



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, savings and basic rate tax bands for income tax, annual exemption for capital gains tax purposes and are responsible for their own tax affairs. Since December 2005, the same tax treatment applies to same-sex 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 breakdown

Separation and divorce 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

Income tax allowances and tax bands

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

If either you or your spouse were 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.

Generally, when husband and wife 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 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, for 2010/11 £10,100 per annum. Gains made before 23 June 2010 which are above this level are charged to 18% tax. Gains made on or after 23 June 2010 are treated as an individual's top slice of income and charged at 18% or 28% or a combination of both rates.

For 2010/11 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.

Continued >>>

The rate of inheritance tax payable is 40% on death and 20% on lifetime chargeable transfers. For 2010/11 the first £325,000 is not chargeable and this is known as the nil rate band.

Transfers of property between spouses are generally exempt from IHT. New rules have been introduced which allow any nil-rate band unused on the first death to be used when the surviving spouse dies. The transfer of the unused nil-rate band from a deceased spouse, irrelevant of the date of death, may be made to the estate of their surviving spouse who dies on or after 9 October 2007.

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.

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'.

Child Tax Credit

A Child Tax Credit (CTC) is available to many taxpayers. The basic 'family' element of the CTC is £545 p.a. The CTC rises to £1,090 in the year a child is born (the baby addition). But you may receive less than this if your family income is above £50,000. And you may receive more than this if your family income is somewhat less than £50,000 due to other elements of the CTC and/or if you pay qualifying childcare costs.

Changes have been proposed to CTC from April 2011. We have a separate factsheet which provides more detail. To see whether you are entitled to claim go to HMRC website at www.hmrc.gov.uk

Marriage Breakdown

Maintenance payments

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

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, 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.

For information of users: This material is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material can be accepted by the authors or the firm.