship.

“Ship” includes every description of vessel used in navigation but does not include fishing vessels, vessels of a kind primarily for sport or recreation, harbour craft or any vessel under 24 metres in length overall.

Guidance: *This section will be included in subsequent versions of the guidance.*



Financing and Leasing

Means providing a credit facility of any kind for consideration to any person (a “customer”) and for the purposes of this definition:

- consideration may include consideration by way of interest
- the provision of credit may be by way of instalments for which a separate charge is made and disclosed to the customer in connection with
 - the supply of goods by hire purchase
 - financial leasing (excluding land and interests in land); or
 - conditional sale or credit sale
- where an advance or credit repayable by a customer is assigned to another person, that other person is deemed to be providing a credit facility.

Any activity falling within the definition of banking, insurance or fund management is excluded from this definition of financing and leasing.

Guidance: *The definition encompasses any company which offers credit or financing of any kind for consideration, such as loans, hire purchase agreements, long term credit plans, and finance leases in relation to assets other than land. This includes intra-group financing.*

The scope also extends to the situation where a loan advanced for consideration by one company, which is within the scope of this sector, is transferred to a different company which then receives the loan capital repayments and consideration.

The scope does not extend to cases where credit is offered and there is no expectation of consideration from the credit when providing it. A lending fee would be consideration, whereas the grant of security in favour of the lender would not constitute consideration.

The scope does not extend to cases where the company has purchased debt securities as an investment, as opposed to providing a credit facility, for example, where the company has purchased gilts, quoted bonds or similar securities which are actively traded on one of the major security exchanges.

In banking, insurance and fund management businesses it may be a normal part of their activities to provide credit, and so these sectors are excluded from being within the scope of Financing and Leasing, to prevent duplicate reporting.



Headquartering

Means provision of services for foreign group entities which are material for decision making in the group, excluding shipping, insurance, banking, fund management, financing and leasing, distribution and service centre business or activities related to holding intangible property.

Guidance: *The definition encompasses companies which provide headquarters services to other non-resident members of the same group/connected persons. A headquarters will take responsibility for the overall success of the group, or an important aspect of the group's performance, and ensure corporate governance. Such headquarters services include:*

- *The provision of senior management*
- *Taking responsibility or control of material risk for activities carried out by, or assets owned by, any of those persons*
- *The provision of substantive advice in relation to such risks.*

In banking, insurance, fund management, financing and leasing, shipping or distribution and service centre businesses it may be a normal part of their activities to provide headquarters services, and so these activities are excluded from being within the scope of headquarters, to prevent duplicate reporting.

Operation of a Holding Company

A “holding Company” is a company that is a pure equity holding company. A “pure equity holding company” is a company which as its primary function acquires and holds shares or an equitable interest in other companies, performs no commercial activity and which:

- holds the majority of the voting rights in another
- is a member of another company and has the right to appoint or remove a majority of the board of directors of that other company; or
- is a member of another company and controls alone, under an agreement with other members, a majority of the voting rights in that other company.

Guidance: *A company will be regarded as a (pure equity) holding company if its primary function is to acquire and hold equities, and the equities in question are controlling stakes in other companies. It will be subject to the substance requirements if it receives income on its own behalf from those holdings (i.e. if it is the beneficial owner of the shares).*

If a company also undertakes other commercial activities, then it is outside of this narrow definition and will instead need to meet the higher substance requirements, if applicable for any relevant activity it carries on.



For example if the company provides senior management, takes responsibility, control or provides substantive advice in respect of material risks to companies it controls, then it will not be a (pure equity) holding company. The company could be considered to carry on the activity of providing headquarters services if those services were provided to foreign companies.

In determining whether the company also undertakes other commercial activities, two aspects must be considered. Firstly, whether the activities are commercial (i.e. they are directly linked to the sale/exchange of goods or assets or services in pursuit of profit such as renting land or property).

Secondly, whether there is any activity taking place. Passively holding investments and receiving income or gains from them is not considered to be an activity for this purpose.

If a company meets the criteria to be regarded as a (pure equity) holding company, the placing of dividend monies received on deposit or using them to acquire and passively hold other securities such as gilts, will not constitute a “commercial activity” and therefore the company will still be regarded as a (pure equity) holding company and subject to substance requirements.

Holding Intangible Property

Means the activity of an IP company. An “IP company” is a company which holds, exploits or receives income from an IP asset or assets. An “IP asset” includes a patent, technical know-how, a trademark, a brand and copyright.

Income from an IP asset includes royalties, income from a franchise agreement and income from licensing the IP asset.

Where a company receives income from IP, it will also have to consider if it a “high risk IP company”. A high risk IP Company is an IP company which falls within the following:

- an IP company that owns an IP asset that
 - has been acquired from related parties or obtained through the funding of overseas research and development activities; and
 - is licensed to related parties or monetised through activities performed by foreign related parties.

OR

- an IP company that owns an IP asset and does not carry on the core income-generating activity specified in the Order in the Island.

Guidance: *This section will be included in subsequent versions of the guidance.*



Distribution and Service Centre Business

Means as the sole or main activity:

- the purchase of raw materials and finished products from foreign group entities and the resale of the materials and products for a percentage of the profit; or
- the provision of services to foreign group entities.

Guidance: *The definition encompasses companies which purchase raw materials and finished products from other non-resident members of the same group/connected persons and re-sell them for a profit.*

The definition also encompasses companies which provide services, consulting or other administrative services, to other non-resident members of the same group/connected persons.

The scope does not extend to cases where such activities are not the main activity of a company.

The scope does not extend such activities to cases where a company purchases raw materials and finished products from, or provides services to third parties.

In banking, insurance, fund management, financing and leasing, shipping or headquartering businesses it may be a normal part of their activities to provide such services, and so these activities are excluded from being within the scope of Distribution and Service Centre, to prevent duplicate reporting.

The content of this document is intended to provide a general overview of the subject matter. Please contact your usual administrator should you require any further assistance.

Please note: ILS World does not offer tax or legal advice and would therefore recommend you obtain your own advice if necessary. If you require an introduction to a tax or legal adviser we would be happy to assist.

