

Lords expected to support arctic systems verdict

When the "Arctic Systems" case is heard by the House of Lords in June, most legal observers believe that the Lords will support the appeal [won last March](#) by the couple Geoff and Diana Jones.

"The Lords tend to take a common-sense approach to the law, and that means that they will be likely to see the Jones' view of the matter—in which they merely followed advice that every accountant and tax lawyer in the land would have concurred with," said one law specialist legal advisor (who preferred not to be named). "In this, most of us agree, and we expected the Appeals Court verdict as well." (The Appeals Court reference is: Court of Appeal in Jones v Garnett [2005] EWCA Civ 1553).

The Jones family are contesting the case with the support of the [Professional Contractors Group](#) which, like the rest of the industry, sees the case as a crucial test for how contractors may operate family businesses under [Section 660a](#) of the code. About 100 similar cases may depend on this one for their rulings.

Arctic Systems, which was set up in 1992 and owned jointly by the Joneses, had a sole director - Mr Jones - while Mrs Jones was its company secretary. It remunerated both for their respective services and, as the business flourished, paid them dividends.

Both Mr. and Mrs. Jones took their payments from the business in the form of dividends. In 1999/2000, the dividend payouts totalled £25,767 each. But the Revenue claimed that the 1992 arrangements amounted to a "settlement", and that the dividend paid to Mrs Jones represented income under this. The Internal Revenue argued that that the couple owed £42,000 in additional tax payments on dividends paid from their company over a six-year period, because Mrs. Jones should be taxed at the same rate as her husband. It is clear from the way the Jones' operate their business that Mr. Jones is the big earner of the two.

The Appeals Court did not accept the argument of The Revenue, and ordered that Mrs. Jones be taxed at the lower rate normally appropriate to her lower income. The Court ruled that the payments to Mrs. Jones did not constitute a settlement, as The Revenue had argued. As the Institute of Chartered Accountants points out: The Revenue will not revise their guidance on the settlements legislation until the House of Lords' opinion is known. They note that the Court of Appeal judgement represents the law as it now stands, and that taxpayers whose circumstances are consistent with the situation in Jones v Garnett are entitled to self assess or, within the time limits allowed, amend a self assessment in accordance with that judgement.

"Spouses who work with their husbands or wives in family businesses should be recognised," says Kate Cottrell, a principal with the Westoning, Beds. -based law firm Bauer and Cottrell. "They contribute not only through work, but also in sharing the stresses, handling the thousand-and-one little things that need to be done. Tax law should take this into account."

But, assuming the Lords support the Appeals Court verdict, what will be the long-term consequences of the decision? "If the Revenue is not satisfied with such a decision, it is possible that pressure will be put on the legislature to introduce legislation that does achieve its aims. If such legislation is introduced, one can only hope that it is drafted with clarity to avoid the need for the courts to interpret its true meaning several years or even decades later. This would at least bring some measure of stability to the contracting industry, which is currently beleaguered by red-tape and uncertainty on all fronts," comments James May, head of Contractor Services at the Hove-based legal consultancy [Lawspeed](#).

But it is important for the industry that measures be taken to see that the tax laws are respected. "Historically, in the contracting industry, and many small businesses, there have been family members 'working,' taking a salary without actually doing any work at all," says an experienced contractor. "When I joined the industry ten years ago, I was encouraged by advisors to hire my mother as a director and to pay her dividends. That's the kind of practice we need to put an end to."

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