



The voice of freelancing

Commentary on the Chancellor's evidence to the Treasury Select Committee regarding "income shifting"

On March 19th 2008 the Chancellor gave evidence to the Treasury Committee on, among other things, the proposed legislation on what he terms "income shifting". PCG has been shocked by some of his comments, which illustrate the fundamental misunderstandings on which the proposals are based.

In the quotes below, the Chancellor is responding to questions from John Thurso MP (Lib Dem) and Philip Dunne MP (Con). PCG's commentary is in italics.

Q415 John Thurso: At paragraph 4.69, the Red Book states, "The government firmly believes it is unfair that some individuals can arrange their affairs to gain a tax advantage by shifting part of their income to another person." Why is it unfair?

Mr Darling: If you have two people who are employed, they pay through the PAYE system and they have no choice about it. It just comes off at whatever rate is applicable. What is unfair is if you get a husband and wife, the husband is doing all the work and the wife does not make a contribution to the business and she can utilise her tax advantage in a way that just would not be open to anybody else.

The Chancellor's comments here are extremely surprising. He makes no distinction between employees and people who are in business on their own account: the fact that the Chancellor of the Exchequer sees two such fundamentally different economic units as directly comparable is deeply disturbing.

[...]

We had always understood that that was what the law was until the Arctic case last summer. I do not have any problem with husbands and wives who are partners in a business and they are both working. It seems to me that it is absolutely right that we should recognise that through the tax system. Where you have the problem is where one of them is not doing any work at all.

The Chancellor is incorrect to suggest that family businesses were unable to distribute profits among their owners and potentially realise a tax saving prior to Arctic: this had been long-standing best practice since the independent taxation of spouses was introduced in the 1980s, and was recommended by the Government's Business Link website.

It is also strange that the Chancellor accepts as legitimate businesses where both owners are working, and condemns those where one owner is not. As was accepted by both sides during the Arctic Systems case, both owners of Arctic Systems worked for the business; it would be wholly wrong to suggest that either was "not doing any work at all". Yet HMRC spent upwards of half a million pounds pursuing this business - now apparently perfectly acceptable to the Government - to the House of Lords, and the draft "income shifting" legislation would capture it within scope.

[...]

What I think is unfair and the whole point of having a consultation to look at this is, if you get one couple who happen to be in the PAYE system - one may be working and one may not - the working man or woman cannot transfer money to the spouse.

Again, the Chancellor makes the bizarre direct comparison between employees and people who are in business: he seems not to have any grasp of the fundamental differences between the two, principally the commercial risk to which businesspeople are exposed.

[...]

Mr Darling: That is exploiting a situation that is not open to the majority of people. Up until last summer when we had this court case, I think it was generally understood that if somebody was working, making a



The voice of freelancing

contribution, they could be fairly rewarded for that. What I readily accept, which is why we have delayed this, is that it is quite difficult to legislate for it. What I am very sure about is that if we do not address this problem we are going to lose more and more tax.

The Chancellor's assertion that the Exchequer will "lose more and more tax" following Arctic is bizarre: the tax arrangements tested in the case were totally standard, and have been recommended by accountants for twenty years. Nothing changed after the Arctic case: all it did was confirm the status quo. There is no risk whatsoever of Exchequer revenues being hit as a result of it.

The Chancellor is also wrong to speak of tax being "lost"; the whole point of the Arctic case was that the revenues sought by HMRC were never owed. Any attempt to obtain them via new legislation represents a tax increase; it does not represent any reclaiming of "lost" tax revenues.

[...]

Mr Darling: I have no difficulty with the idea that you get many husbands and wives who are partners in business, who both make a contribution. Some of it is very obvious in terms of somebody doing work and some of it is less obvious.

PCG cannot understand why, if Mr Darling has "no difficulty" with husbands and wives being in business together, and has sufficient understanding of business to know that the contributions of co-owners can vary and not be "obvious", he feels able to justify HMRC chasing Geoff and Diana Jones to the House of Lords, and how he can justify "income shifting" legislation that will penalise the very businesses with whom he has "no difficulty".

Q398 Mr Dunne: I have other questions. By contrast, you have decided to defer the income shifting arrangements for a whole year to undertake further consultation. The point I was making is that businessmen have to make decisions and it may take more than the few weeks that were available to them to implement those.

Mr Darling: Yes, but on income shifting you may recall it started off with the decision of the Arctic case in October.

It is disingenuous of the Chancellor to suggest that "it started off" with the Arctic Systems case (we presume that his reference to October is intended to allude to the Pre-Budget Report, which included confirmation of the Government's intention to legislate, rather than the Arctic case itself, which concluded in the House of Lords over the summer). The Inland Revenue made its intention to re-interpret the settlements legislation clear in 2003, with the publication of Tax Bulletin 64.

Moreover, the profit-sharing that the Chancellor refers to as "income shifting" has been taking place since the independent taxation of spouses was introduced in the 1980s: nothing has changed since Arctic.

Commenting on: UNCORRECTED TRANSCRIPT OF ORAL EVIDENCE To be published as HC 430-iii
House of COMMONS, MINUTES OF EVIDENCE TAKEN BEFORE, TREASURY COMMITTEE