

REVISION OF THE JULY 2007 MODERNISATION OF THE ARRANGEMENTS FOR THE SHARING OF COMMON DUTIES BETWEEN THE UK AND THE ISLE OF MAN

Introduction

1. The **1979 Agreement** between the Governments of the United Kingdom and the Isle of Man sets out the framework for UK/IOM relations in respect of customs and excise matters. The **1979 Isle of Man Act** gives effect to the Agreement and lays down the general basis for determining the Isle of Man's share of the common duties, including VAT.

2. The detailed revenue sharing arrangements, and formula and accounting procedures to be employed, are agreed between the two parties and formalised in a **HM Treasury Direction**.

Modernisation of UK/IOM Revenue Sharing Arrangements

3. In July 2007 the two parties agreed to a modernised and simplified set of arrangements to be based on relative changes in national income, hereinafter called the 'GNP Growth' model. The two parties agreed that **1999/2000** represented an appropriate base year; and that the new 'GNP growth' model would apply with effect from the beginning of the **2007/08 financial year**.

The rest of this document is split into three areas: the first deals with the functioning of the GNP Growth Model; the second with transitional arrangements; and the third with the in year payment methodologies and other issues, where the intention is to enable appropriate funding flows between the two parties, avoiding the build up of significant over/under payments.

Description of 'GNP growth' model

4. With the 'GNP growth' model revenues are shared on the basis of shares in the base year adjusted for subsequent relative changes in national income. For the UK, national income is measured by Gross National Income (GNI) at current market prices (National Statistics identifier ABMX), adjusted to current basic prices (less taxes plus subsidies on products) (National Statistics identifier NQBU). For the IOM, national income is measured by Gross National Product (GNP) at factor cost in current prices. Where data required by the model is not available, published real growth forecasts are used.

For UK growth the central point in the range of GDP forecasts published in the annual Financial Statement and Budget Report is used, and for IOM growth it is the national income forecast in the Central Planning Assumptions published in the Isle of Man Government Plan.

Functioning of 'GNP growth' model

5. The 'GNP Growth' model operates as set out in steps 1 to 6 below. Steps 1 to 4 lead to the provisional IOM share for any given year. Steps 5 and 6 deal with adjustments to be made after the year end when actual/more up to date data is available.

Step 1: Obtain national income data

Obtain national income data for both the UK and IOM for the base year of 1999/2000 and for the focal year.¹ The latest published data, including growth forecasts, is used.

Step 2: Calculate the IOM sharing fraction for the focal year

- a) Calculate the national income change factor for each jurisdiction by dividing focal year national income by base year national income;
- b) Multiply base year VAT revenue allocations by the national income change factor for each jurisdiction to give notional VAT allocations for each jurisdiction; and
- c) Divide the IOM's notional VAT allocation by the sum of both jurisdictions' notional VAT allocations to give the provisional IOM sharing fraction for the focal year.

The formula for the sharing fraction for the IOM can be expressed as follows:

$$\text{Sharing Fraction for IOM} = (\text{IOM VAT revenue in base year} \times \text{IOM national income change factor since base year}) / (\text{IOM VAT revenue in base year} \times \text{IOM national income change factor since base year} + \text{UK VAT revenue in base year} \times \text{UK national income change factor since base year})$$

¹ For the UK data for calendar years is converted to financial years by a simple $\frac{3}{4}$ plus $\frac{1}{4}$ conversion.

Step 3: Apply the Provisional IOM Sharing Fraction to forecast VAT receipts

Apply the provisional IOM sharing fraction to the published forecast for UK VAT receipts² in the focal year to determine the provisional VAT revenue allocated to the IOM.

Step 4: Apply the Provisional IOM Sharing Fraction to forecasts of receipts from other common duties

Apply the provisional IOM sharing fraction to the published forecasts for UK receipts³ in the focal year from other common duties covered by the 1979 Agreement that are not shared on the basis of actual consumption (see paragraph 6) to determine the provisional duty revenue allocated to the IOM.

(Note – the sum of steps 3 and 4 give the provisional annual share of IOM joint revenues.)

Step 5: Annual adjustment to take account of certified joint revenues

Within three months of the end of the focal year (i.e. by 30 June) obtain certified joint VAT and all relevant shared common duty revenue figures.⁴ Apply the provisional IOM sharing fraction from the previous focal year to the difference between certified revenues and the forecasts of revenues used in the Step 4 calculation for the previous focal year and make a single adjusting payment (see paragraph 10 Step 3). Prepare the IOM Account with the provisional sharing fraction applied to certified revenue.

Step 6: Annual adjustments to take account of new national income data

Within three months of the end of the focal year (i.e. by 30 June) obtain new and revised national income data. The provisional sharing fractions to the VAT and duty revenues allocated to the IOM will be adjusted accordingly. These revenue adjustments, which will be shown as 'previous year adjustments' in the IOM Account, are subject to a 5 year cap, so that, for example, no adjustment of the 2007/08 revenue allocation may be made in respect of changes to national income published after 31 March 2013 (see paragraph 12).

The Appendix contains an example, using illustrative data, of the GNP growth model calculation.

² IOM VAT receipts (for which there are no published forecasts) are included in Step 5

³ Pool Betting Duty and IOM other duty receipts (for which there are no published forecasts) are included in Step 5

⁴ The figures appear in the audited IOM Service Account and UK Trust Statement.

Scope of 'GNP growth' model

6. The sharing fraction will be applied to the following common duties:

- VAT
- Tobacco products duty
- Beer end products duty
- Spirits duty
- Wine and made wine duty
- Cider and Perry duty
- Customs duty
- Anti-dumping duty
- Agricultural duties
- Pool betting duty

Lottery duty and Hydrocarbon Oil duty will continue to be shared on the basis of actual consumption. Air Passenger Duty is outside the scope of the revenue sharing arrangements.

Transitional arrangements

7. To mitigate the fiscal impact of adjusting to the 'GNP Growth' model, the two parties agree to a **5 year transitional period**.

8. During the transitional period, in addition to the IOM's GNP-based share of the jointly collected revenues, the UK will transfer to the IOM 80% / 60% / 40% / 20% of the difference between the IOM's estimated 2005/06 VAT revenue figure (in the IOM Budget Report & Estimates 2005/06) and the IOM's estimated 2005/06 VAT revenue in 2005/06 using the 'GNP Growth' model. This difference has been agreed to be £73million. The transitional payments to be made to the IOM under this arrangement are detailed in the **Annex**. For each year the agreed amount will be divided by 12 and added to the IOM's monthly payments. The transitional payment arrangements are subject to review in 2008.

9. For 2007/08 the calculation of IOM's GNP-based share of the jointly collected revenues used national income forecasts in the IOM Central Planning Assumptions on the Isle of Man Government website in June 2007.

In-year Revenue Transfers

10. To ensure that collected tax revenues are remitted to each jurisdiction's exchequer at the earliest practicable date, arrangements have been developed for making monthly in-year transfers. The arrangements will operate as follows.

Step 1 – Calculate net monthly transfers to or from the IOM before the start of the relevant year.

- i. Calculate the annual IOM share of joint revenues (Steps 3 and 4 in paragraph 5) plus the transitional amount (paragraph 8);
- ii. Deduct agreed forecast of IOM joint revenues to be collected by the IOM for the year; and
- iii. Divide the result by 12 to determine the monthly transfers to the IOM (if the result is positive) or from the IOM to the UK (if the result is negative).

Monthly transfers will be paid by HMRC to the IOM or by IOM to HMRC on an agreed date⁵ each month in line with the calculation at iii).

Step 2 – Monitor level of actual joint revenues collected and make adjustments in-year on a quarterly basis.

- a. Compare on a monthly basis IOM profiled forecast of joint revenues (i.e. Step 1 ii) divided by 12) to actual joint revenue collected by IOM for that month;
- b. maintain cumulative record of plus and minus adjustments each month; and
- c. apply that compensating plus or minus adjustment to the calculation of the first monthly payment after each quarter end.

⁵ payment will be effected on the 21st of the month or closest working day

The direction of revenue transfer will be determined by whether funds are due to IOM or to HMRC at the end of each quarter and will be paid by HMRC or IOM as appropriate on the agreed date for months 4, 7, 10 and 1 of the new year. The quarterly adjustments will allow for fluctuating monthly revenue levels and avoid the potential for any material under/overpayment building up during the year.

It is assumed that actual joint revenue receipts by IOM will follow forecasts. Where the trend indicated by actual receipts exceeds the results in Step 1 by more than 10% on the annual figures, then transfers to IOM will be suspended, Step 1 will be recalculated and the full amount of the overpaid advance will immediately become due to HMRC. Where the trend indicated by actual receipts is 10% (or more) beneath the results in Step 1 on the annual figures, then transfers to IOM will be suspended, Step 1 will be recalculated and the full amount of the underpaid arrears will immediately become due to IOM.

Step 3 – Make annual adjustments at year end

The annual adjustment calculations will use the revenue receipt and national income adjustments (Steps 5 and 6 in paragraph 5), calculated within the specified timeframe and any additional revenue amounts due to IOM will be paid as a single adjusting payment by HMRC in the first possible month (probably July) in the relevant year. The payment will be made with, or offset against, the monthly payment due for that month as appropriate. Any overpayment to IOM will be paid as a single adjusting payment by IOM in the first possible month (probably July) along with or offset against the monthly payments due for that month as appropriate.

Other related issues

11. Capacity to make repayments

Both IOM and HMRC will ensure that where an immediate repayment does become due then funds will have been deposited in a sufficiently flexible way to allow instant access.

12. In addition to agreeing modernised revenue sharing arrangements (as set out above), in March 2007 the two parties also agreed to the following:

- Any retrospective **adjustments to revenue allocations to be made within 5 years of the relevant year end**; and
- HMRC/IOM to undertake a **joint review of the 'Cost of Collection' arrangements** at the end of the transitional period.

13. It was also agreed that the **1979 Agreement would be amended to update its provisions**, in particular to include a **two year period of notice** for either party to end the Agreement.

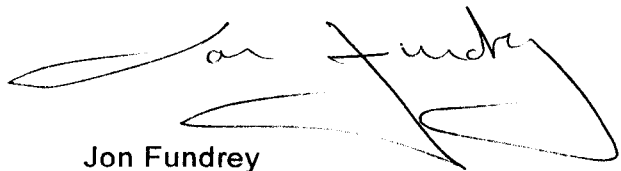
Date of adoption and implementation

14. The original arrangements set out in this note, were endorsed by UK and IOM Treasury Ministers in March 2007; the revised arrangements have been adopted and applied from the start of the 2008/09 financial year.

Signed



Mark Shimmin
Chief Financial Officer
Isle of Man Government
5th August 2008



Jon Fundrey
Financial Controller
HM Revenue & Customs
5th August 2008

TRANSITIONAL (VAT) PAYMENTS TO BE MADE TO THE IOM
(see paragraphs 8 and 9)

Expected VAT revenue 2005/06	£276m
(GNP growth model) VAT revenue using 1999/2000 as the base year:	£203m
Difference:	£73m

Year 1 (2007/08)	£58m (80% of £73m)
Year 2 (2008/09)	£44m (60% of £73m)
Year 3 (2009/10)	£29m (40% of £73m)
Year 4 (2010/11)	£15m (20% of £73m)

Appendix

Worked example of revenue allocations for 2007/08 using GNP Growth Model (using illustrative, rounded figures)

	Isle of Man	United Kingdom			
1	1999/00 VAT allocations	£132,364,000	£56,707,076,000		
	Step 1 Obtain National income data				
	Obtain data before April 2007				
2	1999/00 national income (£ billion) (2006 vintage)	1.031778	809.525		
	2004/05 national income (£ billion) (Last published for UK and IOM)	1.559063	1,081.009		
	2005/06 Obtain growth rates (%)	6.0%	4.0%		
	2006/07 Obtain growth rates (%)	6.0%	4.0%		
	2007/08 Obtain growth rates (%)	6.0%	4.0%		
3	Step 1 2007/08 National income forecast (£ billion) (See Note 1)	1.856869	1,215.988		
	Step 2 Calculate IOM sharing fraction for the focal year				
4	Step 2a) National income change (3 / 2)	1.800	1.502		
	Step 2b) Notional VAT allocation (1 x 4) = (1 x 3 / 2)	£238,212,683	£85,179,701,861		
5	Step 2c) Provisional sharing fractions (See Note 2)	0.002788791	0.997211209	VAT	Other duties
	Obtain forecasts of VAT and Other duties receipts for 2007/08 (£ billion) before April 2007			79.0	17.0
6	Step 3 Apply provisional sharing fraction to forecast VAT receipts (5 x 6)			96.0	96.0
A1	Step 4 Apply provisional sharing fraction to forecast receipts of other duties (5 x 6)	£220,314,462.60			
A2	Total interim revenue allocations for 2007/08 (A1 + A2)	£47,409,441.32			
A	Step 5 Annual adjustment to take account of certified joint revenues	£267,723,903.92		VAT	Other duties
	Obtain certified revenue receipts for 2007/08 (£ billion) before end of June 2008			80.0	18.0
7	Adjustment for certified revenue using provisional sharing fraction (5 x (7 - 6)) (See Note 3)	£5,577,581.33		98.0	98.0
B	Step 6 Annual adjustments for national income data (See Note 5)				
	Obtain new and revised national income data, probably mid-2009				
8	1999/00 national income (£ billion) (2009 vintage) (Compare with 2)	1.031778			
9	2007/08 national income (£ billion) (2009 vintage)	1.909919			
10	Step 6a) Revised National income change (9 / 8) (Compare with 4)	1.851			
	Step 6b) Revised Notional VAT allocation (1 x 10)	245,018,354			
11	Step 6c) Revised sharing fractions (See Note 2)	0.002839636			
C	Adjust for national income data ((11 - 5) x 7) (See Note 4)	£4,982,862.22			

Note 1

Calculated by applying growth rates to 2004/05 data being the most recent published by the UK and IOM.

Note 2

The provisional and revised sharing fractions are calculated by dividing each jurisdiction's notional VAT allocation by the total notional VAT allocation.

Note 3

The calculation is the provisional sharing fraction applied to the difference between actual and forecast total receipts.

Note 4

The calculation is the difference between the revised and provisional sharing fractions applied to actual revenue receipts.

Note 5

Only one paragraph 5 Step 6 adjustment is shown.