Buckleys ACCOUNTANTS

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Taxation of the Family

Individuals are subject to a system of independent taxation so husbands, wives and civil partners are taxed separately. This can give rise to valuable tax planning opportunities. Furthermore, the tax position of any children is important.

Marriage and civil partnership breakdowns can also have a considerable impact for tax purposes.

We highlight below the main areas of importance where advance planning can help to minimise overall tax liabilities.

It is important that professional advice is sought on specific issues relevant to your personal circumstances.

Setting the scene

Married couples and civil partners

Independent taxation means that husbands and wives are taxed separately on their income and capital gains. The effect is that both have their own allowances, savings and basic rate tax bands for income tax, annual exemption for capital gains tax purposes and are responsible for their own tax affairs. The same tax treatment applies to couples who have entered into a civil partnership under the Civil Partnership Act.

Children

A child is an independent person for tax purposes and is therefore entitled to a personal allowance and the savings and basic rate tax band before being taxed at the higher rate. It may be possible to save tax by generating income or capital gains in the children's hands.

Marriage and civil partnership breakdown

Separation, divorce and dissolution can have significant tax implications. In particular, the following areas warrant careful consideration:

- available tax allowances
- transfers of assets between spouses.

Tax planning for married couples and civil partners

Income tax allowances and tax bands

Everyone is entitled to a basic personal allowance. This allowance cannot however be transferred between spouses and civil partners except for the circumstances outlined below.

Transferable Tax Allowance or Marriage Allowance

Married couples and civil partners may be eligible for a Transferable Tax Allowance.

The Transferable Tax Allowance (also referred to as the Marriage Allowance) enables spouses and civil partners to transfer a fixed amount of their personal allowance to their partner. The option to transfer is not available to unmarried couples.

The option to transfer is available to couples where neither pays tax at the higher or additional rate. If eligible, one partner is able to transfer 10% of their personal allowance to the other partner, which is currently £1,260.

Couples are entitled to the full benefit in their first year of marriage.

For those couples where one person does not use all of their personal allowance the benefit will be worth approximately £250.

Eligible couples can apply for the marriage allowance at www.gov.uk/marriage-allowance. The spouse or partner with the lower income applies to transfer some of their personal allowance by entering some basic details.

Those who do not apply via the government gateway will be able to make an application at a later date and still receive the allowance.

If either spouse or civil partner were born before 6 April 1935, then a married couple's allowance is available. For marriages before 5 December 2005 the allowance is based on the husband's income, for marriages and civil partnerships formed after that date the allowance is based on the income of the highest earner.

Joint ownership of assets

In general, married couples and civil partners should try to arrange their ownership of income producing assets so as to ensure that personal allowances are fully utilised and any higher rate liabilities minimised.

Generally, when a couple jointly own assets, any income arising is assumed to be shared equally for tax purposes. This applies even where the asset is owned in unequal shares unless an election is made to split the income in proportion to the ownership of the asset.

Married couples and civil partners are taxed on dividends from jointly owned shares in 'close' companies according to their actual ownership of the shares. Close companies are broadly those owned by the directors or five or fewer people. For example if a spouse is entitled to 95% of the income from jointly owned shares they will pay tax on 95% of the dividends from those shares. This measure is designed to close a perceived loophole in the rules and does not apply to income from any other jointly owned assets.

We can advise on the most appropriate strategy for jointly owned assets so that tax liabilities are minimised.

Capital gains tax (CGT)

Each spouse's CGT liability is computed by reference to their own disposals of assets and each is entitled to their own annual exemption of £6,000 for 2023/24 (£12,300 for 2022/23). Some limited tax savings may be made by ensuring that maximum advantage is taken of any available capital losses and annual exemptions.

This can often be achieved by transferring assets between spouses before sale - a course of action generally having no adverse CGT or inheritance tax (IHT) implications. Advance planning is vital, and the possible income tax effects of transferring assets should not be overlooked.

Further details of how CGT operates are outlined in the factsheet Capital Gains Tax.

Inheritance tax (IHT)

When a person dies IHT becomes due on their estate. Some lifetime gifts are treated as chargeable transfers but most are ignored providing the donor survives for seven years after the gift.

The rate of IHT payable is 40% on death and 20% on lifetime chargeable transfers. The first £325,000 is not chargeable and this is known as the nil rate band and is frozen at this amount until April 2028.

Transfers of property between spouses are generally exempt from IHT. Rules allow any nil rate band unused on the first death to be used when the surviving spouse dies.

The amount of the nil rate band available for transfer will be based on the proportion of the nil rate band which was unused when the first spouse died. Key documentary evidence will be required for a claim, so do get in touch to discuss the information needed.

IHT residence nil rate band

An additional nil rate band is available where an interest in a main residence passes to direct descendants. The amount of relief is £175,000 for 2023/24 and is frozen at this amount until 2028. For many married couples and civil partners the relief is effectively doubled as each individual has a main nil rate band and each will potentially benefit from the residence nil rate band.

The additional band can only be used in respect of one residential property which does not have to be the main family home but must at some point have been a residence of the deceased. Restrictions apply where estates are in excess of £2 million.

Where a person died before 6 April 2017, their estate will not qualify for the relief. A surviving spouse may be entitled to an increase in the residence nil rate band if the spouse who died earlier has not used, or was not entitled to use, their full residence nil rate band. The calculations involved are potentially complex but the increase will often result in a doubling of the residence nil rate band for the surviving spouse.

The residence nil rate band may also be available when a person downsizes or ceases to own a home on or after 8 July 2015 where assets of an equivalent value, up to the value of the residence nil rate band, are passed on death to direct descendants.

Taxpayers now have three nil rate bands to consider. The standard nil rate band has been a part of the legislation from the start of IHT in 1986. In 2007 the ability to utilise the unused nil rate band of a deceased spouse was introduced, enabling many surviving spouses to have a nil rate band of up to £650,000. From 6 April 2020 some surviving spouses are able to add £350,000 in respect of the residence nil rate band to arrive at a total nil rate band of £1 million. However this will only be achieved by careful planning and, in some cases, it may be better for the first deceased spouse to have given some assets to the next generation and use up some or all of the available nil rate bands.

For many individuals, the residence nil rate band will be important but individuals will need to revisit their wills to ensure that the relief will be available and efficiently utilised.

Gifts

A gift for family maintenance does not give rise to an IHT charge. This would include the transfer of property made on divorce under a court order, gifts for the education of children or maintenance of a dependent relative.

Gifts in consideration of marriage are exempt up to £5,000 if made by a parent with lower limits for other donors.

Small gifts to individuals not exceeding £250 in total per tax year per recipient are exempt. The exemption cannot be used to cover part of a larger gift.

Gifts which are made out of income which are typical and habitual and do not result in a fall in the standard of living of the donor are exempt. Payments under deed of covenant and the payment of annual premiums on life insurance policies would usually fall within this exemption.

Children

Use of allowances and lower rate tax bands

It may be possible for tax savings to be achieved by the transfer of income producing assets to a child so as to take advantage of the child's personal allowance.

This cannot be done by the parent if the annual income arising is above £100. The income will still be taxed on the parent. However, transfers of income producing assets by others (eg grandparents) will be effective.

A parent can however allow a child to use any entitlement to the CGT annual exemption by using a 'bare trust'.

Universal Credit

Universal Credit may be available to some families. To see whether you are entitled to claim visit www.gov.uk/universal-credit

Junior Individual Savings Accounts (Junior ISA)

The Junior ISA is available for UK resident children under the age of 18 who do not have a Child Trust Fund account. Junior ISAs are tax advantaged and have many features in common with existing ISAs. They are available as cash or stocks and share-based products. The annual subscription limit is £9,000 for 2023/24 (£9,000 for 2022/23).

High Income Child Benefit Charge

A charge applies to a taxpayer who has adjusted net income over £50,000 in a tax year where either they or their partner are in receipt of Child Benefit for the year. Where both partners have adjusted net income in excess of £50,000 the charge will apply to the partner with the higher income.

The income tax charge will apply at a rate of 1% of the full Child Benefit award for each £100 of income between £50,000 and £60,000. The charge on taxpayers with income above £60,000 will be equal to the amount of Child Benefit paid.

Child Benefit claimants can elect not to receive Child Benefit if they or their partner do not wish to pay the charge.

Example

The Child Benefit for two children amounts to £1,884.

The taxpayer's adjusted net income is £54,000.

The income tax charge will be £754.

This is calculated as £18.84 for every £100 above £50,000.

For a taxpayer with adjusted net income of £60,000 or above the income tax charge will equal the Child Benefit.

Marriage and civil partnership breakdown

Maintenance payments

An important element in tax planning on marriage breakdown used to involve arrangements for the payment of maintenance. Generally no tax relief is due on maintenance payments.

Asset transfers

Marriage and civil partnership breakdowns often involve the transfer of assets between partners. Unless the timing of any such transfers is carefully planned there can be adverse CGT consequences.

If an asset is transferred between a husband and wife or civil partners who are living together, the asset is deemed to be transferred at a price that does not give rise to a gain or a loss. This treatment continues up to the end of the tax year in which the separation takes place.

CGT can therefore present a problem where transfers take place after the end of the tax year of separation but before divorce, although gifts holdover relief is usually available on transfers of qualifying assets under a Court Order.

IHT on the other hand will not cause a problem if transfers take place before the granting of a decree absolute on divorce. Transfers after this date may still not be a problem as often there is no gratuitous intent.

How we can help

Some general points can be made when planning for efficient taxation of the family.

Any plan must take into account specific circumstances and it is important that any proposed course of action gives consideration to all areas of tax that may be affected by the proposals.

Tax savings can only be achieved if an appropriate course of action is planned in advance. It is therefore vital that professional advice is sought at an early stage. We would welcome the chance to tailor a plan to your own personal circumstances so please do contact us.

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