

Statutory Document No. 2018/0263



Income Tax Act 1970

INCOME TAX (SUBSTANCE REQUIREMENTS) ORDER 2018

Approved by Tynwald:

Coming into Operation: in accordance with article 2

The Treasury makes the following Order under section 115A of the Income Tax Act 1970.

1 Title

This Order is the Income Tax (Substance Requirements) Order 2018.

2 Commencement

If approved by Tynwald¹, this Order comes into operation on the day after it is approved and has effect in respect of accounting periods commencing on or after 1 January 2019.

3 Amendment of the Income Tax Act 1970

- (1) The Income Tax Act 1970 is amended as follows.
- (2) After section A66(4) (corporate taxpayers: returns) insert —

(4A) A corporate taxpayer is required to include in the return the information requested by the Assessor relating to the substance requirements in Part 6A. 5 .
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- (3) In section A66(6) (corporate taxpayers: returns), after “reasonably requires”, insert **5** for the administration or application of any provision of this Act **5**.
- (4) In section 80A(2)(a) (duty to preserve records), in both places for “4” substitute **5 5**.

¹ Tynwald approval is required under section 115A(2) of the Income Tax Act 1970

- (5) After section 80A (duty to preserve records), insert —

PART 6A – SUBSTANCE REQUIREMENTS

80B Definitions

In this Part —

“**banking**” means the regulated activity of deposit taking by a person holding a licence, issued under section 7 of the *Financial Services Act 2008*, which permits the undertaking of Class 1(1) or Class 1(2) activity as those classes of activity are described in the Regulated Activities Order 2011², as that order is amended from time to time;

“**distribution and service centre business**” means, as the sole or main activity, —

- (a) 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
- (b) the provision of services to foreign group entities;

“**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 —

- (a) consideration may include consideration by way of interest;
- (b) 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 —
 - (i) the supply of goods by hire purchase;
 - (ii) financial leasing (excluding land and interests in land); or
 - (iii) conditional sale or credit sale; and
- (c) 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;

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but any activity falling within the definition of banking, insurance or fund management is excluded from this definition of financing and leasing;

“**foreign tax official**” means a foreign tax official of any EU Member State with which there is an international arrangement and in which an immediate or ultimate parent company or an ultimate beneficial owner of the relevant sector company is resident;

“**fund management**” means one of the following classes of regulated activity, undertaken by a person in accordance with a licence issued under section 7 of the *Financial Services Act 2008* —

- (a) Class 3(1) (acting as a manager of a collective investment scheme other than an exempt scheme or an exempt-type scheme);
- (b) Class 3(9), where the activity is providing management services to a person acting as a manager of a collective investment scheme other than an exempt scheme or exempt-type scheme; or
- (c) Class 3(11), where the activity is acting as a manager to a collective investment scheme which is an exempt scheme or an exempt-type scheme,

and reference to a class of activity in paragraphs (a) to (c) is to be construed by reference to the class as described in the Regulated Activities Order 2011³, as that order is amended from time to time;

“**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;

a “**high risk IP company**” is an IP company which falls within paragraph (a) or (b) —

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

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- (b) an IP company that owns an IP asset and does not carry on the core income-generating activity specified in section 80E(5)(g)(i) or (ii) in the Island;

a “**holding company**” is a company that is a pure equity holding company;

“**holding intangible property**” means the activity of an IP company;

“**income from an IP asset**” includes —

- (a) royalties;
- (b) income from a franchise agreement; and
- (c) income from licensing the IP asset;

“**insurance**” means the undertaking of insurance business in or from the Island which is authorised or permitted under the *Insurance Act 2008*;

“**international arrangement**” has the meaning given in section 104B(4);

an “**IP asset**” includes —

- (a) a patent;
- (b) technical know-how;
- (c) a trademark;
- (d) a brand; and
- (e) copyright;

an “**IP company**” is a company which holds, exploits or receives income from an IP asset or assets;

“**material for decision making in the group**” includes —

- (a) the provision of senior corporate management;
- (b) the assumption or control of risk for activities or assets owned by another group entity; and
- (c) advice to another group entity on the assumption or control of risk for its activities or assets;

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 —

- (a) holds the majority of the voting rights in another;
- (b) 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

- (c) 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;

“**relevant sector**” has the meaning given in section 80D(1);

“**relevant sector company**” has the meaning given in section 80D(2);

“**ship**” includes every description of vessel used in navigation but does not include —

- (a) fishing vessels;
- (b) vessels of a kind primarily for sport or recreation;
- (c) harbour craft; or
- (d) any vessel under 24 metres in length overall;

“**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 —

- (a) the rental on a charter basis of a ship;
- (b) 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;
- (c) 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
- (d) the management of the crew of a ship; and

“**ultimate beneficial owner**” means a person who would come within the definition of a “registrable beneficial owner” in section 3 of the *Beneficial Ownership Act 2017*, as that Act is amended from time to time, if a reference in the definition of “beneficial owner” in section 4 of that Act to a legal entity to which that Act applies is construed as a reference to a relevant sector company to which this Part applies.

80C Substance requirements: imposition of substance requirements

A corporate taxpayer that is a resident company must, for each accounting period in which it derives any income from a relevant sector, have adequate substance in the Island. (See section 80E.)

80D Substance requirements: relevant sectors

- (1) In this Part a “relevant sector” means any of the following business sectors –
 - (a) banking;
 - (b) insurance;
 - (c) shipping;
 - (d) fund management;
 - (e) financing and leasing;
 - (f) headquartering;
 - (g) operation of a holding company;
 - (h) holding intangible property; and
 - (i) distribution and service centre business.
- (2) A corporate taxpayer that is a resident company with income from a relevant sector is a “relevant sector company”.

80E Substance requirements: adequate substance

- (1) For a relevant sector company (other than a pure equity holding company), to have adequate substance it must ensure that –
 - (a) it is directed and managed in the Island;
 - (b) there is an adequate number of qualified employees in the Island (whether or not employed by it or another person and whether on temporary or long-term contracts);
 - (c) it has adequate operating expenditure proportionate to the level of activity carried on in the Island;
 - (d) it has an adequate physical presence in the Island; and
 - (e) it conducts core income-generating activity in the Island.
- (2) For the purposes of subsection (1)(e), a relevant sector company conducts core income-generating activity in the Island even if it outsources such activity, provided that it is able to demonstrate adequate supervision of the outsourced activity and the activity is conducted in the Island.
- (3) A pure equity holding company has adequate substance if it –
 - (a) complies with its statutory obligations under whichever of the *Companies Act 1931*, *Companies Act 2006* or *Foreign Companies Act 2014* is relevant; and
 - (b) has adequate people and premises for holding and managing the equitable interests or shares.

- (4) For the purposes of subsection (1)(a), a relevant sector company is “directed and managed in the Island” if –
- (a) the company’s board of directors meets in the Island at an adequate frequency given the level of decision-making required;
 - (b) during each meeting in the Island, there must be a quorum of directors physically present in the Island;
 - (c) strategic decisions of the company must be set at meetings of the board of directors and minutes of the meetings must reflect those decisions;
 - (d) the board of directors, as a whole, must have the necessary knowledge and expertise to discharge its duties as a board; and
 - (e) the minutes of all board meetings and the company records are kept in the Island.
- (5) For the purposes of subsection (1)(e), “core income-generating activity” includes –
- (a) in the case of the banking relevant sector –
 - (i) raising funds;
 - (ii) managing risk including credit, currency and interest risk;
 - (iii) taking hedging positions;
 - (iv) providing loans, credit or other financial services to customers;
 - (v) managing regulatory capital; and
 - (vi) preparing regulatory reports and returns;
 - (b) in the case of the insurance relevant sector –
 - (i) predicting and calculating risk;
 - (ii) insuring or re-insuring against risk; and
 - (iii) providing client services;
 - (c) in the case of the shipping relevant sector –
 - (i) managing crew (including hiring, paying, and overseeing crew members);
 - (ii) hauling and maintaining ships;
 - (iii) overseeing and tracking deliveries;
 - (iv) determining what goods to order and when to deliver them; and
 - (v) organising and overseeing voyages;

- (d) in the case of the fund management relevant sector —
 - (i) taking decisions on the holding and selling of investments;
 - (ii) calculating risks and reserves;
 - (iii) taking decisions on currency or interest fluctuations and hedging positions; and
 - (iv) preparing relevant regulatory or other reports for government authorities and investors;
- (e) in the case of the financing and leasing relevant sector —
 - (i) agreeing funding terms;
 - (ii) identifying and acquiring assets to be leased (in the case of leasing);
 - (iii) setting the terms and duration of any financing or leasing;
 - (iv) monitoring and revising any agreements; and
 - (v) managing any risks;
- (f) in the case of the headquartering relevant sector —
 - (i) taking relevant management decisions;
 - (ii) incurring expenditures on behalf of group entities; and
 - (iii) co-ordinating group activities;
- (g) in the case of a relevant sector company with income from holding intangible property —
 - (i) research and development (rather than acquiring or outsourcing);
 - (ii) marketing, branding and distribution;
 - (iii) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intangible asset;
 - (iv) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the third party acquisition and subsequent exploitation of the intangible asset; and
 - (v) carrying on the underlying trading activities through which the intangible asset is exploited and which lead to the generation of revenue from third parties;

- (h) in the case of the distribution and service centre business relevant sector –
 - (i) transporting and storing goods;
 - (ii) managing stocks and processing orders; and
 - (iii) the provision of consultation or administrative services.
- (6) For the purpose of subsection (4)(a), in the case of an IP company, periodic decisions of non-resident board members are not taken into account.

80F Substance requirements: verification

- (1) The Assessor may, in respect of any accounting period, request any additional information in order to satisfy the Assessor that a relevant sector company meets the substance requirements.
- (2) A person who fails to comply with a request under subsection (1) commits an offence and is liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (3) Where the Assessor is not satisfied that a relevant sector company meets the substance requirements, the Assessor shall issue a notice to the company, the contents of which shall include notification –
 - (a) that the Assessor has decided that the relevant sector company does not meet the substance requirements;
 - (b) of the reasons for that decision; and
 - (c) of the sanctions that will apply under sections 80H and 80I.

80G Substance requirements: high risk IP company

- (1) In the case of a high risk IP company, the adequate substance requirements in section 80E relating to conducting core income-generating activity in the Island are presumed not to be met, unless the company provides evidence to rebut this presumption.
- (2) In respect of any accounting period, the Assessor shall disclose to a foreign tax official any relevant information which relates to a high risk IP company under and in accordance with the articles on spontaneous exchange of information in an international arrangement, irrespective of whether the substance requirements are met.
- (3) The provision regarding the disclosure of information in relation to a high risk IP company referred to in subsection (2) is in

addition to the provisions regarding the disclosure of information in sections 80H, 80I and 80J.

- (4) Nothing in this Part authorises a disclosure, in contravention of any provisions of the data protection legislation, of personal data which is not exempt from those provisions.
- (5) In subsection (4), “**data protection legislation**” has the meaning given in regulation 5(1) of the GDPR and LED Implementing Regulations 2018⁴ as it has effect from time to time.

80H Substance requirements: initial sanction

If the Assessor is not satisfied that a relevant sector company meets the substance requirements in an accounting period the Assessor shall –

- (a) disclose to a foreign tax official any relevant information which relates to the relevant sector company under and in accordance with the articles on spontaneous exchange of information in an international arrangement; and
- (b) issue a notice to the company, the contents of which shall include notification that –
 - (i) in the case of a high risk IP company, the company is liable to a civil penalty of £50,000; and
 - (ii) in the case of all other relevant sector companies, the company is liable to a civil penalty of £10,000.

80I Substance requirements: additional sanctions

- (1) If, in the accounting period next following the accounting period in which a relevant sector company was subject to an initial sanction under section 80H, the Assessor is again not satisfied that the company meets the substance requirements, the Assessor shall –
 - (a) disclose information in the manner set out in section 80H; and
 - (b) in the case of a high risk IP company, issue a notice to the company, the contents of which shall include notification that –
 - (i) the company is liable to an additional civil penalty of £100,000; and

⁴ SD 2018/0145

- (ii) where the Assessor decides there is no realistic possibility of the company meeting the substance requirements, the Assessor may serve notice on the Department for Enterprise or the Registrar, as the case may be, requiring the Department or the Registrar to strike the high risk IP company off the register; and
 - (c) in the case of all other relevant sector companies, issue a notice to the company, the contents of which shall include notification that the company is liable to an additional civil penalty of £50,000.
- (2) If, in the accounting period next following that specified in subsection (1), the Assessor is again not satisfied that the relevant sector company meets the substance requirements, the Assessor shall –
 - (a) again disclose information in the manner set out in section 80H; and
 - (b) in the case of a high risk IP company, issue a notice to the company, the contents of which shall include notification that the Assessor may serve notice on the Department for Enterprise or the Registrar, as the case may be, requiring the Department or the Registrar to strike the high risk IP company off the register; and
 - (c) in the case of all other relevant sector companies, issue a notice to the company, the contents of which shall include notification that –
 - (i) the company is liable to an additional civil penalty of £100,000; and
 - (ii) where the Assessor decides there is no realistic possibility of the company meeting the substance requirements, the Assessor may serve notice on the Department for Enterprise or the Registrar, as the case may be, requiring the Department or the Registrar to strike the company off the register.
- (3) If, in the accounting period next following that specified in subsection (2), the Assessor is again not satisfied that the relevant sector company meets the substance requirements, the Assessor shall in the case of a relevant sector company, other than a high risk IP company, –
 - (a) again disclose information in the manner set out in section 80H; and

- (b) issue a notice to the company, the contents of which shall include notification that the Assessor may serve notice on the Department for Enterprise or the Registrar, as the case may be, requiring the Department or the Registrar to strike the company off the register.
- (4) If, in any accounting period following an accounting period for which the Assessor has issued a notice to a high risk IP company under (2)(b) or to a relevant sector company other than a high risk IP company under (3)(b), the Assessor is still not satisfied that the relevant sector company meets the substance requirements, the Assessor shall in all cases —
 - (a) again disclose information in the manner set out in section 80H; and
 - (b) issue a notice to the company, the contents of which shall include notification that —
 - (i) the company is liable to an additional civil penalty of £100,000; and
 - (ii) the Assessor may serve notice on the Department for Enterprise or the Registrar, as the case may be, requiring the Department or the Registrar to strike the company off the register.
- (5) In the case of a relevant sector company that is not incorporated in the Island, references in subsection (1), (2), (3) or (4) to the power to serve notice on the Department for Enterprise or the Registrar requiring a company to be struck off the register, shall be construed as the power to notify the tax administration in the company's jurisdiction of incorporation, of the company's failure to comply with this Part.

80J Avoidance

- (1) If it appears to the Assessor that in any accounting period a corporate taxpayer has acted so as to avoid or seek to avoid the application of this Part, the Assessor may —
 - (a) disclose to a foreign tax official, under and in accordance with the articles on spontaneous exchange of information in an international arrangement, any relevant information provided to the Assessor which relates to that corporate taxpayer; and
 - (b) issue a notice to the company, the contents of which shall include notification that the corporate taxpayer shall be liable to a civil penalty of £10,000.

- (2) A person who fraudulently avoids or seeks to avoid the application of this Part commits an offence and is liable —
 - (a) on conviction on information, to custody for a term not exceeding 7 years, a fine or both; or
 - (b) on summary conviction —
 - (i) to custody for a term not exceeding 6 months;
 - (ii) a fine not exceeding level 5 on the standard scale; or
 - (iii) both.
- (3) Where a person commits an offence under subsection (2), the Assessor may disclose to a foreign tax official, under and in accordance with the articles on spontaneous exchange of information in an international arrangement, any relevant information provided to the Assessor which relates to the relevant sector company.

80K Appeals

- (1) An appeal shall lie to the Commissioners (see section 88 (Income Tax Commissioners)) with respect to —
 - (a) a decision of the Assessor under any of the following sections —
 - (i) 80F(3);
 - (ii) 80I; or
 - (iii) 80J(1),
 and on appeal the Commissioners may confirm or reverse the decision; and
 - (b) any liability to a penalty under this Part and on an appeal the Commissioners may confirm, vary or reverse the penalty.
- (2) The procedure with respect to an appeal under subsection (1) shall, with the necessary modifications, be the same as that for an appeal against an assessment.
- (3) Despite subsection (2), on an appeal under —
 - (a) subsection (1)(a)(i) or (ii) it is for the appellant to prove that it does have adequate substance in the Island; and
 - (b) subsection (1)(a)(iii) it is for the appellant to prove that it is not a relevant sector company or that it has not acted so as to avoid or seek to avoid the application of this Part to that company.

80L Substance requirements: civil penalties general

- (1) Where a company is liable to a penalty under this Part, the Assessor or, on appeal, the Commissioners may reduce the penalty to such amount (including nil) as the Assessor or the Commissioners think proper.
- (2) The Commissioners may cancel the whole or any part of a reduction made by the Assessor under subsection (1).
- (3) In exercising their powers under this section, the Assessor and the Commissioners shall not take into account —
 - (a) the insufficiency of the funds available to any person for paying the amount of penalty; or
 - (b) the fact that the company liable to the penalty or a person acting on that taxpayer's behalf has acted in good faith.

80M Guidance

- (1) The Assessor may issue guidance about any of the provisions in this Part.
- (2) Regard must be had to guidance issued under subsection (1) in interpreting this Part.
- (3) The Assessor may revise guidance issued under subsection (1) and a reference to guidance includes a reference to revised guidance.
- (4) Guidance issued under subsection (1) must be published by the Assessor in a manner the Assessor considers will bring it to the attention of those likely to be affected by it.

80N Amendments by order

- (1) The Treasury may, by order, amend —
 - (a) the definitions in section 80B;
 - (b) section 80C;
 - (c) section 80D;
 - (d) section 80E; and
 - (e) any other provision of this Part, in order to comply with the recommendations or standards of the Code of Conduct Group (Business Taxation) established on 9 March 1998 (in accordance with a resolution of the European Council dated 1 December 1997 on a code of conduct for business taxation) or any other international standard.

Tynwald procedure — approval required.

- (2) An order under subsection (1) may include such consequential, incidental, transitory, transitional or supplemental provision, including amendment to other provisions of this Act as may appear to the Treasury to be necessary or expedient in consequence of or in connection with the amendment of this Part. **22**.
- (6) In section 120(1) (definitions) in the definition of “**tax position**” —
- (a) at the end of paragraph (d), omit “or”;
- (b) at the end of paragraph (e), omit “and”; and
- (c) after paragraph (f), insert —
- 23** and
- (g) the person’s status in relation to a relevant sector or as a high risk IP company (see sections 80B and 80D) and the substance requirement (see Part 6A). **22**.

4 Amendment of Companies Act 1931

After section 273(10A) of the *Companies Act 1931* (Department may strike defunct company off register), insert —

- 24**(10B) If the Department has received a notice from the Assessor under section 80I of the *Income Tax Act 1970* (substance requirements: additional sanctions), it must strike the name of that company off the register in the same manner and subject to the same notice and conditions as a company that is not in operation. **22**.

5 Amendment of Companies Act 2006

In section 183(1) of the *Companies Act 2006* (striking company off register),—

- (a) after paragraph (c), omit “or”; and
- (b) after paragraph (d), insert —
- 25**; or
- (e) the Registrar has received a notice from the Assessor under section 80I of the *Income Tax Act 1970* (substance requirements: additional sanctions). **22**.

MADE 16 NOVEMBER 2018

A L CANNAN
Minister for the Treasury



EXPLANATORY NOTE

(This note is not part of the Order)

This Order is made under section 115A of the Income Tax Act 1970 (“the Act”). It is made pursuant to the recommendations of the EU Code of Conduct Group on Business Taxation.

The Order amends the Act so as to introduce a substance test for certain Isle of Man resident companies that are within relevant business sectors.

The Order requires the submission of further information from a company in order for the Assessor to determine whether the company has substance in the Island.

The amendments to the Act further provide that —

- a) a relevant sector company which fails to provide any additional information which the Assessor requires in order to determine whether that company meets the substance requirements, commits an offence;
- b) where a relevant sector company, other than a high risk IP company, fails to meet the substance requirements —
 - (i) the Assessor will disclose relevant information about that company to a foreign tax official of an EU Member State with which the Island has an international arrangement and in which an immediate or ultimate parent company or ultimate beneficial owner of the company is resident; the company will also be liable to a civil penalty;
 - (ii) in respect of a second consecutive accounting period, the company will be subject to disclosure of information and to an additional, and larger, civil penalty;
 - (iii) in respect of a third consecutive accounting period, the company will be subject to disclosure of information and to an additional, and further increased, civil penalty and, if the Assessor believes the company cannot realistically meet the substance requirements the Assessor can serve notice on the Department for Enterprise or the Registrar, as appropriate, requiring the company to be struck off the register;
 - (iv) in the case of a fourth consecutive accounting period, the company will be subject to disclosure of information and the Assessor can serve notice requiring the Department for Enterprise or the Registrar, as the case may be, to strike the company off the relevant register.
- c) where a relevant sector company is a high risk IP company —
 - (i) it will be presumed that one particular substance requirement is not met unless the company provides evidence to rebut that presumption;

- (ii) in any accounting period the Assessor will disclose relevant information about that company to a foreign tax official of an EU Member State with which the Island has an international arrangement and in which an immediate or ultimate parent company or ultimate beneficial owner of the company is resident;
 - (iii) if the company fails to meet the substance requirements it will be subject to disclosure of relevant information and to a civil penalty in the first accounting period in which the failure occurs in the same manner as a non-high risk IP company except that the civil penalty for a high risk IP company is larger;
 - (iv) if the company fails to meet the requirements in a second consecutive accounting period, it will be subject to disclosure of information and to an additional, and larger, civil penalty and, if the Assessor believes the company cannot realistically meet the substance requirements the Assessor can serve notice on the Department for Enterprise or the Registrar, as appropriate, requiring the company to be struck off the register;
 - (v) if the company fails to meet the requirements in a third consecutive accounting period, it will be subject to disclosure of information and the Assessor can serve notice on the Department for Enterprise or the Registrar, as appropriate, requiring the company to be struck off the register;
- d) in any accounting period following the issue of a notice to a high risk IP company under (2)(b) or to a relevant sector company other than a high risk IP company under (3)(b), if the Assessor is still not satisfied that the relevant sector company meets the substance requirements, the company will be subject to disclosure of information, to a further civil penalty and the Assessor can serve notice on the Department for Enterprise or the Registrar, as appropriate, requiring the company to be struck off the register.

In each case, if the company is not incorporated in the Island, the Assessor will notify the tax administration in the company's jurisdiction of incorporation, of the failure to comply with Part 6A, in accordance with an international arrangement.

The Order also creates an offence of fraudulently avoiding or seeking to avoid the application of the new Part 6A of the Act, enables appeals to be made to the Income Tax Commissioners, provides that the Assessor may issue guidance and amends both the Companies Act 1931 and the Companies Act 2006 to provide that receipt of a notice from the Assessor by the Department for Enterprise or the Registrar, as appropriate, can require a company to be struck off the register.