

Contractors face unworkable proposals on income splitting

There were no positive reactions from tax experts to the [Government's proposed measures for 'income splitting'](#) in contractor companies. Instead, the epithets applied were: "conceptually difficult," "unworkable," and an invitation to the same kind of uncertainty that followed the [IR35](#) and the [managed service company legislation](#).

Unworkable Proposal

Says Frank Haskew, head of the taxation faculty at the London-based [Institute of Chartered Accountants](#): "Whilst we understand the Government's concerns about 'income splitting' following the [Arctic Systems case](#), we are not convinced that income splitting is workable in practice. We welcome the decision to consult but think that a more considered response is required."

"The fact is, says Haskew, "is that the Treasury is floundering over this. We risk seeing the uncertainty created by IR35 and managed service companies all over again."

Despite Protests

"This proposal for 'income splitting' went through despite our protests," says [Simon Sweetman](#), a tax consultant based in Felixstowe, Suffolk, and a member of the [Federation of Small Business](#).

"First of all, the time period for the consultation is too short. Then consultants will have to content themselves with minor changes in the draft legislation. We will only have until March to act on this complex and ill-defined subject, Sweetman complains. A spokesman for the Treasury told ContractorCalculator that the draft consultation would appear toward the end of November."

“ It risks creating the uncertainty that IR35 and managed service companies legislation did before ”

Frank Haskew- Institute of Chartered Accountants

Difficult To Frame

Then Sweetman explains the difficulties involved in drafting such a singular proposal. "Companies of a certain size will have to be singled out in some way; it's not clear how. Public companies are exempt, but partnerships are not. And some way will have to be found to decide how to choose who is splitting income: married couples are certainly intended, but what about other kinds of income splitting?"

Who Is Worthy?

But the most difficult question remains that of deciding who is worthy of income splitting, and who isn't? Says Haskew: "How will we decide--before the intervention of the Revenue--if a family member or partner plays a sufficient role in the business to permit income splitting? According to the Arctic Systems case, a spouse and bookkeeper isn't worthy? But what will be the threshold to determine who is? Families make sacrifices to allow the fee earner to make the business work; are all family members to be shut out from dividend income?"

The Revenue Will Earn Nothing

"The worst aspect of it, says Haskew, is that the proposals will almost certainly not earn any money for the Revenue as it will prove impossible to enforce, just like [IR35](#)."

Andrew Hubbard, vice-president of the London-based [Chartered Institute of Taxation](#), points out that what is needed is a full-scale review of small business taxation, one that the experts have been calling for over a period of years, instead of patchwork measures like this."

"There was a full-scale review of small business taxation that took place in 2004 in which all the appropriate organisations were involved," Hubbard reminds us. "The review was to create an entirely different system for small business, one that would avoid the pitfalls like those we are seeing today. Unfortunately, that review got stuck in the mud. But a full-scale overhaul is what is needed, and not sticking plasters of this type."

Hubbard despairs of finding a workable approach within the terms set by the Government. "The critical question for professional bodies like the CIOT is: how can this issue be made into law in a way that is clear and not unreasonably burdensome for small businesses to comply?"

“ The proposal will almost certainly earn no money for the Revenue ”

Frank Haskew- Institute of Chartered Accountants

All the experts agree that there is no clear answer to this question at present, least of all within the Treasury.

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