Personal Tax

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 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.

From 6 April 2004, 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, currently £8,200 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.

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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 tax on death is 40% and 20% on lifetime chargeable transfers. The first £263,000 is not chargeable.

Gifts between husband and wife are generally exempt. It may be desirable to use the spouse exemption to transfer assets to ensure that both spouses can make full use of lifetime exemptions and the nil rate band.

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.

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) has been available to many taxpayers since 6 April 2003.

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.

We have a separate factsheet which provides more detail. To see whether you are entitled to claim go to the Revenue website at www.inlandrevenue.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. However the Inland Revenue has announced a change of practice where assets are transferred under a court order which improves the position.

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.