INCOME-SPLITTING – IS IT FEASIBLE?
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During the 2012, SAIPA tax seminars were presented throughout the country, and during the recent tax filing season, we received many queries relating to the feasibility of income-splitting.

Income-splitting* is a scheme of breaking-up income between spouses when only one spouse makes a contribution to the business in a trade carried out by one spouse only.

Rationale for income-splitting
A self-employed business spouse is tempted to employ his/her spouse in the business since the salary paid is eligible for deduction against the taxable income of the business. The business as a result has a lower taxable income and a lower tax liability. The hired spouse is taxed separately and is likely to be taxed at a lower tax rate. Frequently, the salary paid is excessive - above the market rate - in relation to the job description but this is not the only difficulty encountered.

A hypothetical example of income splitting occurs when the husband is the only member of a CC, employs eight other non-connected staff, and wishes to employ his wife in the CC. It is given that the wife is a full-time housewife, managing the daily household chores, whilst the husband is at work and the children are at school. The wife is hired as a personal assistant to a member of the CC.

This discussion also applies to owner-managed businesses that are in a position to employ other persons. The SAIPA Tax Help Desk, consequently, undertook the task of investigating the feasibility of the practice of income-splitting.

Discussion
While it is given that the wife – the hired spouse – does not physically report for duty at the business premises, the employer spouse (husband in this situation) could easily produce or issue an IRP 5, thereby formally declaring the hired spouse is, in fact, an employee of the business. The issuing of an IRP 5 is not the only requirement to confirm employee status of the hired spouse. The employer also needs to provide a proof of leave application for the year by the hired spouse and identify the office space occupied by the hired spouse, a direct telephone number – by-passing the switchboard – to the office occupied by the hired spouse.

SAIPA has received reports that SARS has, in the past, undertaken on-site inspection of companies that were hiring spouses. These inspectors approach receptionists of such companies requesting to see the hired spouses. Not surprisingly, receptionists often do not know such persons (the hired spouses). Occasionally, receptionists respond by saying: “Oh! That is the boss’s wife and seldom comes to the business premises!” The ‘game’ is instantly over for the taxpayer.
It is clear in this situation that the employer-spouse did not incur expenditure against taxable income, because such expenditure – the hiring of spouse – did not occur for the purposes of the employer-spouse trading activities or the production of income.

The payment to the hired spouse is likely a payment for the employer-spouse’s (business owner) maintenance of family which is domestic and private. Such expenditures are not allowed as deduction against taxable income by the legislation and such deductions against taxable income are punishable by the Revenue Authority.

The deduction of the salary against the business income will be denied if a manager’s salary is paid to the spouse - allegedly hired as a personal assistant. The excessive income paid to the hired spouse will be deemed to have accrued to the employer spouse and will be taxed in the name employer spouse.

**Conclusion**

Taxpayers – business owners – are strongly discouraged from engaging in the practice of income-splitting. Income-splitting does not prohibit the business-owner from legitimately hiring his/her spouse and caution must be taken in order to ensure that the hired spouse is not paid a salary above the market rate in relation to the position occupied.

*The ensuing discussion applies to the given context only.*