

## Contractors could pay 10% more in the treasury's Arctic Systems attack

In what seems to be a determined attempt to hurt the burgeoning UK contracting industry, [HM Treasury has announced](#) the intention of increasing the tax burden on small business. The Treasury said on July 26 that it would seek to remove the tax provision that allows contractors to divide the income from their companies with their spouses as dividends (see [Treasury statement](#)).

### Treasury Loses Arctic Systems...

The announcement comes in the wake of the [Revenue's definitive defeat in the Arctic Systems case](#) which was decided by the House of Lords on July 25. The Law Lords ruled that spouses may transfer property between themselves from which future income is derived. Ordinary shares in a company will always qualify for the exemption (although preference shares may not). This means that husband and wife contractor teams may continue to share the income from their limited companies in dividends and that they will only be taxed individually for the income.

### ...But Now Seeks To Change the Law

Should the Treasury have its way and succeed in changing the law, the legislation will mean a decrease in net income (or increased tax bill) of around 10-12% for contractors who earn more than GBP 25 per hour, ContractorCalculator has determined. (You can check the effect on your own income using the [Section660 Calculator](#) on our site. It calculates the effect of dividend splits no longer being possible.) Contractor couples could pay up to GBP 830 more in taxes each month, or close to GBP 10,000 more per year!

### Is It Fair?

But does the Treasury have some basis for this attack? Many expert observers believe that the law is just as it stands, and that an attack of this kind would have an unwarranted effect on the UK economy.

Says Bill Dodwell, a tax partner at the consulting firm [Deloitte](#) in London: "There are very strong arguments in favour of leaving the current system unchanged."

"The result from the Arctic Systems case is that the Treasury will need to consider the right tax policy. Gordon Brown, in the last Budget, increased the small companies rate of corporation tax over 3 years from 19% to 22%, specifically to increase the rate of tax borne in this situation. Very small businesses, such as Arctic Systems, have provided a considerable boost to the economy over the last ten years and bear considerable risk, since their income has much less security than is the case for employees. They also have to bear their own pension costs."

**“ There are very strong arguments in favour of leaving the current system unchanged ”**

Bill Dodwell - Deloitte

### The Government Should Consult

The London-based [Chartered Institute of Taxation](#), an independent agency consulted by the Government on tax law, agrees that the Treasury should reconsider this move, and are asking the Government to take their time and reflect on the decision before rushing to legislate.

Andrew Hubbard, CIOT vice-president, says: "It is entirely right and proper for Government to decide who pays tax and how it is paid. However, the Ministerial statement [on Arctic Systems of July 26] will almost certainly lead to yet more complex tax legislation to deal with the situation that Mr and Mrs Jones faced. Given the new Chancellor's stated commitment to making the tax system simpler, this would be a backward step and one which we would like to avoid."

The CIOT hopes that HM Treasury and HM Revenue & Customs will fully consult and listen to all interested parties before creating tax law that increases uncertainty further and puts yet more obstacles in the way of small businesses.

Says Hubbard: "The Government announced a review of small business taxation in 2004 and it would be much better to await the outcome of this review rather than rush through legislation. The professional bodies believe that there have been too many cases in the recent past where legislation introduced without proper consideration and consultation has ended up creating more problems than it solves."

### No Quick Fix

Francesca Lagerberg, chairman of the Technical Committee of the London-based Institute of Chartered Accountants Tax Faculty, says: "The Government is looking to review situations where family members are involved together in a business. It appears that the tax authorities will seek to separate out 'commercial' situations from those where it believes dividends are being passed to lower rate taxpayers primarily to keep down the tax bill. The reality is that most businesses do not fall into such neat categories. There is a danger that rushed legislation will result in unworkable legislation, plunging thousands of taxpayers into yet more uncertainty about

their tax position. There is no 'quick fix' formula that we think could work."

## PCG Also Protests

The London-based [Professional Contractors Group](#), which provided financial and expert support for the Arctic Systems case, has also protested against the Treasury announcement.

Says PCG chairman David Ramsden: "We question why the Government suddenly wishes to jeopardise the UK's vibrant small business sector by reversing this well-established policy."

“ There is no quick fix here ”

Francesca Lagerberg- ICAEW

"We are also dismayed that new legislation is on the cards, given that HM Revenue and Customs consistently refused to acknowledge that the Arctic Systems case was a test case – if it did not test any significant new point of law, why does the law suddenly need changing? And if the law needs changing, why did the Government not just do that to begin with, instead of chasing Geoff and Diana Jones to the House of Lords? This development clearly shows that the Government should have been honest and legislated in the first place, so that we could have had a proper debate about how small businesses should be taxed."

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