Funding the Future

Guernsey - putting anti-avoidance rules to use

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Sometimes a tax haven does something that is blunt, even crude, and yet seems indicative of what is right. Take Guernsey for example. It was reported yesterdays that it has decided to use its powers to prevent companies doing what is known in the UK as the 'IR35' trick. This involves a company being set up to sell the services of an individual which then pays that person a low salary for their services to avoid social security contributions due and instead pays a dividend to provide them with a reward in lieu of salary (effectively).

The UK has agonised on how to tackle this obvious abuse of the corporate form (on which I should declare that I was one of the very first to comment in the UK, way back in 1985 in Accountancy magazine). IR35 has not worked well. The rules on settlements are being used, but in a way not envisioned by ministers based on published Hansard statements, and recent rules on agency companies set up to achieve this effect tackle only one part of the problem.

Guernsey in the meantime, now facing this issue in a big way for the first time as it has increased social security contributions to pay for corporate tax cuts (the injustice of which is apparent, but not the issue here) has responded by deeming the payments to be earned income to which social security contributions apply. As ['This is Guernsey'] reports:

From this month, share dividends that a company pays to its employees will be treated as earnings and social security contributions must be paid.

'*Our inspectors have come across a small number of cases where the employees of local companies have been getting artificially low weekly or monthly wages, but also receiving regular share dividends from the company,' said minister Mary Lowe. She added that sometimes the dividends had been more than the normal wage or salary.*

'*We see this as a blatant avoidance of social security contributions and we're going to* *nip it in the bud. If someone is avoiding their full contribution liability, it means that the other contributors are having to pay.*'

Social Security has decided to include the dividends in its definition of earnings. This applies only to employees of a private company who also own some of the shares in it.

'*Higher social security contributions are part of the zero-10 tax package and we must make sure that people pay their fair dues. The department already have the power in law to treat dividends as earnings. So we can address this particular issue. And the States approved stronger anti-avoidance powers which we may need in future for other practices that we consider unfair.*'

The hypocrisy in certain parts of this are so obvious as to beggar belief. The unfairness is, of course, that local people in Guernsey are paying more tax so that tax avoiders and evaders can use the place in secret to ensure they pay tax to no one. That is a duality of standard that shows the implicit corruption of thinking in places like Guernsey.

But, there is another dimension. This move, precipitate as it might be shows the power of general anti-avoidance provisions. Of course the issue of what is, and is not, a fair wage is of concern and would need clarification if used in the UK, but the arrangements being attacked here are often artificial (I have seen weekly dividends, for example) and as such still deserve to be addressed. The role of general anti-avoidance provisions in creating justice has to be considered.

And let's also be clear. There would be no real injustice in this in the UK where anyone undertaking a legitimate trade could do so as a sole practitioner, partnership or LLP as an alternative and almost certainly avoid this problem. So please let's have no artificial howls of protest that my comments are intended to restrain trade. They're not. They're a suggestion that some people are repackage employments as something else through the artificial use of limited companies. And that is non-compliant tax abuse, as any person in the street knows.