EXPLANATORY MEMORANDUM TO

THE DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (ISLE OF MAN) ORDER 2018

2018 No. 1347

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Order brings into effect arrangements between the United Kingdom and The Isle of Man ("the Arrangements") for the avoidance of double taxation and the prevention of avoidance. The Arrangements replace previous arrangements ("the 1955 Arrangements") between the two governments.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland.

3.3 In accordance with section 505 of the Taxation (International and Other Provisions) Act 2010 this instrument covers the entire United Kingdom and the territorial application of this instrument is not limited either by the Act or by the instrument.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Financial Secretary to the Treasury, Mel Stride, has made the following statement regarding Human Rights:

"In my view the provisions of the Double Taxation Relief and International Tax Enforcement (Isle of Man) Order 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 The Order is being made to give effect in UK legislation to the Arrangements, which have been signed by the two governments. The Arrangements are specified in the Schedule to the Order, and are given domestic legislative effect. The Order does not implement EU legislation.

7. Policy background

What is being done and why?

7.1 The Arrangements aim to prevent income or gains being taxed both in the territory in which they arise and the territory in which the recipient is resident. They do this by allocating the taxing rights that each treaty partner has under its domestic law over the same income and gains and/or by providing relief from double taxation. They provide additional protection for taxpayers by specific measures combating discrimination in tax treatment. More generally, such arrangements benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens.

7.2 They protect the Exchequer by including provisions to combat tax avoidance and evasion. For example measures providing for the exchange of information between revenue authorities make it more difficult for residents of both territories to evade taxation by concealing assets offshore.

7.3 Like all of the United Kingdom's double taxation arrangements (DTAs), the Arrangements largely follow the approach adopted in the Organisation for Economic Cooperation and Development's ("OECD") *Model Tax Convention on Income and on Capital*. In doing so they encourage and maintain international consensus on the appropriate tax treatment of cross-border economic activity and thus promote international trade and investment.

7.4 The government keeps all of the United Kingdom's DTAs under review to ensure that they are in line with current policy. The previous DTA with the Isle of Man was signed in 1955. The DTA was last updated in 2016 to deal with a Budget measure to enable the UK to tax the profits of Isle of Man resident property developers. Updating the DTA now to follow the latest OECD Model Double Taxation Convention will reduce the need for further individual changes, will make the DTA easier for businesses to understand and reflects changes in policy and legislation in the United Kingdom since the earlier DTA was signed.

7.5 In particular, the new DTA meets the minimum standards recommended by the OECD/G20 Business Erosion and Profit Shifting (BEPS) project, which are designed to prevent the DTA from being abused by people trying to reduce their tax liability where the arrangements are not intended to apply. The BEPS project created a single set of consensus-based international tax rules to protect against tax avoidance while offering increased certainty and predictability to taxpayers.

7.6 And, for the first time, the new agreement includes an Assistance in Collection article, enabling the two territories to lend assistance in the collection of tax debts.

7.7 The Arrangements introduce the expanded title and preamble from the latest OECD Model, which is one of the elements of the minimum standard on preventing treaty abuse agreed under Action 6 of the OECD/G20 BEPS project.

The following paragraphs in this section explain the other main differences between the Arrangements and the 1955 Arrangements.

7.8 Article 1 ("Persons Covered") has no equivalent in the 1955 Arrangements. It defines the scope of the agreement and also includes provisions relating to transparent entities and the taxation of a territory's own residents. Both of the latter two provisions were recommended by the BEPS project.

7.9 The equivalent of Article 4 ("Residence") in the 1955 Arrangements is at subclause (g) of clause (1) of Paragraph 2. The revised definition of a resident of a territory generally follows the OECD Model and includes provisions for establishing the status of dual residents.

7.10 The equivalent of Article 5 ("Permanent Establishment") in the 1955 Arrangements is at subclause (k) of clause (1) of Paragraph 2. The new article provides for a more expansive definition of a permanent establishment (PE), including rules on construction sites and an expanded list of activities that will not be considered to constitute a PE. It also includes a rule to prevent companies fragmenting their activities in order to avoid the PE threshold.

7.11 The equivalent of Article 7 ("Business Profits") in the 1955 Arrangements is at Paragraph 3. The new article updates rules on the taxation of business profits to those in the current OECD Model.

7.12 Article 10 ("Dividends") has no equivalent in the 1955 Arrangements. It provides for dividends paid by a company resident in one territory to a beneficial owner resident in the other territory to be exempt from tax in the paying territory. However, dividends paid by Real Estate Investment Trust residents will be subject to a withholding tax of 15%. The 1955 Arrangements did not generally limit a territory's right to tax dividends paid to a resident of the other territory.

7.13 Article 11 ("Interest") has no equivalent in the 1955 Arrangements. It exempts from withholding tax interest arising in one territory and beneficially owned by a resident of the other territory, but only where the beneficial owner of the interest falls under one of the categories listed in paragraph 3, for example the other territory itself, a bank or building society, a pension scheme or an individual. The 1955 Arrangements did not generally limit a territory's right to tax interest paid to a resident of the other territory.

7.14 Article 12 ("Royalties") has no equivalent in the 1955 Arrangements. It exempts from withholding tax royalties arising in one territory and beneficially owned by a resident of the other territory, but only where the beneficial owner of the royalties falls under one of the categories listed in paragraph 3 (for example where the owner is the other territory itself or an individual). The 1955 Arrangements did not generally limit a territory's right to tax royalties paid to a resident of the other territory.

7.15 The equivalent of Article 13 ("Capital Gains") in the 1955 Arrangements is at paragraph 3B. The new article largely follows the OECD Model and provides that gains other than those specified will be taxable only in the territory where the person making the gain is resident. The 1955 Arrangements did not generally limit a territory's right to tax gains made by a resident of the other territory.

7.16 The equivalent of Article 14 ("Income from Employment") in the 1955 Arrangements is at paragraph 7. The new article updates the provisions on the taxation of employment income in line with the current OECD Model article. It provides that, in general, employment income of a resident of one territory can be taxed in the other territory if the employment is exercised there. Unlike the provisions of the 1955 Arrangements, the new article also provides a rule specific to individuals exercising employment in international traffic.

7.17 Article 15 ("Directors' Fees") has no equivalent in the 1955 Arrangements. It mirrors the current OECD Model article and provides that directors' fees etc. can be taxed in the territory where the company paying them is a resident.

7.18 The equivalent of Article 16 ("Artistes and Sportsmen") in the 1955 Arrangements is at clause (3) of paragraph 7. The new article mirrors the current OECD Model article and provides that income in respect of the personal activities of entertainers and sportsmen can be taxed in the territory in which those activities are exercised, whether it accrues to the entertainer or athlete themselves or to some other person (e.g. a company controlled by them). The 1955 Arrangements achieve a similar result by providing that it does not apply to such income.

7.19 Article 20 ("Other Income") has no equivalent in the 1955 Arrangements. The new article follows the approach of the current OECD Model article and provides that income not dealt with elsewhere in the Agreement will be taxable only in the territory in which the beneficial owner is resident. It also includes provisions clarifying the treatment of income paid out of trusts and estates and excess amounts paid because of a special relationship.

7.20 Article 21 ("Miscellaneous Rules Applicable to Certain Offshore Activities") has no equivalent in the 1955 Arrangements. It contains the rules for the operation of the Arrangements when activities are carried out offshore, primarily in respect of the exploration for or exploitation of oil and gas resources.

7.21 The equivalent of Article 22 ("Elimination of Double Taxation") in the 1955 Arrangements is at paragraph 9. The new article broadly reflects the provisions of the 195 Arrangements in providing for credit relief, but includes in addition provisions for the exemption from tax for dividends and the profits of permanent establishments in specified circumstances.

7.22 Article 23 ("Entitlement to Benefits") has no equivalent in the 1955 Arrangements. The new article introduces the "principal purpose test" (PPT) which aims to deny treaty benefits to those seeking to take advantage of the provisions of the Arrangements to secure a result which is contrary to their object and purpose. The PPT is one of the elements of the minimum standard on preventing treaty abuse agreed under Action 6 of the OECD/G20 BEPS project.

7.23 Article 24 ("Non-Discrimination") has no equivalent in the 1955 Arrangements. The new article provides that, subject to certain conditions, neither territory shall impose discriminatory taxes (or requirements) on the entities, permanent establishments and enterprises of the other.

7.24 The equivalent of Article 26 ("Exchange of Information") in the 1955 Arrangements is at paragraph 10. The new article follows the latest OECD Model and provides for the exchange of certain information between the competent authorities of the two territories in compliance with international standards.

7.25 Article 28 ("Entry into Force") explains when the new DTA will take effect. The Arrangements will enter into force after each of the territories notify the other that the Arrangements have been made law. The Arrangements will then have effect for taxes withheld at source from the first day of the second month following the entry into force, for Income Tax from 6 April 2019 and for Corporation Tax from 1 April 2019.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 Consolidation is not appropriate because this comprehensive DTA replaces entirely the existing 1955 DTA (as amended). A copy of the text was made available on GOV.UK on 3 July 2018 following signature of the Exchange of letters on 2 July 2018:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/721065/2018_Isle_of_Man-UK_Double_Taxation_Agreement___not_in_force.pdf

10. Consultation outcome

10.1 HMRC regularly consults with external interested parties, including business representatives, about the effectiveness of existing arrangements for information exchange, as well as new needs.

10.2 No representations were made on the 1955 Arrangements in response to this exercise. As explained in paragraph 7.4, the updated Agreement will reduce the need for further individual changes, make the DTA easier for businesses to understand and reflect changes in policy and legislation in the United Kingdom since the earlier DTA was signed.

11. Guidance

11.1 General guidance on the operation of the UK's double taxation agreements can be found on the HMRC pages of the gov.uk website at:

https://www.gov.uk/hmrc-internal-manuals/international-manual/intm150000

or in the Double Taxation Relief Manual at:

https://www.gov.uk/hmrc-internal-manuals/double-taxation-relief

This Manual will be updated once the Arrangements enter into force.

12. Impact

12.1 The Agreement is not expected to have significant practical impact on commercial activity as they largely replicate the effect of the 1955 Arrangements.

12.2 The impact on business, charities or voluntary bodies is negligible. The provisions of the Arrangements do not introduce new tax burdens; rather, they provide relief from tax and thus are of benefit to business both large and small. Taxpayers may have to make a claim to HMRC or the other territory's fiscal authority in order to benefit from the Arrangements.

12.3 There is no impact on the public sector.

12.4 A Tax Information and Impact Note has not been produced for the Order as it gives effect to a DTA. DTAs impose no obligations on taxpayers, rather they seek to eliminate double taxation and fiscal evasion.

13. Regulating small business

13.1 The Arrangements only apply to small businesses if they have taxed income arising in the Isle of Man. As with other businesses, the impact is negligible. No special approach for small business is therefore necessary.

14. Monitoring & review

14.1 There are no specific plans to review this Statutory Instrument. However, both governments will keep the Arrangements scheduled to the Order under consideration to ensure that they continue to meet the policy objectives set out above in Section 7.

14.2 The Order does not include a statutory review clause. In accordance with section 28(3)(a) Small Business, Enterprise and Employment Act 2015 there is no requirement to make provision for review of any secondary legislation that makes or amends provision imposing, abolishing or varying any tax, duty, levy or other charge.

15. Contact

15.1 Adrian Coates at HM Revenue and Customs, Telephone: 03000 586841 or adrian.coates@hmrc.gsi.gov.uk can be contacted with any queries regarding the instrument.

15.2 Fiona Hay at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Mel Stride MP, Financial Secretary to the Treasury and Paymaster General can confirm that this Explanatory Memorandum meets the required standard.