

## Contractor Doctor: I've just married – can I share contracting income with my spouse?

Dear Contractor Doctor,

I am an IT contractor and have been contracting through my own [contractor limited company](#) for three years. My contracting income takes me into the higher rate tax band. I'm the sole director and own all the shares of the contracting company I incorporated three years ago.

I've just got married and I read somewhere that I can save tax if I get my new husband involved in my contracting business.

Can I share my contracting income with my spouse and reduce my tax liabilities?

Thanks

Maria

Contractor Doctor says:

Married contractors, or those in a civil partnership, can introduce a spouse into their contracting business to gain tax advantages. In fact, ['income shifting'](#), as it is known, is one of the oldest and widest used tax strategies for family businesses, and that includes husband and wife owned contractor limited companies.

A limited company contractor can [give shares in their contracting business to their spouse](#). Assuming the contractor has worked on a [classic low salary-high dividend model](#), this means that some of the [dividend income](#) is diverted to the spouse.

The result is that the fee-earning contractor reduces their personal income and, if they're a higher-rate or top-rate taxpayer, should pay less tax as a result. The new spouse now receives an income from the contracting business and, if the spouse has no or little other income, may pay little or no tax because the salary and dividend income they receive is within their higher rate tax band.

As long as certain conditions are satisfied, income splitting can all be done between cohabiting married couples and civil partners without any additional income tax, capital gains tax or inheritance tax liabilities, because of something called a 'spousal exemption' to the [settlements legislation](#).

### The settlements legislation

Married contractors considering income shifting may have come across a piece of tax law called the settlements legislation. Because HMRC was concerned about what it considered to be excessive tax avoidance by fee-earning contractors making 'bounteous settlements' of shares on their non-fee-earning spouses, it resuscitated a piece of 1920s tax law known as the settlements legislation.

It is also known as [Section 660](#) (a now defunct but still widely used name) and the 'income shifting legislation', but its correct name is Section 624 of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005.

The settlements legislation potentially considers the gift of shares from a fee-earning contractor to a non-fee-earning spouse as a 'bounteous settlement', and that any income arising from that settlement should continue to be taxed as if it were the fee-earning contractor's.

Instead of the contractor and spouse sharing income and maximising the use of the tax allowances, this appeared to open the door to HMRC taxing all the income on the fee-earner, thus hugely increasing the fee-earning spouse's tax bill.

And what was worse, was that HMRC backdated its assessments, so that if a husband and wife had been operating in this fashion for six years, then six year's worth of the non-earning spouse's income would be added to the contractor's, plus interest and penalties.

### The Arctic Systems ruling

The 'spousal exemption' from the settlements legislation was confirmed by the [Arctic Systems test case that went all the way to the Law Lords](#). In this case HMRC tried to prove that IT contractor Geoff Jones, the fee-earning spouse, had made a 'bounteous settlement' of shares in his company on his wife Diana, a non-fee earner. HMRC argued that the resulting dividend payments should be treated as Geoff Jones' income, and taxed accordingly.

But HMRC lost, and the case set the precedent that ordinary share ownership confers more than just a right to income. It also confirmed the existing exemption in the settlements legislation that allows contractors to jointly own their contractor limited company with a spouse or civil partner.

## Cohabiting married couples and civil partners only

The Arctic Systems case does not offer all contractors the opportunity to split their income and halve their tax bill with the significant other of their choice; it only applies in tightly defined circumstances. But fortunately, these circumstances do, or can, apply to the vast majority of married contractors.



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For contractors to qualify for a spousal exemption when income splitting by giving shares to a spouse:

The fee-earner and non-fee-earner must be married or in a civil partnership and living together. If they're not living together, the exemption does not apply

The shares gifted to the non-fee-earning spouse must be ordinary shares with full voting rights: preference shares or other classes of shares will not qualify for the spouse's exemption

The gift of shares is not simply a right to income – which is to say purely the income from dividends – rather than the rights, responsibilities and liabilities that come with share ownership in a business; a spouse must play an active role as a shareholder and, potentially, a director of the contracting company

The gift of shares is an 'outright gift': any dividends paid to the spouse should be their income to spend as they wish and not just a mechanism for routing money back to the main shareholder

All share transfers and dividends must be backed up by paperwork – use signed [stock transfer forms](#) and produce [board minutes and vouchers for dividends](#), or ask your accountant to prepare them.

Good luck with your contracting!

Contractor Doctor

Published: Tuesday, March 27, 2012

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