Contractor Doctor: Can I give children shares in my contracting company to save tax?

Dear Contractor Doctor,

The IT contracting business I run with my wife is doing so well at the moment that, even though the shares in our contractor limited company are equally split, we're approaching becoming higher rate taxpayers.

We've read that it is possible to create shares in our business that can pay dividends, but don't give the shareholders any say in how the company is run. We're thinking of giving shares to our three children to split dividends even further, and to keep me and my wife under the higher rate tax threshold.

Can I give my children shares in my contracting company to save tax?

Thanks

Liu

Contractor Doctor says:

It is perfectly legitimate to give shares to a child, but under current HMRC rules it won't save Liu any tax, because he'll continue to pay tax on his children's earnings as if they were his own.

There may also be complications if the contractor limited company's articles of association don't allow ownership of its shares by anyone under the age of 18; this is a common provision for many companies and could hinder the long-term growth plans of the contractor's company if they were to hand out shares to family members, and reducing the potential to bring on board investors in the future. In addition, children under 16 can no longer become company directors.

If ordinary voting shares are given to a child who is a minor, a contractor may even experience problems with accessing some services from their bank or entering into contracts or other arrangements that require all shareholders to agree.

Do children pay tax?

According to HMRC's guidance, children pay tax, just like any other individual, if their income exceeds their tax-free allowance. Once this happens, a child's income is taxed according to the same rules and rates as adults.

But they can receive income, such as dividends or bank interest, below the personal allowance without paying any tax. To prevent tax on interest being deducted at source, a parent, guardian or trustee must complete and sign a form R85 if the child is under sixteen.

HMRC's £100 rule

It is HMRC's £100 rule which scuppers Liu's tax avoidance strategy to further split the dividends from his contractor limited company by making use of his children's personal allowances.

According to HMRC, "where gifts from a parent produce more than £100 gross income a year, the whole of the income from the gifts is taxed as the parent's income". HMRC adds that the child can't reclaim any tax on this income nor can interest be paid without tax being deducted at source.

So, Liu could give shares in his and his wife's business to their children, but the dividend income from the shares would simply be added to the couple's income, potentially taking them both above the higher rate threshold he is trying to avoid.

The £100 rule applies separately to each parent, so if either parent makes a gift that results in more than £100 gross income a year, this income will be treated as each individual parent's income.

And the £100 rule applies to children until they reach the age of eighteen, or when they marry, whichever comes first.

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>
> HMRC

Where the £100 rule does not apply

Although gifts of shares to his children wouldn't save him any tax, Liu could give shares to his nieces and nephews, or the children of friends. HMRC says that the £100 rule "does not apply to gifts given by grandparents, other relatives of friends".

However, the nieces and nephews would pay tax once the dividend income exceeded their personal allowances and Liu potentially loses control of a chunk of his business, and income.

There is an outside chance that a contractor could try to prove that the shares are not a gift, but the child would have to pay for the shares with money that did not come from their parents, and the shares might still be subject to further challenge by HMRC under the **settlements legislation**.

Good luck with your contracting!

Contractor Doctor

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