



**HM TREASURY AND HM REVENUE & CUSTOMS
INCOME SHIFTING: A CONSULTATION ON DRAFT LEGISLATION**

**Response by
THE SOCIETY OF PROFESSIONAL ACCOUNTANTS**

FEBRUARY 2008

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INCOME SHIFTING

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INCOME SHIFTING

1. Executive Summary

The Society of Professional Accountants (SPA) is pleased to respond to the consultation paper dated December 2007.

1.1. Timescale of Consultation

We are disappointed that the consultation provided little time for detailed examination of the draft legislation as it fell in the Christmas / New Year period. It should be remembered that January has become one of the heaviest workload periods – particularly for smaller practitioners - given the deadline for filing Self Assessment Income Tax Returns.

1.2. Proposed timing of Implementation

We are concerned that the intention to introduce legislation with effect from 6 April 2008 giving no realistic period when the many smaller businesses can consult with their advisors to examine whether any structural changes are required. It is unclear within the proposed time scale due how taxpayers without agents will be aware of any change in legislation.

We would prefer the consultation period to extend to at least 30 June 2008 with implementation of any new legislation from 6 April 2009.

1.3. Impact on Business Relationships and Levels of Taxation

1.3.1. We are concerned that HMRC's underlying concept, that reward should necessarily follow effort, is not one that recognises arrangements frequently found in business between related – or unrelated – parties based on the balance of differing skills, facility or finance.

1.3.2. We are concerned that the proposed legislation will work against the entrepreneurial spirit of many emerging small businesses forming the nursery of and making a significant contribution to our national GAP.

1.3.3 Recent years have seen a succession of withdrawal of allowances and extension of the network of taxes collected; this nation is becoming the highest taxed within the European Union or compared with other nations elsewhere, with those in work or business 'appearing' on the HMRC 'radar' bearing the brunt of our government's ever increasing appetite for expenditure.

1.4. Lack of Coincidence with Surrounding Law

We are concerned that HMRC's underlying concept in 1.3 does not recognise existing and surrounding legislation, particularly that now adopted in divorce proceedings or the free transfer of assets between spouses. Such uncertainty appears likely to lead to further legal challenges in the years ahead.

1.5. Uncertainty and Subjectivity of Proposed Legislation

We are concerned that any legislation will prove subjective rather than definitive with each case having to be separately assessed, with no certainty of action available to businesses, which is the core of good planning, growth and success.

1.6. Wider consideration commended

1.6.1. Overall we consider this attack on 'Income Shifting' reflects a somewhat overhasty reaction to the Arctic case lost recently by HMR&C; too soon and with not sufficient consideration of surrounding law or to the actuality of small business' existence, more so when the target population identified is perhaps

_% of total active businesses and the yield a very small fraction of total taxes raised.

1.6.2. We feel wider consideration should be given to the views of business and professional organisations representing the population of SME businesses targeted by the proposed legislation, together with a later implementation date that allows a reasonable period for reflection on individual business arrangements and any necessary adjustments that may be required.

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2. Background to SPA

- 2.1 SPA is a wholly independent society of small practitioners holding a qualification issued by a recognised professional accountancy Institute. It was formed in early 1996 and currently there are some 1800 principals in 1400 member practices. Our members provide accountancy and taxation services to an estimated 175,000 private businesses, small limited companies and individuals.
- 2.2 The Society's stated policy is to promote and improve the relationship between members and their Institutes by providing constructive criticism together with practical proposals for improvements. Further to provide commentary and proposals to other authorities influencing our practising environment.
- 2.3 SPA has previously made submissions on small businesses limited company activities to the DTI on Audit Exemption levels, to the Accountancy Standards Board on Financial Reporting Standards for Small Entities (FRSSE), to the DTI on Modern Company Law 'Developing the Framework'. Also to the Chancellor of the Exchequer concerning individual tax payers on 'Advancing Self Assessment Tax Return Filing Dates', and to HM Revenue and Customs on 'Payments, Repayments and Debt'.

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3. Arguments and Detailed Response to Questions posed

Q.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?

A.1. We feel that the proposed legislation puts a heavy burden of uncertainty on businesses or their agents in reviewing each case and reaching a conclusion whether any 'tax advantage' taken was reasonable or not.

Secondly the criteria to be applied do not reflect various commercial arrangements other than effort/hours engaged. These are omitted from your paper and may determine income distribution being 50:50. Such as:

- One party providing a specialist skill – marketing, technical or whatever
- One party providing financial backing
- One party providing essential administration support

In these situations only one party to a business may be providing the output – whatever that is, but needs a complementary service to enable the business to be efficiently and effectively managed in its widest sense. In these circumstances the provision of individual effort is secondary to the need for a balanced team.

Hence the answer to this question can only be stated as 'possibly'.

Q.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.

A.2. We can envisage no circumstances where the proposed legislation would capture situations that are not within the aim of receiving the tax advantaged gained by income shifting.

Q.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?

A.3. We can offer no constructive comment on this question as our view is that HMRC's approach is negative and too narrow in its thinking, and the proposed legislation is uncertain and its applications would be subjective.

Your paper does not refer to and we are uncertain how those businesses without agents will understand the need to consider the proposed legislation.

Q.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?

A.4. We believe that where agents are engaged by a business each case will need to be separately reviewed within the proposed legislation, that the initial burden and hence the cost of the administrative time will be considerable and high.

Q.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?

A.5. The answer to this question is dealt with within the answer to (4) above.

Q.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?

A.6. The estimated reduction in tax paid taken from income shifting appears to be:

Companies (60,000)	£5,385
Retention (20,000)	£7,500

Many of the businesses concerned have very small incomes, the impact of 'losing' the indicated income above would be significant, with the certainty that for a significant number either higher prices would have to be charged or businesses closed. It is not clear whether this impact assessment allows for this factor in the 'savings' or 'revenue' figures.

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