Review of direct tax opportunities and implications for a net zero Isle of Man

1. EXECUTIVE SUMMARY

1.1. This paper looks at:
- What international tax policy makers are advising in respect of climate change
- What are the Isle of Man's closest neighbours are considering
- How to design relevant direct tax incentives/disincentives for the Isle of Man

1.2. The only direct taxes in the Isle of Man are Income Tax and National Insurance.

1.3. In the Isle of Man direct taxation policy has been underpinned by three key principles for almost 20 years, these are:
- Fiscal sovereignty
- Economic stability
- Adherence to International Tax Standards

1.4. It is assumed that any new direct tax policies to address climate change would also need to abide by these principles.

1.5. Tax incentives are deductions, exclusions or exemptions from a tax liability offered as an enticement to engage in a particular activity or to encourage a particular behaviour. A tax disincentive is the reverse, it is a tax charge or similar designed to discourage a particular activity or behaviour.

1.6. Corporate income tax incentives are normally used to promote research and development activities, export activities, and support the competitiveness of their enterprises in the global market as well as to attract foreign investment and foster national industries. Individual income tax incentives typically address things like encouraging saving for retirement.

1.7. As the only direct taxes in the Isle of Man are Income Tax and National Insurance the only direct tax incentives that can be considered in the Isle of Man relate to these two levies. Direct tax disincentives could in theory also include new direct taxes.

1.8. In addition there are important factors to consider in connection with the use of direct tax initiatives to bring about behavioural change.

1.9. The Isle of Man's ability to provide tax incentives is restricted by the fact that it already has a narrow direct tax base and low rates. For example most companies do not pay any income tax therefore it is very difficult to incentivise them by reducing their income tax liability.

1.10. The ability to provide tax incentives is also obviously restricted by the need for the direct tax system to generate sufficient revenues. In short, the more tax incentives reduce tax revenue the less money is available to provide public services.

1.11. Using direct tax as a disincentive i.e. imposing new direct tax charges should not be considered a revenue source as the policy objective is to stop the behaviour. If the measure is successful it should not generate any income as the behaviour will have been stopped.

1.12. The efficacy of providing an incentive via the income tax system is also a factor. For example, providing an income tax incentive to insulate your house may seem logical but if those that have not insulated are on low incomes they may not be paying tax or the value of the incentive may be lower as they are only paying a small amount of income tax. In these cases direct grants maybe a more effective way of providing the incentive.

1.13. More generally, best practice requires that any new tax incentive is measured and reviewed for its effectiveness by looking at whether it is in fact achieving the desired policy objective.

1.14. Opportunities - the first step is to consider what behaviour it is desirable to encourage or discourage. The following have been identified so far but there may be others:

- Discourage the ownership and usage of petrol/diesel cars or those with higher CO_2 emissions
- Encourage the ownership and usage of electric cars or those with lower CO_2 emissions
- Encourage other forms of transport with lower CO_2 emissions e.g. cycling, public transport
- Encourage more efficient ways of home heating/reducing the need for home heating

1.15. The second step is to identify possible direct tax policies that would encourage/discourage these behaviours.

1.16. There is existing tax measures/incentives which can be expanded and become more focused as part of a package of measures. For example, a number of exemptions exist for reducing income tax and national insurance liabilities and encourage better forms of transport such as the cycle to work scheme, benefit in kind (BIK) exemption for electric cars provided by employers to employees. This could easily be expanded to encourage travel by other forms of transport for example a BIK exemption for public transport costs and higher BIK charges for cars.

2. INTRODUCTION

2.1. This paper outlines the direct tax opportunities and implications for a net zero Isle of Man. For the purposes of this paper net zero has been taken to mean the amount of greenhouse gases emitted into the atmosphere is no more than the amount taken out.

2.2. A separate paper is being prepared on the indirect tax opportunities and implications.

2.3. In preparing this paper, the following has been looked at:

- What international tax policy makers are advising in respect of climate change
- What are the Isle of Man's closest neighbours are considering
- How to design relevant direct tax incentives/disincentives for the Isle of Man

3. BACKGROUND - DIRECT TAXATION IN THE ISLE OF MAN

3.1. The only direct taxes in the Isle of Man are Income Tax and, arguably National Insurance. Further detail on these systems is provided in Annex 1 to this paper.

3.2. Tax incentives are deductions, exclusions or exemptions from a tax liability offered as an enticement to engage in a particular activity or to encourage a particular behaviour. A tax disincentive is the reverse, it is a tax charge or similar designed to discourage a particular activity or behaviour.

3.3. Corporate income tax incentives are normally used to promote research and development activities, export activities, and support the competitiveness of their enterprises in the global market as well as to attract foreign investment and foster national industries. Individual income tax incentives typically address things like encouraging saving for retirement.

3.4. As the only direct taxes in the Isle of Man are Income Tax and National Insurance the only direct tax incentives that can be considered in the Isle of Man relate to these two levies. Direct tax disincentives could in theory also include new direct taxes.

4. CLIMATE CHANGE AND TAXATION - THE INTERNATIONAL VIEW

The UN Sustainable Development Goals

4.1. In 2015 the United Nations (UN) General Assembly adopted the 2030 Agenda for Sustainable Development and the 17 UN Sustainable Development Goals (SDGs), calling on all countries to improve the lives of people everywhere. A core aim of the SDGs is to eradicate poverty in all its forms and dimensions, recognizing that it is the greatest global challenge and is an indispensable requirement of sustainable development. However, one of the 17 SDGs relates to Climate Action (see Figure 1)

Figure 1: Sustainable Development Goals, from https://www.un.org/sustainabledevelopment/climate-change/

Platform for collaboration on Tax (PCT)

4.2. The Platform for Collaboration on Tax is a joint effort by the International Monetary Fund (IMF), the Organization for Economic Co-operation and Development (OECD), the United Nations (UN) and the World Bank Group (WBG). In 2018 the Platform for Collaboration on Tax organized its first global conference on "Taxation and the Sustainable Development Goals (SDGs)", bringing together nearly 500 participants from 106 countries.

4.3. The findings for sustainable development goal 13 'Climate Action' were presented recently to the Chartered Institute of Tax ADIT conference as:-

- High consumption taxes on gas, higher on oil and highest on coal
- No consumption taxes or duties on renewable energy sources
- High fuel duties and road taxes
- Consumption taxes on meat but not vegetables
- New zero emission targets

4.4. As might be expected given the policy objective, these findings mainly recommend action in respect of indirect tax (consumption taxes). As this is the topic of a separate paper the remainder of this paper considers the opportunities within the existing direct tax system to change behaviour to reduce the emission of greenhouse gases (or to encourage action that will take greenhouse gases out of the atmosphere).

5. TAXATION POLICY AND BEHAVIOURAL CHANGE

5.1. In the Isle of Man direct taxation policy has been underpinned by three key principles for almost 20 years, these are:

- Fiscal sovereignty
- Economic stability
- Adherence to International Tax Standards

5.2. It is assumed that any new direct tax policies to address climate change would also need to abide by these principles.

5.3. In addition there are important factors to consider in connection with the use of direct tax initiatives to bring about behavioural change.

5.4. The Isle of Man's ability to provide tax incentives is restricted by the fact that it already has a narrow direct tax base and low rates. For example, most companies do not pay any income tax therefore it is very difficult to incentivise them by reducing their income tax liability.

5.5. The ability to provide tax incentives is also obviously restricted by the need for the direct tax system to generate sufficient revenues. In short, the more tax incentives reduce tax revenue the less money is available to provide public services.

5.6. Using direct tax as a disincentive i.e. imposing new direct tax charges should not be considered a revenue source as the policy objective is to stop the behaviour. If the measure is successful it should not generate any income as the behaviour will have been stopped.

5.7. The efficacy of providing an incentive via the income tax system is also a factor. For example, providing an income tax incentive to insulate your house may seem logical but if those that have not insulated are on low incomes they may not be paying tax or the value of the incentive may be lower as they are only paying a small amount of income tax. In these cases direct grants maybe a more effective way of providing the incentive.

5.8. More generally best practice requires that any new tax incentive is measured and reviewed for its effectiveness by looking at whether it is in fact achieving the desired policy objective.

6. OPPORTUNITIES

6.1. The first step is to consider what behaviour it is desirable to encourage or discourage. We have identified the following so far but there may be others:

- Discourage the ownership and usage of petrol/diesel cars or those with higher CO_2 emissions
- Encourage the ownership and usage of electric cars or those with lower CO_2 emissions
- Encourage other forms of transport with lower CO_2 emissions e.g. cycling, public transport
- Encourage more efficient ways of home heating/reducing the need for home heating

6.2. The second step is to identify possible direct tax policies that would encourage/discourage these behaviours (see sections 6 and 7 below). These then need to be evaluated bearing in mind the principles and factors explained in section 4 above.

7. CURRENT RELEVANT INITIATIVES/TAX MEASURES

Benefits in kind

7.1. Benefits provided by an employer to their employees are subject to an income tax charge based on the type and cost of the benefit provided. For example if an employer provides an employee with a car the provision of this benefit attracts a tax charge. This type of benefit is referred to in tax legislation as a "benefit in kind". Providing an exemption from a benefit in kind charge is a form of tax incentive. Increasing the charges for a benefit in kind could act as a tax disincentive

7.2. *Discourage the ownership and usage of petrol/diesel cars or those with higher CO_2 emissions/Encourage the ownership and usage of electric cars or those with lower CO_2 emissions*

7.3. Full details of the benefit in kind tax charges and exemptions for company cars, other vehicles and fuel are available via the Isle of Man Government website (Gov.im, 2019)

7.4. The Isle of Man's benefit in kind charges for company cars are currently based on cylinder capacity not CO_2 emissions.

7.5. There are existing exemptions for electric cars and commercial vehicles, such as a van or lorry where the main business purpose is the transportation of goods or materials used within the trade; or the transportation of goods in the course of conducting a delivery service; or the transportation of the tools or equipment used by the employee in performing their duties, other current exemptions include the following;

- Car parking fees used principally for business purposes
- Car parking free or subsidised (used principally for business purposes)
- Electric cars (does not include hybrid petrol/electric cars)
- Public transport season tickets or multi journey tickets provided by the employer

7.6. There is also a fuel scale charge when an employee has a company car and the employer provides fuel for any mileage other than business mileage. This scale charge is currently based on car cylinder capacity.

Encourage other forms of transport

7.7. A benefit in kind exemption was introduced in the Isle of Man 2017 Budget for employers providing employees with bikes and related safety equipment for use between their home and place of work. This exemption was extended to include certain types of electrically assisted bikes in 2019. Full details of the exemption and the limits are available in Practice Note 200/18 (Gov.im, 2018).

7.8. Isle of Man government offers its employees a cycle to work scheme based on this exemption see Isle of Man Government Cycle to Work Scheme Policy & Procedure (Isle of Man Government, 2018).

8. COMPARISONS WITH OTHER JURISDICTIONS

United Kingdom

8.1. The UK has a personal income tax regime and a corporation tax regime together with inheritance tax and capital gains tax. The personal allowance in the UK is £12,500 and rates of personal income tax in the UK are 10 to 46%. The corporate tax rate is 19/20%.

8.2. The UK has a benefit in kind system very similar to that described above for the Isle of Man. However its charges for cars provided by employers are based on CO_2 emissions. From April 2020 a new method of measure CO_2 emission is being phased in considering environmental impact. A 0% rate for zero-emission cars will be introduced for 2021 but will increase to 2% by 2022/23. The UK also has a cycle to work scheme.

8.3. In the UK businesses[1] are given tax incentives for investing in certain types of asset through their "capital allowances" system. Under this system businesses can obtain

[1] Note businesses in the UK pay either income tax or corporation tax unlike in the Isle of Man where companies are frequently able to benefit from the 0% rate of income tax.

tax relief for the cost of investing in certain assets earlier than would otherwise be the case. The relevant assets are:

- Some cars with low CO_2 emissions
- Energy saving equipment that's on the energy technology product list, for example certain motors
- Water saving equipment that's on the water efficient technologies product list, for example meters, efficient toilets and taps
- Plant and machinery for gas refueling stations, for example storage tanks, pumps
- Gas, biogas and hydrogen refueling equipment
- New zero-emission goods vehicles

Jersey

8.4. Jersey has a similar tax regime to the Isle of Man. Jersey charges income tax on individuals above a personal allowance of £15,400 at a maximum rate of 20% (they brand this as 20 means 20 with a marginal rate of 26%). Their income tax for companies is broadly similar to the Isle of Man as they also have a 0% rates for the majority of companies with a 10%/20% rate for generally banking, utility companies and large retailers. Jersey also has a minimum tax cap which is £145,000 pa.

8.5. In Jersey there is no benefit in kind exemptions available for cycle to work or electric cars.

8.6. In Jersey capital allowances are given at a rate of 25% per year and there are no first year allowances available.

Guernsey

8.7. Guernsey has a similar tax regime to the Isle of Man. Guernsey charges income tax on individuals above a personal allowance of £11,000 at a rate of 20%. Their income tax for companies is broadly similar to the Isle of Man as they also have a 0% tax rate for the majority of companies with a 10%/20% rate for generally banking, utility companies and large retailers. They also have a tax cap which is £130,000/£260,000 per annum but is only £50,000 for new residents.

9. CONCLUSIONS

9.1. The opportunities to use the Isle of Man's direct tax system to incentivise behaviours that will reduce the amount of greenhouse gases emitted into the atmosphere are limited primarily because of the system's existing narrow base and low rates but there are areas connected with the benefit in kind system that could be explored.

9.2. New direct taxes that would act as a disincentive in relation to behaviours that increase the amount of greenhouse gases emitted into the atmosphere are more difficult to envisage as the relevant behaviours tend to relate to consumption (the subject of the indirect tax) rather than to income, wealth or capital. This paper also assumes that Carbon Taxes and Aviation Taxes are covered by the paper on indirect tax.

9.3. Areas that could be investigated further are:
Plastic taxes – to reduce single use plastic (see the UK's consultation on this topic (HM Treasury, 2019)).

10. REFERENCES

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ANNEX 1

Income Tax in the Isle of Man

Overview

Income tax and National Insurance are the two significant direct levies in the Isle of Man. National Insurance classes and rates are structured in a similar way to the UK system. Income tax revenues and National Insurance revenues in the Isle of Man for 2018/19 were £237.74 m and £211.95 m respectively.

Isle of Man income tax applies to all persons, i.e. both corporates and non-corporates; there is no separate system of corporation tax. The Isle of Man has no capital gains tax, inheritance or estate tax, wealth tax, stamp duty or stamp duty land tax. The Island's income tax rules are completely separate from those of the UK, as the power to legislate on income tax matters lies with Tynwald, the Isle of Man's parliament.

Responsibility for Isle of Man income tax and National Insurance contributions lies with the Assessor of Income Tax (the head of the Income Tax Division of the Isle of Man Government's Treasury Department ('ITD')).

The Isle of Man tax year runs from 6 April to the following 5 April.

Individuals

Isle of Man resident individuals are liable to income tax on their worldwide income. Non-resident individuals are liable to income tax on their Isle of Man source income, except for that received from certain approved sources, e.g. Isle of Man bank interest. Both are required to file annual tax returns.

The standard rate of income tax for a resident individual is 10% and the higher rate is 20%. The rate for non-residents is also 20%. Isle of Man tax law also provides for various personal allowances and tax deductions. The latest rates of taxation, tax thresholds, allowances and deductions can be found on the ITD website at: https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/individuals/residents/rates-and-allowances/.

An annual tax cap applies in respect of the tax liability of Isle of Man residents. This provides for a resident's tax liability to be capped. The applicable cap, which is doubled in the case of married couples or civil partners who elect for joint assessment, is currently £175,000 per annum in respect of elections commencing from 6 April 2019 and will increase to £200,000 from 6 April 2020. With effect from 6 April 2014, a taxpayer must elect for the cap to apply for five consecutive tax years.

Companies

The Isle of Man has no special tax regimes for different classes of company. All companies are required to file an income tax return on an accounting period basis.

Isle of Man incorporated companies and foreign companies which are managed and controlled in the Isle of Man are resident for income tax purposes and are liable to income tax on their worldwide income. Non-resident companies are liable to income tax on their Isle of Man source income. The standard income tax rate for both resident and non-resident companies is 0%. The standard rate generally applies to all forms of income received by all companies except:

- Licensed banks, which are taxed at 10% on income from their banking business;
- Income derived from mining and quarrying, landfill, property development, commercial property letting and rental income in the Isle of Man which was taxed at 10% until 6 April 2015 when the rate increased to 20%; and
- With effect from 6 April 2013, companies which carry on retail business in the Isle of Man and have taxable income of more than £500,000 from such business became subject to a 10% rate of tax.

Trading companies subject to Isle of Man income tax at the standard 0% rate can elect to pay tax at the 10% rate.

Partnerships

For the purposes of Isle of Man tax law, the expression 'partnership' includes general and limited partnerships.

Isle of Man tax law does not treat a partnership as a separate person and it is therefore not liable to income tax in its own right. Rather, each partner is liable to pay income tax at the appropriate rate in respect of their whole income, including their share of the profits of any partnership.

The profits of a partnership are calculated for income tax purposes in the same manner as those of a sole trader and therefore the income tax returns are supported by the financial accounts of the partnership, any expenses and disbursements being allowed as a deduction provided they are wholly and exclusively incurred in acquiring the income of the partnership.

As each partner is liable to pay income tax on his share of the profits of the partnership, the identity of each partner is required to be disclosed.

Guidance on the taxation of partnerships in the Isle of Man can be found in ITD Practice Note, PN145/07.

Limited Liability Companies

Companies formed under the Limited Liability Companies Act 1996 ('LLCA 1996') are treated as partnerships for Isle of Man tax purposes.

Tax Base

As at 1 July 2019, there were 74,221 resident individuals and 4,252 non-resident individuals on the income tax system.

Of the resident individual tax base approximately 29% have taxable income below the personal allowance and therefore do not pay income tax.

National Insurance

Overview

The National Insurance contribution regime that operates in the Isle of Man is based very closely on the one which operates in the United Kingdom and both jurisdictions have been party to a bilateral Social Security agreement since 1948; this agreement was amended in 2016.

National Insurance contributions can be paid by individuals who are employed, self-employed or non-employed. Individuals who are employed are required to pay National Insurance on their earnings along with their employer; this is referred to as Class 1 National Insurance.

Self employed

Persons who are self-employed pay two different National Insurance contributions: a weekly contribution referred to as Class 2 National Insurance and an annual payment based on their profits referred to as Class 4 National Insurance.

Voluntary contributions

Individuals who are neither employed nor self-employed can pay a voluntary National Insurance contribution which contributes to their state pension entitlement; this is referred to as Class 3 National Insurance.

Further information on the rates and thresholds that apply to National Insurance contributions can be found on the ITD website at:
https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/individuals/residents/rates-and-allowances/

Social Security Benefits

The Class of National Insurance contributions paid affects the benefits a person may be entitled to.

Class 1	**Class 2**	**Class 3**	**Benefit**
Yes	No	No	Jobseeker's Allowance
Yes	Yes	No	Incapacity Benefit
Yes	Yes	No	Maternity Allowance
Yes	Yes	Yes	Bereavement Payment
Yes	Yes	Yes	Widowed Parent's Allowance
Yes	Yes	Yes	Bereavement Allowance
Yes	Yes	Yes	Retirement Pension (basic)
Yes	No	No	Additional Pension

Further information in relation to Social Security Benefits can be found on the ITD website at:
https://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/national-insurance-contributions/.