NASH HARVEY LLP
Factsheet

TAXATION OF THE FAMILY

Married couples are subject to a system of independent taxation under which husbands and wives are taxed separately. This can give rise to valuable tax planning opportunities. Furthermore, the tax position of any children is important.

Marriage 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

Since 1990, independent taxation has meant that husbands and wives are taxed separately on their income and capital gains. The effect is that both have their own allowances, lower and basic rate tax bands for income and capital gains tax purposes and are responsible for their own tax affairs.

Children

A child is an independent person for tax purposes and is therefore entitled to a personal allowance and a full starting rate 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 breakdown

Separation and divorce can have significant tax implications. In particular, the following areas warrant careful consideration:
current and future tax allowances
transfers of assets between spouses.

TAX PLANNING OPPORTUNITIES

Income tax allowances and tax bands

Everyone is entitled to a basic personal allowance. This allowance cannot however be transferred between spouses.

For taxpayers aged less than 75 and born before 6 April 1935, a married couple's allowance is available. This is given to the husband, although it is possible, by election, to transfer it to the wife.

Joint ownership of assets

In general, married couples 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.

When assets are jointly owned by husband and wife, 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.

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, currently £7,700 per annum. Gains above this level are charged to tax by treating them as the top slice of income.

Considerable tax savings may be made by ensuring that maximum advantage is taken of annual exemptions, the starting rate of tax (10%) and the lower rate of tax (20%).

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.

Children

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 allow a child to use any entitlement to the CGT annual exemption by using a ‘bare trust’.

Children’s tax credit

A children's tax credit is available to some taxpayers from 6 April 2001. Individuals who have one or more children under 16 living with them can claim the children's tax credit. It takes the form of an allowance for which relief is given at 10%. In 2002/03, the amount is £5,290 @ 10%, ie £529.

The credit is gradually withdrawn where the person claiming it is liable to tax at the higher rate. Such people lose £1 of tax credit for every £15 of income above the higher rate threshold.

From April 2002, some families will be entitled to an enhanced children's tax credit worth up to £1,049 in total. This only applies in the year of a child's birth.

MARRIAGE BREAKDOWN

Allowances

Once a couple have separated, there are additional complications to the children's tax credit.

Where there is only one child, the children's tax credit is shared between the parents in a ratio which they can agree between themselves.

However, where there is more than one child then, so long as those children spend part of their time with each parent, an allowance is available to each parent independently (subject to the income restriction).

We can advise on how best to maximise the available relief.

Asset transfers

Marriage breakdown often involves the transfer of assets between husbands and wives. 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 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.

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.

Maintenance payments

An important element in tax planning on marriage breakdown used to involve arrangements for the payment of maintenance. From 6 April 2000 there is only limited tax relief for some taxpayers over 65.

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.