

Isle of Man Economic Substance Rules.

The Isle of Man Government, together with the Channel Islands, released joint guidance (“Guidance”) on the implementation of the substance requirements affecting Isle of Man tax resident companies that derive income from activity in the following business sectors:

- Banking;
- Insurance;
- Shipping;
- Fund Management (not including Collective Investment Vehicles but may include their subsidiaries);
- Finance and Leasing;
- Headquartering;
- Distribution and Services Centres;
- Operation of a (Pure Equity) Holding Company; and
- Intellectual Property (“IP”).

Eligibility

While the exact requirements will depend largely on the relevant business sector (for example, pure equity holding companies are subject to fewer requirements than IP companies), the general requirements to be satisfied by each Isle of Man tax resident company deriving income from any of the above sectors are that it:

1. is directed and managed in the Isle of Man;
2. has an adequate number of qualified employees;
3. has adequate expenditure proportionate to the level of activity carried out in the Isle of Man;
4. has adequate physical presence in the Isle of Man;
5. conducts core income generating activities on the Isle of Man.

The requirement to be directed and managed in the Isle of Man is a separate test to the “central management and control” test used in determining the tax residence of a company.

Companies that meet the ‘management and control’ test for tax residency will still be required to ensure that they also meet the ‘directed and managed’ requirement in order to show adequate substance.

Pursuant to the Guidance, a company must comply with the following (for each accounting period) to satisfy the ‘directed and managed’ requirement:

- the board of directors of the relevant company must meet in the Isle of Man at an adequate frequency given the level of decision making required (and where a company has a single director, there must be evidence of written resolutions passed by that director when he/she is physically present in the Isle of Man);
- during such “on-Island” meeting, there must be a quorum of directors physically present in the Isle of Man (the definition of “quorum” being determined in that company’s articles of association);
- all strategic decisions of such company must be set at these meetings (with clear minutes reflecting those decisions, even those where the board considers courses of action and rejects them);
- the board of directors as a whole, must have the necessary knowledge and expertise to discharge their duties as a board; and
- all board minutes and company records must be kept on the Isle of Man (these being and including: certificates of incorporation, articles of association, copies of funding documentation and mortgages, and any other documentation required by the board of directors to consider and make decisions).

In satisfying the above 'directed and managed' (as well as the 'management and control') requirements, companies may wish to consider amending their articles of association to specifically provide for, amongst other things, Isle of Man situs board meetings to be held and for a majority of the directors to be resident in the Isle of Man.

Though it should be noted that the adoption of such amendments alone may not sufficiently prove the relevant requirements have been satisfied, if the directors and strategic decisions are not in fact, based in the Isle of Man.

Further details on the requirements to be satisfied are provided in the Guidance and the relevant legislation.

Who do these rules apply to?

All Isle of Man companies will need to determine whether they are caught by the rules, and each Isle of Man tax resident companies will be required to provide additional information to the Income Tax Authority whether it is caught by the substance requirements or not.

Careful consideration should be given when determining a company's classification. If a company fails to meet the substance requirements, it can face sanctions including disclosure to the relevant jurisdictional tax authority and civil penalties. Sanctions also apply to a company that avoids or seeks to avoid to provide the Income Tax Assessor with documentation and information it has requested. In this instance, convictions, disclosure, custody and fines may apply. It is therefore important to consider contacting and engaging professional advice when identifying a company's classification, and determining the correct documents and information that will need to be provided to the Income Tax Assessor.

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