

Income shifting proposals: how contractors should cope

The Treasury is determined to put a stop to what it calls **income shifting** in family companies. If you **share dividends** with your spouse, you will now have to base the proportion of dividends your spouse gets on the "market value" of the services the spouse provides.

Market Value Determination

Based on income actually contributed

Based on cost of third-party services

Based on list of roles

Based on time saved by one spouse for the other

How Will It Work?

How will it work? "The short answer is that it will be very difficult to apply" says Simon Sweetman, a tax consultant based in Felixstowe who works with the London-based **Federation of Small Business**. "There is no clear-cut way to establish the market value of the services one person provides to another in a family company because the role that one person plays is hard to define." Sweetman gives the example of a spouse who drives the contractor to work every morning. "Is that the same value as a taxi ride? Who can say?" Sweetman points out.

What To Look For?

The example Sweetman gives provides a very clear way of seeing what's wrong with the proposal. But what can we do to establish market value?

Money Contributed?

"The most obvious way to establish market value is in terms of the money actually brought in to a company. But is that fair? In a large company, lots of employees don't actually contribute to the revenue stream. Why would that be different in a small company?"

Find Someone Similar?

We return to the example of the spouse who does the company website. You can look on the Web and see what it would cost if your website is done by a third party. You could then value your spouse's contribution in terms of that amount of income brought in, as Sweetman points out. But of course different Web site designers earn more or less income depending on how well skilled they are. You would have to value your spouse's contribution in terms of the equivalent service provider on the market. Again, it's difficult to say exactly how to do this, but it's a strategy.

"This is still not a precise answer, for there is none," Sweetman continues. "Consider what happens if your spouse answers the telephone when you are not there," Sweetman says. "Lots of people don't reply to voice mail. So having your spouse answer the phone could bring in additional business. That role should be valued accordingly, although one can't precisely say how much."

Count Up Roles?

One could arguably count up all the different roles played by a spouse in the business. These could include, for example, driving the contractor to the work site, answering the phone, doing the books, helping the contractor with writing up reports, possibly even doing some of the same work the contractor is doing. Take each one, find a market value, however imprecise, and then add them up.

How Many Hours?

One other possibility would be to consider how many hours of work the contractor saves by having the spouse play various roles in the business. If your spouse does the books for you, how many hours of time does it take? If you had spent that time, you could value it at your hourly rate? Same would go for any letter-writing or reports that your spouse did for you.

Share Transfers

If all of this makes you want to throw up your hands, and just have your spouse sell you the shares in the company, you could go that route, although your spouse would then forego any dividend income. Sweetman explains that, unless your company has significant tangible assets like property or machinery, this could be done by giving a small notional value to the shares. It is almost impossible to establish market value for shares in a small private company for there is no liquid market in which to dispose of these shares.

Time and some nasty court cases will tell which of these approaches are to become established usage. They are all subjects to discuss with a professional,

for above all, you should take advice in this matter which even the most skilled experts are uncertain about.

Published: Wednesday, December 12, 2007

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