Response to the consultation on "Income Shifting" draft legislation

Executive summary

PCG opposes the proposed Family Business Tax (FBT), referred to by the Government as legislation on "income shifting". It is not fair, not workable and not justified by any evidence or argument in the consultation paper.

The proposals are not fair

- PCG believes that when two or more people are equally exposed to the risk of running a business, they should be equally entitled to share in the rewards: this proposal denies this basic principle.
- Nothing has changed since the introduction of the independent taxation of spouses to justify its reversal as proposed here; independent taxation is fair, workable and well-understood, and should be preserved unless and until a compelling reason for its replacement emerges.
- The proposals seek to tax business profits as if they were personal income akin to a salary: they seek to deny the legitimacy of hundreds of thousands of businesses. This is an insult to businesspeople throughout the UK.

The proposals are not workable

- The proposals show a total lack of understanding of how family businesses operate: applying "commercial" tests to them is a nonsense, because they only exist, and only operate, by virtue of family relationships, not "commercial" ones.
- The FBT will create a disproportionate burden on small businesses, who will face an enormous amount of red tape in recording and valuing all work done for the business; this will destroy the progress made by HMRC towards its target of cutting administrative burdens on businesses by 15%, and is in contravention of the Hampton principles of Better Regulation.
- Applying the rules, particularly with regard to applying "market rate" values to work done within a family business, will be impossible to do with any certainty; accordingly, businesses will be unable to meet their obligations under self-assessment.
- Tax inspectors will take an increasingly aggressive attitude towards small businesses: as so many taxpayers will inevitably make mistakes when self-assessing under this legislation, tax inspectors will come to presume, even more than they already do, that all small businesses have got it wrong; the relationship between HMRC and business will sink even lower.

The consultation document does not offer a justification for the measure

- The introduction of this measure is politically-driven: there seems no other explanation for the Government's apparent determination not to listen to reasoned argument.
- The Government has committed to the policy without having established any evidential basis for it, as demonstrated by the incompleteness of the draft Impact Assessment; PCG will be raising the inadequacy of the consultation process with the Better Regulation Executive.
- The FBT is being driven by the Government's need to increase tax revenues, and is essentially a tax grab; PCG calls on the Government to raise taxes fairly and transparently if it needs to, rather than targeting particular groups.

The draft Impact Assessment does not identify the likely impacts

- The proposals will create a disincentive to enterprise: there will be fewer start-ups and many existing businesses may close down and their owners decide to abandon their business careers and seek to return to permanent employment; this will also reduce labour market flexibility.
- The consultation document and draft Impact Assessment suggest that the FBT will produce a higher tax yield for minimal extra costs to business and HMRC: in fact, the costs to HMRC and the taxpayer will be not only high, but disproportionate, and the predicted tax yield is unlikely to emerge.

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Introduction

PCG is opposed to this legislation, both for practical reasons and reasons of principle. We urge the Government not to introduce it: all other representative bodies whose comments we have seen have also expressed the most serious misgivings about the proposals, and it is beholden upon a government in a mature democracy to listen to what its citizens are telling it. That message is unambiguous: this legislation is grossly unfair and not at all workable.

The proposed measure will deal a terrible blow to family businesses in the UK: PCG does not accept that family businesses who will lose out are doing anything wrong, and does not accept the legitimacy of the term "income shifting". Accordingly, this response will refer to the proposals as a Family Business Tax ("FBT") and use the term "income shifting" only in inverted commas.

The discussion will make repeated reference to married couples, as well as family businesses more generally, on the basis that a married couple is the most common unit around which family businesses are established; such references will be taken equally to apply to civil partners throughout, as well as to non-married partners, who will be equally affected given that the legislation does not rest on a "connected persons" test. Married couples are also the most common unit around which jointly-owned businesses are established within the PCG membership. We acknowledge, however, that the legislation is so widely drafted as to oblige most jointly-owned private businesses to consider their positions, whether they are owned by family members or not.

PCG notes that the Government is not consulting on the principle of this legislation, or on whether or not the measure should go ahead. This is despite the draft Impact Assessment stating frankly that it is difficult to quantify the phenomena the measure is aimed at, and also failing to give any convincing data to support the measure. There is therefore no evidence that a problem exists that must be corrected, and a policy decision has been taken before a full Impact Assessment has been carried out. This is not an acceptable basis for the formulation of government policy, and PCG will be raising this issue with the Better Regulation Executive.

We acknowledge that the consultation does not seek views on the principle of the legislation or on whether or not it should be introduced. Nevertheless, this is where PCG will focus its response: as a representative body we would be failing in our duty to our members if we did not draw attention to the serious difficulties this legislation will inevitable entail, irrespective of any changes brought about in respect of the questions that the consultation paper does ask.

PCG notes that the Pre-Budget Report of 2007, in which the Government's intention to introduce the FBT was confirmed and the term "income shifting" coined, also contained a review of anti-avoidance legislation. PCG questions why this legislation is being introduced before the results of that review are known, and is sadly drawn towards the conclusion that the "review" of anti-avoidance legislation can only possibly have been a sham.

If the Government needs to raise more tax, PCG calls on it to do so in a fair, transparent and simple manner, by raising an existing tax rate rather than targeting one particular group of taxpayers and arbitrarily singling them out to be taxed more heavily.

In addition to this document PCG has produced a detailed commentary on the consultation paper, draft legislation, draft guidance and draft Impact Assessment.

Throughout this document, the consultation paper will be cited in a different font.

1. Workability
i) Self-assessment
The Government seems to have given inadequate thought to the likely consequences of these proposals. This is particularly disappointing as, after IR35, the MSC rules and other complex, "targeted" tax measures, it should have plenty of information on which to draw.

As with any enforcement system, it is impossible for the state to apply the rules individually to each citizen: for the system to work, citizens must be willing and able to apply the rules themselves. Just as the police would be overwhelmed if all citizens decided one day to assault the first person that they saw, so HMRC cannot investigate the affairs of every taxpayer in every year.

In all these circumstances, therefore, the obligations imposed on the subject must be clear and bearable, and must be obligations with which the subject is reasonably content to comply. The proposed legislation is far too difficult in practice for this to be the case: while PCG condemns any deliberate non-payment of tax owed in law, it must be observed that these new laws are unlikely to enjoy a good record of compliance, simply because nobody will be able to comply with any confidence.

The key problem here, as with IR35, will be the sheer uncertainty that business owners will face. This measure is worse than IR35 in this respect, however, as there will be two questions to consider:

- firstly, and as with IR35, do the new rules apply?
- secondly, has the tax liability been calculated in a way that HMRC will find acceptable?

This latter question does not apply so much with IR35, as once it has been established whether the legislation applies or not, working out the tax owed is a well-defined process. With the "income shifting" rules, working out the tax liability relies far more on subjective judgments.

One consequence of this will be that taxpayers will be more inclined to take out insurance products to cover their professional costs in the event of an HMRC investigation under the new rules: such an investigation is, given the complexity of the proposed laws and the well-documented pattern of IR35 investigations, likely to be aggressive, lengthy, and highly stressful for the taxpayer. It is entirely rational behaviour on the part of the taxpayer to seek to protect themselves against this eventuality, and the Impact Assessment should have included an estimate of the likely cost burden on business it will entail.

More seriously, the new legislation, in conjunction with the new Penalties framework recently developed by HMRC, is likely to reduce taxpayers' incentives to meet their obligations, in direct contradiction of HMRC's stated objectives. The legislation is so difficult to apply that business owners may well decide that their best option is to make a token effort at doing so, admit to a relatively low liability, and then hope not to be investigated. If they are unlucky enough to be picked on by HMRC, they will be able to claim

quite credibly that they tried to apply the rules but innocently got it wrong: unless HMRC can demonstrate a calculated effort to under-state their tax affairs, the owners will not be faced with a penalty.

ii) Problems for all jointly-owned businesses
The proposals are so widely-drafted that any "non-commercial" arrangements will be caught. Even unconnected persons who set up a business by virtue of being friends could easily stray into the scope of the rules, if their distribution of profits does not precisely match their "contribution": the rules will be so difficult to administer that they will create an enormous disincentive for people to set up businesses jointly. PCG anticipates that many accountants and business advisers will advise people not to set up businesses jointly if they can possibly help it: enterprise in the UK will diminish as a result, as will employment, and as will tax revenues.

iii) Record-keeping
The consultation paper claims in places that the measure will not impose any new red tape on small businesses, and will not require the keeping of additional records. In other places, it admits that the record-keeping requirements of the new measure are considerable: although the requirements are not set out explicitly in the legislation, all taxpayers who own businesses jointly will have to maintain records to demonstrate, in the event of an investigation by HMRC, that profits are shared in a "commercial" way.

B.45 The income shifting legislation does not mean that businesses will have to maintain any additional records.

This is an outrageous statement: it is clear that many businesses will have to keep many new records in order to comply with the legislation.

[B45 contd.] In the vast majority of cases it should be clear from the existing business records, other documents and/or agreements whether the new legislation applies or not.

This is plainly not the case: small family businesses do not generally keep timesheets showing the contribution of each individual to the business, nor do they assess "market rates" for given types of work and then seek to pay the appropriate "market rate". Most rely on informal ways of working that develop over time, often relying on trust that would not be extended to unrelated workers.

B.63 HMRC may enquire into whether the approach adopted in assessing the amount of the shifted income was reasonable. If so, HMRC may ask to see the underlying records and other factors that have been used to assess the amount of income shifted. In addition, HMRC may ask for sight of any business records or other documents that might be relevant in assessing the amount of income shifted. This might include any of the following:

documentation showing how an individual has arrived at the amount of the income shifted;

documentation that demonstrates the nature and extent of the work done by individual 2, which may include contracts of employment, time sheets, board minutes, any research done on the market rates of pay for the duties undertaken by individual 2 etc.;

documentation that demonstrates the amount of capital or loans invested in the business by individual 2, which may include copies of accounts, bank statements, loan agreements, shareholder or partnership agreements; and

documentation that demonstrates the nature and amount of personal guarantees provided by individual 2, which may include copies of accounts, bank statements, loan agreements, shareholder or partnership agreements.

This gives the lie to the ridiculous claim, only pages earlier in the consultation document, that businesses will not be required to keep further records as a result of the new legislation: most of the above records will be records that are unnecessary at present and therefore not kept by most businesses.

Owners of family businesses will not already keep records “showing how an individual has arrived at the amount of income shifted” for the very good reason that they do not “shift income” and do not regard themselves as “shifting income” – the concept is a novel one and has been imagined by the Government. No business in the country keeps records of the amount of “income shifted”, still less do any keep records of how they calculated the figure.

iv) Comparison with transfer pricing rules

The FBT requires businesses who are caught to undertake calculations that are substantially similar to those required of larger companies under transfer pricing rules. Under these tax rules, transactions between connected parties must be taxed with reference to the amount of profit that would have arisen if the same transaction had been carried out on an “arm’s length” basis.

This comparison will show the enormous difficulty of valuing contributions to small family businesses on a “commercial” basis.

The former Inland Revenue’s International Manual (INTM431010) stated:

“But the complexities of applying the arms' length principle in practice should not be underestimated. Because of the closeness of the relationship between the parties there can be genuine difficulties in determining what arm's length terms would have been - especially where it is not possible to find wholly comparable transactions between unconnected parties. There are many factors to take into account. Consequently, the exercise can be as much an art as a science.”

Let us be clear about what this passage tells us about the transfer pricing processes that the Government now expects family businesses to operate:

- the application of arm’s length principles is complex, to an extent that “should not be underestimated”
- determining what the arm’s length terms should be can entail “genuine difficulties”
- it may not be possible to find wholly commercial transactions between unconnected parties for the purposes of making comparisons
- the process is “as much an art as a science”.

It cannot be fair or proportionate to impose these extremely difficult processes on small businesses, many of whom may not even have an accountant (indeed, even those that do may find them of little help, as accountants who specialise in assisting small business clients will have no experience of transfer pricing).

When the Inland Revenue overhauled the transfer pricing legislation in the late 1990s it introduced a code entailing “Board’s approval”: this means that every enquiry case under the transfer pricing rules entails a degree of Head Office oversight. The consultation document makes no mention of including an equivalent safeguard for the new rules.

The Inland Revenue’s Tax Bulletin of October 1998 contained a useful overview of the then-new transfer pricing rules. This included guidance on the types of documentation that might have to be retained in order to demonstrate the basis on which the legislation had been applied. This list was comparable to the consultation document’s paragraph B63 in many respects, but was more candid: in particular, it acknowledged that the taxpayer would have to retain records of analysis of market data used in order to work out “market rates” for salaries, investments and so on. This consideration has, for some reason, been omitted from the present consultation document.

In the context of the FBT, family businesses will have to ascertain what the “market rates” are for each job done, but no guidance is offered on how they should go about this:

- Should plumbers ring up other plumbers to ask their rates? Should farmers ring up other farmers to ask each other how much they would charge for performing different functions on each other’s farms?
- Should the comparison prices be worked out in relation to the salary of, say, an employed book-keeper, or in relation to the call-out rate of a book-keeper who is hired on a commercial basis?
- How are businesses expected to estimate the returns they would have got if they had invested their capital elsewhere – should they be monitoring the stock markets to check the values of investments they have not made?

Even a brief consideration of these questions shows how ludicrous the proposals are in practice: yet the need to ask all of these questions is shown by the existing guidance on transfer pricing. It is disappointing that that the Treasury was apparently unable to undertake a comparison with this existing material when formulating guidance and assessing whether or not the new measure would be burdensome to small businesses: such an exercise would have highlighted many of the problems with the new measure very quickly.

2. “Fairness”

PCG is not convinced by any argument that the current system is unfair: the arrangements that are being attacked here were foreseen and accepted by Parliament when the independent taxation of spouses was introduced, and the Government has failed to demonstrate that anything has changed since then to warrant any new laws.

Indeed, for some years the Government’s own advice website, Business Link, recommended that businesses be set up jointly in exactly the way that the Government now seeks to condemn as “income shifting”. It is still not clear why the Government’s position has moved from understanding these business structures and accepting their legitimacy to the current bizarre attack, but this shift will be particularly galling to those who followed the Government’s advice and are now about to be punished for it.

PCG must observe that, if this measure is essential to ensure fairness in the tax system, the Government would surely have advanced it much earlier. It is, after all, much broader than the effect of the settlements legislation would have been if the House of Lords had found for HMRC in the Arctic Systems case, so why has the Government waited nearly 11 years after coming into office to introduce it?

i) Risk and reward

It is wrong to suggest that the new proposals will provide “fairness” for reasons that are obvious if we consider basic ideas of commercial risk: how can it be fair that spouses who are equally exposed to the risks associated with running a business are not equally entitled to share the rewards, if there are any? How can the new proposals be fair, when they ignore the very basis on which the business owners are making their arrangements, that is to say, that they are married?

ii) Other types of income

Let us imagine a scenario in which a man acquires, through his own endeavours, a number of properties; he then marries, and gifts one of the properties to his wife, who does not work and who has no income of her own. Why should any rental incomes that flow to his wife not be treated in the same way as the dividends from a limited company in which he has gifted her a share? There is no justification for this: both cases clearly ought to be treated consistently, irrespective of the merits or otherwise of the given tax treatment.

It can also be observed that the new proposals are in direct conflict with the principle exercised by the divorce courts that marital assets be divided equally: so, a divorcing couple may split the value of a

company, but a married couple are not entitled to split the profits without a tax penalty. There is no fairness in this.

iii) Complication begets unfairness

The net result of the proposals will be colossal unfairness. As the consultation paper notes, many of the businesses affected will be so small that they will not have advisers who can help them to navigate the new rules (in so far as it is possible to do so at all). The amount of tax paid by each business will become a lottery: different businesses will apply the rules in different ways, even to similar situations. HMRC simply will not have the resources to check every business's tax affairs. The legislation is so unworkable that taxation will become arbitrary and capricious.

Box B.2: Example B – the power to control or influence the amount of shifted income

Individual 1 owns 1000 shares in a major publicly listed company as an investor and gives 250 of these shares to individual 2, who in this example is her husband. Neither individual 1 nor individual 2 works for the company and, at some stage after the gift is made, the company declares a dividend, which is paid to individual 2. It is clear from this example that individual 1 cannot affect the timing or level of dividend declared by the company, as would be the case for any other minor investor. Consequently condition C is not met, so the new legislation would not apply in such circumstances.

The new legislation seems to use the "power to control or influence" test as a means of distinguishing between different types of business. Why the larger business's dividends should be protected and the smaller business penalised is not explained.

In this example, Individual 2 is receiving income as a result of a gift of shares made by Individual 1. If Individual 2 has no other income but Individual 1 does, the result will be a tax saving when compared to what Individual 1 would have paid, had the dividends been paid solely to her. Why should this tax advantage be protected, while others are not?

If we assume for a moment that Individual 1 has a salary that can support both her and her husband, the case for reversing this tax advantage seems clearer than the case for reversing the tax advantages previously established for jointly-owned businesses: Individual 2 is not exposed to commercial risk, because Individual 1 is employed. Yet Individual 2 is allowed to continue enjoying his tax advantage, even though it arises from the efforts of someone else – ie Individual 1, who earned the money to buy the shares. If Individual 1 and Individual 2 had agreed to go into business together, they would be exposed to the risk of the business failing and would also be penalised by the new laws; but as it is, they are exposed to minimal risk and are allowed to carry on enjoying a preferential tax treatment. This cannot possibly be fair.

It is of course the case that earned and unearned income have historically been treated differently by the tax system for various purposes: but this measure applies and undermines these different treatments in a bizarre and arbitrary way. So, a non-fee-earning wife taking dividends will be caught, but a non-fee-earning wife who is allowed to take the interest from the business's deposit account will be outside scope. Rental income will also be out of scope, even where the property has been bought by one spouse using their own money and then gifted to the other. There is no fairness to this at all.

3. Conceptual difficulties with the draft legislation

i) Profits, income and reward

The proposals seek to tax distributed profits as the income of the individual whose labour gave rise to the revenues from which the profits are derived: this denies the reality of the business concerned, is a radical principle which is plainly a nonsense when applied to any real business, and is not a principle which is at work consistently across the tax system. By virtue of resting on such a fundamental mangling of these basic concepts, the proposals are conceptually retarded.

It is vital that the Government understands the true nature of profits: they are a reward for taking risks, and are not in any way comparable to salaries. People who receive profits are in business: they are not employees. By seeking to tax profits as the income of the individual whose labour gave rise to the revenues from which the profits are derived, the Government seems to be denying the commercial reality to which business owners are exposed, and treat them as if they were receiving nothing more than remuneration for labour, ie a salary. Once this is understood, it can be seen why the proposals make so little sense.

For instance, the proposals seem to regard it as acceptable for a business owner to receive a dividend of £10,000 if they have contributed £10,000 of work to the business: if the person in question has done less work than this, the FBT will tax the dividend as the income of another individual, but will not impose employed levels of tax and NICs on it. It surely cannot be the Government's intention to encourage dividends and profit distributions to be used as a reward for labour, but that is exactly what these proposals do.

1.7 However, in some cases, the second individual plays either no role or only a minimal role in the business, with the first individual solely or mainly responsible for the activity of the business and for the generation of the income that is then distributed. Regardless of this, it is possible for the two individuals to arrange the distribution of salary and dividends from the company to gain a tax advantage, by the first individual forgoing income that can then be distributed to the second individual and taxed at a lower rate as a result. In these situations the Government considers that income has been shifted from the first individual to the second.

This passage gets to the heart of the conceptual error that underpins the proposed legislation. It assumes that in a situation where fees paid to a business have been generated by the labour of one person, all the profits of the business represent the "income" of that person.

This is clearly not the case.

When someone buys a portion of fish and chips, the chip shop does not deduct the cost of the ingredients, the cost of the premises and the cost of the cooking equipment, and then distribute the remainder of the money to the workers who cooked the food and served the customer, even though the money was clearly generated by their labour.

When a large management consultancy hires out a consultant to a client, it does not deduct the administrative costs of arranging the secondment and of the consultant's travel, and then distribute the remainder of the fee to the consultant, even though the money was clearly generated by their labour.

When a guest stays in a hotel, the hotel does not deduct the cost of building and furnishing the hotel, plus heating and lighting it, and then distribute the remainder of the guest's room rate to the staff who serviced his room and checked him in and out, even though the money was clearly generated by their labour.

It is demonstrably false to assert, therefore, that money generated on a commercial basis by the labour of a given individual within a business can be taken to be that individual's income. Yet the entirety of the proposals rest on this misconception.

If a business generates profits, they are a reward for risk. This risk might take various forms: an owner might put their own property at risk by investing in a business; the commercial nature of business relationships means that it is very easy to terminate them and there is no protection in place to oblige them to continue in certain circumstances, unlike employment relationships. These profits may be distributed to the owners of the business as agreed between partners, or by the business's directors as

appropriate: there is no justification for preventing certain businesses from distributing profits in the normal way just because the owners happen to be married, related in some other way or otherwise inclined to share profits in a particular way for personal reasons.

ii) "Non-commercial" arrangements and family businesses
The proposals focus on the idea of "non-commercial arrangements": where a payment is made to an individual that would not have been made in a purely "arm's length" transaction, this is to be counted as "income shifting".

This completely misses the entire point of family businesses: they are run by families. Indeed, they are set up by families, because family members have chosen to go into business together: very often, a husband and wife may decide to go into business together, but neither would contemplate going into business with any third party. Likewise, often an initial investment in a family business will be one that would not have been available commercially: a family member might invest in another family member's business not on the basis of commercial considerations, but because they are family. Were it not for "non-commercial arrangements" many businesses simply would not exist.

This informs how family businesses are run: if something needs doing, a family member will do it. This is particularly true in a crisis situation, and it seems impossible to put a value on having someone you trust on hand to help out in an emergency.

Family businesses do not seek to remunerate family members for such work on the basis of a "market rate": the priority is to make a profit, and until a business is profitable it may not even be possible for it to pay a "market rate" – PCG is dismayed to note that the examples given in the consultation paper do not seem to consider instances where businesses make losses for the first few years of their existence, even though this is quite common.

The proposals take no account of the reality of business life for many small businesses, in which context the concepts of "market rates" and "arm's length transactions" are not only inappropriate, but meaningless.

iii) "Forgoing income"
"Forgoing income" is a similarly problematic concept. It must be remembered that the profits of a business are not automatically distributed: they can be retained in the business in order to be re-invested, or for other prudent commercial reasons. It is therefore wholly wrong to treat profits as money that flows to shareholders automatically in the same way as salary is paid to an employee: in the first instance there may not be any profits; and in the second, they may not be distributed for a long time after they were generated.

When they are paid out, which could be years later, such a payment could constitute "income shifting" as defined in the legislation. It is perhaps a situation such as this that the purposive test is intended to exempt but, as will be explored in the accompanying commentary on the draft legislation, the test is meaningless and will not provide any exemption so long as the payment looks to a tax inspector like it might have had an avoidance motive.

4. Possible alternative approaches
If the Government wished to make a change to promote "fairness" within the tax system, and to make up for the fact that business owners who are married to each other can make use of each other's tax allowances while employees who are married to each other cannot, the logical reform would surely be to make tax allowances transferable between spouses. This would remedy the "unfairness" that the Government stated it perceived after Jones v Garnett effectively and simply, without creating the appalling legislative muddle that is threatened by the FBT.

France, Germany and the United States all operate versions of this system, under which married couples, or even family units including children, are taxed as a whole.

The fact that this option has not been pursued may, PCG suspects, be because it would cost the Exchequer money rather than raising more tax: this reinforces our impression that the new measure is aimed at generating more revenue far more than at ensuring “fairness”.

This would of course entail the reversal of the independent taxation of spouses: on balance, and unless or until any convincing argument to the contrary emerges, PCG believes that independent taxation should be preserved, and that the present situation represents a fair balance. For instance, while two employees who are married to each other, or one employee married to a person who does not work, may not be able to transfer their allowances, they have the rights and entitlements associated with employment as a compensation. This is in contrast to the married business owners, who are exposed to far greater risk.

Independent taxation will be largely reversed by the new measure anyway: PCG notes that, despite claims at the time of the Pre-Budget Report that “income splitting” runs counter to the principle of independent taxation – which is of course the opposite of the truth – the Government has failed to address directly the issue of independent taxation, and has not put forward any arguments for its reversal.

5. Responses to Questions posed in the consultation document

1. To what extent would the draft legislation capture situations in which income arising from a company or partnership distribution has been shifted from one individual to another, for the purposes of gaining a tax advantage?

PCG does not accept that “income shifting” represents valid terminology to describe the practices that the legislation seeks to target. Nonetheless, it seems to PCG that the legislation has captured the practices that it seems to intend to capture, although given that the policy objectives of the legislation are hard to discern at all it may also be possible to say that the legislation captures, or will impinge upon, many more circumstances than intended.

2. Would the legislation capture situations that are not within the aim of removing the tax advantage gained by income shifting? If so, the Government would welcome examples, an explanation of why you believe these situations are not within the aim of the legislation and, if possible, any suggestions on how these situations may be effectively excluded from the legislation.

As PCG does not accept that “income shifting” is anything other than a loaded term that the Treasury is seeking to apply to long-standing legitimate business practices, we can only reply that we do not accept that any business arrangements should be taxed as the consultation paper proposes.

3. In what ways could the legislation and guidance provide greater clarity for businesses and their advisers, enabling them to understand when income has been shifted and what to do in these circumstances?

Given that the enactment of “principles-based” legislation of this sort will inevitably lead to massive uncertainty, we cannot suggest anything that could be done to the legislation to avoid this.

4. Can you suggest any practical steps that the Government could take to ensure that the administrative burdens of the proposed approach are minimised, while ensuring that its aims are achieved?

PCG can think of no way of protecting businesses from the administrative burdens that this legislation will impose: however it is framed, and whatever guidance is available, the legislation will, in practice, inevitably place enormous burdens on all jointly-owned businesses where the contributions of the owners differs to even a small extent: they will have no alternative but to keep extensive records to justify their tax calculations in the event of an investigation by HMRC.

A few measures that might alleviate the burden somewhat suggest themselves, however. For instance, the legislation could allow for HMRC to stipulate, by regulation, sources of "market rate" comparators that tax inspectors will be obliged to regard as acceptable for the purposes of the legislation (provided that the arithmetic by which the comparator is applied to work out the tax owed is correct); HMRC could even provide a non-exhaustive table of "market rates" itself.

Alternatively, the purposive test could be strengthened, which would take many businesses out of scope and therefore relieve them of the burdensome administrative obligations.

5. In situations where income shifting has occurred, are you aware of any practical problems that business owners may have in making their self assessment returns correctly? If so, in what ways can the Government mitigate these problems?

PCG does not accept that "income shifting" occurs as described in the consultation paper; conceptually, it is a mirage and rests on wholly false assumptions about the nature of "income". That said, PCG can foresee many practical difficulties for businesses caught by this legislation in seeking to implement it, as set out above. Given the overall approach of the legislation, however, PCG can see no way in which these problems can be meaningfully alleviated.

HMRC could consider offering a clearance procedure to assist businesses in navigating the new rules. A similar service was instituted for IR35, under which contractors can have their contracts checked by HMRC, although PCG's advice to its members is that using the service has been seen to increase the risk of IR35 investigations and should therefore be avoided. Assuming that such a service would be fair and not simply expose businesses using it to an increased risk of an aggressive investigation under the FBT, it could be valuable in providing certainty to businesses – and certainty will be a valuable commodity where this legislation is concerned.

6. Do you believe that the consultation stage Impact Assessment in Annex C accurately represents the likely impacts on business and the costs that they would incur? If not, what do you believe are the likely impacts and costs and for what reasons?

PCG does not believe that the Impact Assessment has fully or accurately estimated the costs to businesses caused by the legislation. See PCG's commentary on the draft Impact Assessment for a full exploration of this issue.