What is section 660?

Editors note (Feb 2012):
Section 660 was replaced by the settlements legislation in 2005, as Section 624 of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005. For more info see settlements legislation.

Introduction

Section 660 is a hot topic that significantly affects not only contractors but a huge number of other small businesses.

This article provides an overview of section 660, explains what it is and how it will affect contractors financially.

What is Section 660?

Original tax legislation introduced the concept over 70 years ago and it has remained in current tax legislation as amended since that time.

It deals with situations where income arises for one person but is allocated to another. This allocation activity is referred to as a "settlement".

The legislation is intended to stop one person "settling" his income to another, to then pay tax at a lower rate.

The courts have held that in order for this legislation to apply, one party must give to the other party something for free and have referred to such a transfer as a "bounty".

For many years contractors have set up dual ownership companies with their partners, and transferred a proportion of the income to them via dividends.

The application of Section 660 is an attempt to tax all the dividend income as if the partner did not exist and it was all paid to the fee earning contractor.

When did this become an issue?

Although it has existed for years, it has only recently been applied aggressively against the contracting industry as part of an ongoing campaign by HMRC against one person service companies.

How much could it cost contractors?

HMRC seek to apply the legislation retrospectively (a 'a back duty case') by taking into account the last six years.

The potential tax charge with interest and penalties, should HMRC prove successful, would to an average contractor, amount to several tens of thousands of pounds.

For an examination of the potential cost see '**How Much Could Section 660 Cost You**'.

You can also calculate how it could affect you personally using the **Section 660 Calculator**.

What can you do?

It is of paramount importance to take advice on this subject, particularly if you are a prime target, i.e. your company has existed/been trading for a number of years and you have been paying dividends to a non working or lower rate tax paying spouse/partner, when you (the sole fee earner) are a higher rate tax payer.

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An attack by HMRC is also far more likely if a very small salary has been paid with very large dividends being allocated to non working partners.

What if you are caught by IR35?

If your contract falls within IR35 and all income is paid by salary you will not be affected. The legislation only applies to income allocations to the non fee earner, which would not be possible with an IR35 caught contract.

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