Tax & Pensions on Divorce

9th July 2020

SOFIA THOMAS

Leading experts in tax on divorce

Tax & Divorce

- Businesses
  - Salary + dividends
    - What's the net income
  - Will they be impacted by IR35?
    - Lower income for 2021-22
  - Sale of business
    - BADR?
      - Pre clearance
    - IR?
  - Cash extraction
    - Company purchase of own shares
      - Pre clearance
  - Holdover relief
    - Only exceptional circumstances
- Former Matrimonial Home
  - PPR Relief
    - If left the home >9m ago possible CGT
    - If transfering to spouse ensure election is made
    - Lettings relief almost non applicable
  - Multiple main homes?
  - SDLT
    - 3% additional charge if buying new home before sale of this one
    - No additional 3% if one person remains on legal title
  - CGT
    - Payable within 30 days & Report due within 30 days
- Income
  - Valuing shares
    - Restricted stock - CGT/IT/NIC
    - Listed v Private
  - Self employment income
    - Payment due Jan and July
    - NIC at 9%
  - Joint income
    - Married couples allowance
    - Rental income
    - Dividends from personal company
- Settlements
  - No tax on cash settlement
    - If deferred settlement, tax due on interest electment
  - CGT
    - If settlement linked to property sale, possible CGT
    - Who will bear the tax?
    - What is the residency position of the seller?
- Pensions
  - Lifetime allowance charge £1,073,000
    - 55% or 25% tax on excess when drawn down
    - Notify HMRC if protections apply
    - Check if the LTA can be enhanced for the member receiving pension credit
  - Income tax on pension income
    - Charge remains with the member if there is an earmarking order
- Investment Properties
  - Buy to let interest income restrictions
    - Only 20% credit for interest
affects higher earners
impact for child benefit
    - Correctly reported on TR?
  - Beneficial v legal ownership
    - Impact for CGT and IT
    - Has a DoT been executed?
Was the correct tax paid at that time?
  - Investment property relief
    - 2 or more investment properties jointly owned?
    - Joint claim
    - Interaction with PPR
  - Property investors or property traders
    - Difference between top tax at 28% or 45%
Could also change the value of the properties
- Overseas Aspects
  - PPR relief applies worldwide
    - Would a UK claim disadvantage an overseas property?
    - Has a claim already been made?
  - Has overseas income been correctly declared
    - Penalties up to 200%
  - Leaving the UK
    - Closing UK SA account
    - Change to CGT & IT position
    - Tax position of child maintenance
- Trusts
  - Placing property in trust for children
    - 10 year charges
    - Exit charges
  - Valuing assets in trusts
    - DT - who does the income belong to?

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Why should tax be considered in a divorce?

- It can skew the final award
- If one party has historical tax debts it can reduce the amount of funds available for distribution
- Prevent people from wanting to disclose full assets
- When the assets are disclosed can cause issues with HMRC
- Marital or single debt
- There is no limit on when tax debt can be collected
- Money can be taken directly from clients’ bank accounts (w tribunal permission)

CGT, Income Tax & Stamp Duty Overviews

Tax considerations on Divorce:
A short guide for Family Solicitors 2020-21

Available for free download at:
www.sofiathomas.co.uk/resources

Considerations for Capital Gains Tax

Reliefs and elections

Main Home – PPR Relief, s.225b
Investment properties – rollover relief
Shares – BADR, Investors relief

Main home relief extends to 9 months once someone has left the main home

Transferring home to spouse possible extension of relief. If the conditions for this relief are met, then a notification must be submitted to HMRC.

CGT on residential disposals is payable within 30 days + a land transactions return is due

Late filing and payment penalties may be due. No penalties if a reasonable excuse – but this is notoriously difficult to meet.

Transfers outside the tax year of separation take place at deemed market value

CGT will almost certainly be due.
Tax will be payable on the market value – so an appropriate, defendable market value should be chosen.

Transfers in the tax year of separation take place at no gain no loss

Latent gains will be absorbed by the person receiving the property.
If there have been works done to the property, ensure that the new owner has all documentation.

CGT implications on sale or transfer of the main assets

		Main Home	Investment Property	Assets Under £6,000	Cars	Business Assets
In tax year of separation	Transfer to spouse	No CGT	No CGT	No CGT	No CGT (No allowable losses)	No CGT
	Sale of asset	No CGT (provided PPR conditions met) Seek tax advice	Yes, CGT on gain	No CGT	No CGT (No allowable losses)	Yes, CGT (confirm if BADR or Investors relief applies to reduce the liability) Seek tax advice
After the tax year of separation but before divorce	Transfer to spouse	Possible CGT implications (If either spouse has been absent from the home >9 months) Seek tax advice	Possible CGT (investment property relief may apply to defer the gain) Seek tax advice	No CGT	No CGT (No allowable losses)	Yes, CGT (confirm if BADR or Investors relief applies to reduce the liability) Seek tax advice
	Sale of asset	Possible CGT implications (either spouse <9 months absent from home) Seek tax advice	Yes, CGT on gain	No CGT	No CGT (No allowable losses)	Yes, CGT (confirm if BADR or Investors relief applies to reduce the liability) Seek tax advice

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Considerations for Income Tax

Reliefs and elections

EIS & SEIS relief – income tax reducers
Gift aid relief
Pension tax relief

Historical liabilities or potential future liabilities

If the conditions for this relief is met, then a notification must be submitted to HMRC.

Income generating assets can have different effective tax rates on each party. Can impact pensions and child benefit.

Buy to let interest restrictions will impact on 40% taxpayers, creates a very high effective tax rate – also impacts child benefit.

Tax returns are due by 31 Jan following end of the tax year. Penalties of up to £1,600 if not filed.

Payments on account are always based on the prior year's earnings so a true up is always needed at the end of the year.

PAYE is withheld at source, income between 100k to 130k likely to have a liability at the end of the year
Self employed & partnerships payment due by 31 Jan plus payments on account, due 31 Jan and 31 July

Individuals earning >100k are not entitled to their full tax free personal allowance; can create liabilities at the end of the tax year.

Personal Tax Account

Personal tax account: sign in or set up

Use your personal tax account to check your records and manage your details with HM Revenue and Customs (HMRC).

This service is also available in Welsh (Cymraeg).

There's a different service if you want to sign in to GOV.UK Verify to file your Self Assessment tax return.

Start now

- ✓ Details of employment earnings
- ✓ Income tax estimate
- ✓ State Pension
- ✓ Manage Child Benefit
- ✓ Check/ update Marriage allowance
- ✓ Track tax forms which have been submitted

Available at: https://www.gov.uk/personal-tax-account

Personal Tax Account

Income

P60s

Pay As You Earn (PAYE)

Check or update the employment, pension or other income information used to work out your PAYE Income Tax and tax codes.

Self Assessment

View and manage your Self Assessment tax return. The deadline for online returns is 31 January 2020.

Complete your tax return

Make a payment

Check if you need to fill in a tax return

National Insurance

You have a National Insurance number to make sure your National Insurance contributions and tax are recorded against your name only.

View your National Insurance letter

View gaps in your record

View tax returns and tax calculations

Benefits

Changes to child benefit

Tax credits

View your next payments and the people on your claim, and make changes to your claim.

Child Benefit

A tax-free payment to help parents with the cost of bringing up children.

Tell us if your child is staying in full-time education

Tell us if your child's circumstances change

Marriage Allowance

Transfer part of your Personal Allowance to your partner so they pay less tax.

Find out if you qualify for Marriage Allowance

Considerations for Stamp Duty Land Tax

Reliefs and elections

First time buyers relief
Main home replacement
0% on first 500k up to 31 March 2020

3% will not apply if they must remain legal owner of Home A and they buy Home B – if they have no other property

The additional rate will still apply if they own other properties

Replacement of the main home within 3 years now extended

The purchase is a replacement of the main home

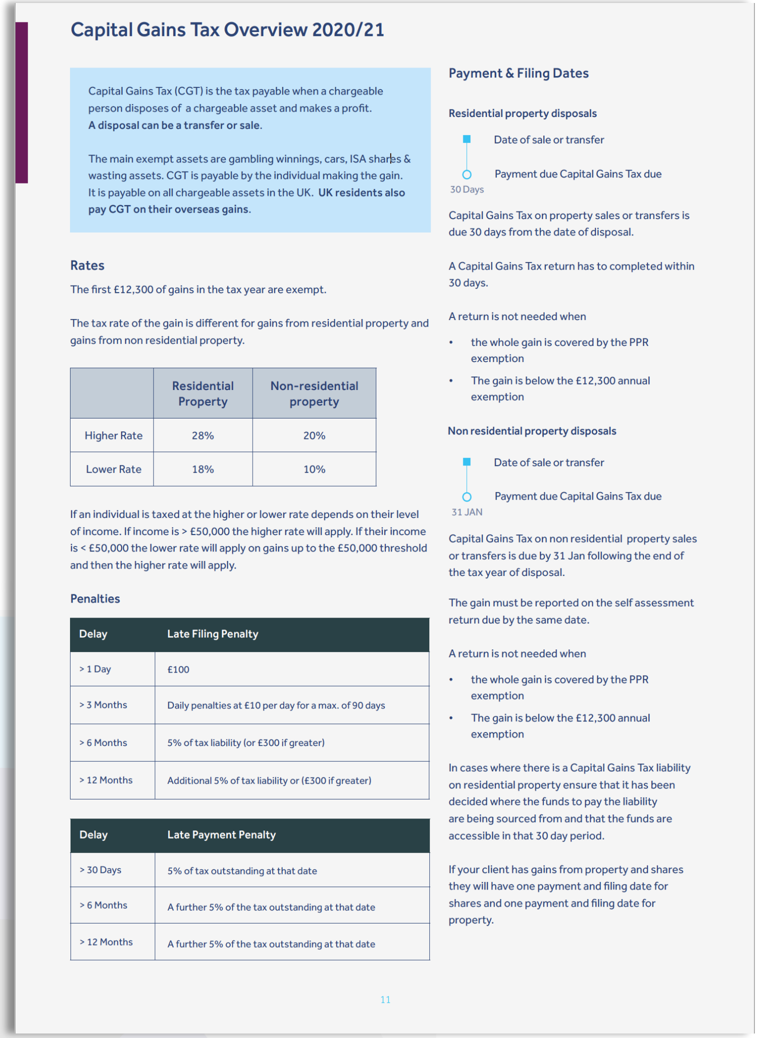
Additional 3% rate will impact people who have more than one property

If at the end of the date of the transaction the individual will have a major interest in more than one property the additional rate of SDLT will apply to that purchase **unless**

No stamp duty payable for married couples when transferring property between each other

If property is transferred to someone outside of the divorce SDLT may still be payable – it is charged on the consideration

CGT, Income Tax & Stamp Duty Overviews



Capital Gains Tax Overview 2020/21

Capital Gains Tax (CGT) is the tax payable when a chargeable person disposes of a chargeable asset and makes a profit. **A disposal can be a transfer or sale.**

The main exempt assets are gambling winnings, cars, ISA shares & wasting assets. CGT is payable by the individual making the gain. It is payable on all chargeable assets in the UK. **UK residents also pay CGT on their overseas gains.**

Rates

The first £12,300 of gains in the tax year are exempt.

The tax rate of the gain is different for gains from residential property and gains from non residential property.

	Residential Property	Non-residential property
Higher Rate	28%	20%
Lower Rate	18%	10%

If an individual is taxed at the higher or lower rate depends on their level of income. If income is > £50,000 the higher rate will apply. If their income is < £50,000 the lower rate will apply on gains up to the £50,000 threshold and then the higher rate will apply.

Penalties

Delay	Late Filing Penalty
> 1 Day	£100
> 3 Months	Daily penalties at £10 per day for a max. of 90 days
> 6 Months	5% of tax liability (or £300 if greater)
> 12 Months	Additional 5% of tax liability or (£300 if greater)

Delay	Late Payment Penalty
> 30 Days	5% of tax outstanding at that date
> 6 Months	A further 5% of the tax outstanding at that date
> 12 Months	A further 5% of the tax outstanding at that date

Payment & Filing Dates

Residential property disposals

Date of sale or transfer

Payment due Capital Gains Tax due

30 Days

Capital Gains Tax on property sales or transfers is due 30 days from the date of disposal.

A Capital Gains Tax return has to completed within 30 days.

A return is not needed when

- the whole gain is covered by the PPR exemption
- The gain is below the £12,300 annual exemption

Non residential property disposals

Date of sale or transfer

Payment due Capital Gains Tax due

31 JAN

Capital Gains Tax on non residential property sales or transfers is due by 31 Jan following the end of the tax year of disposal.

The gain must be reported on the self assessment return due by the same date.

A return is not needed when

- the whole gain is covered by the PPR exemption
- The gain is below the £12,300 annual exemption

In cases where there is a Capital Gains Tax liability on residential property ensure that it has been decided where the funds to pay the liability are being sourced from and that the funds are accessible in that 30 day period.

If your client has gains from property and shares they will have one payment and filing date for shares and one payment and filing date for property.

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General 2020/21 Tax Returns

If individuals fail to complete a tax return when one is required they will be faced with penalties of up to £1,600 and possible investigations from HMRC. The number of individuals who are required to complete a tax return has risen in recent years. Even people who are employed may need to complete one if they or their partner is claiming child benefit and they or their partner earns over £50,000.

Your client will need to complete a tax return for the year if they meet one of the following conditions

- They have income of over £100,000 per year
- They are a director of a company
- They received income from property (either from the UK or overseas)
- They received more than £10,000 from dividends or savings and investments
- They need to pay tax on any of the following
  - Income from a trust
  - Income from outside the UK
  - £2,500 or more in interest, commission or cash in hand payments
  - A payment or charge on a private pensions
- They need to pay capital gains tax
- They or their partner received child benefit and they or their partner earned over £50,000. The higher earner will need to complete a tax return

This is a brief summary of the requirements for completing a tax return. If your client is unsure of their obligations they can check on the HMRC website.

Does your client need to file a tax return for 2019/20

NO

If they are an employee, HMRC may issue them a P800 calculation in September or October which is HMRC's reconciliation and will advise them if more tax is due or if they are due a refund.

YES

Have they completed a tax return?

NO

You may need to estimate their tax liability (see page 9) to arrive at their net income. If the 31 Jan 2021 deadline has passed penalties will be payable.

YES

Have they reported all their income (including any overseas income and gains)?

NO

Client should seek advice immediately. They have until 31 Jan 2022 to amend their 2019-20 tax return. Penalties for incorrect return can be up to 100% of the tax due.

YES

Have they paid/are they able to meet their tax liabilities?

YES

They must keep adequate records for at least 22 months after the end of the tax year.

NO

Has their income been affected due to COVID-19? They may be able to defer some of their tax liabilities.

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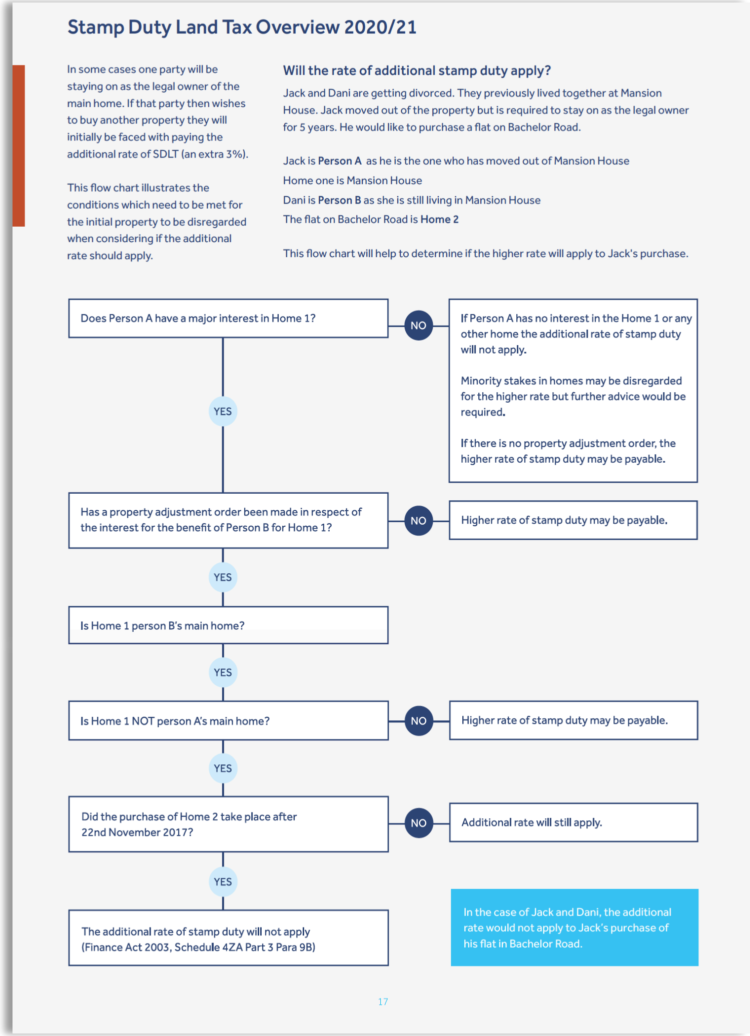

Stamp Duty Land Tax Overview 2020/21

In some cases one party will be staying on as the legal owner of the main home. If that party then wishes to buy another property they will initially be faced with paying the additional rate of SDLT (an extra 3%).

This flow chart illustrates the conditions which need to be met for the initial property to be disregarded when considering if the additional rate should apply.

Will the rate of additional stamp duty apply?

Jack and Dani are getting divorced. They previously lived together at Mansion House. Jack moved out of the property but is required to stay on as the legal owner for 5 years. He would like to purchase a flat on Bachelor Road.

Jack is **Person A** as he is the one who has moved out of Mansion House

Home one is Mansion House

Dani is **Person B** as she is still living in Mansion House

The flat on Bachelor Road is **Home 2**

This flow chart will help to determine if the higher rate will apply to Jack's purchase.

Does Person A have a major interest in Home 1?

NO: If Person A has no interest in the Home 1 or any other home the additional rate of stamp duty will not apply. Minority stakes in homes may be disregarded for the higher rate but further advice would be required. If there is no property adjustment order, the higher rate of stamp duty may be payable.

YES

Has a property adjustment order been made in respect of the interest for the benefit of Person B for Home 1?

NO: Higher rate of stamp duty may be payable.

YES

Is Home 1 person B's main home?

YES

Is Home 1 NOT person A's main home?

NO: Higher rate of stamp duty may be payable.

YES

Did the purchase of Home 2 take place after 22nd November 2017?

NO: Additional rate will still apply.

YES

The additional rate of stamp duty will not apply (Finance Act 2003, Schedule 4ZA Part 3 Para 9B)

In the case of Jack and Dani, the additional rate would not apply to Jack's purchase of his flat in Bachelor Road.

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Available for free download at:
www.sofiathomas.co.uk/resources

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High level risk assessment

One of the challenges can be to know when tax advice may be needed. We have compiled the below flow chart to assist in helping to determine if the circumstances in the divorce are high or low risk for tax implications.

We are always happy to have an initial blind chat with you if you would like to discuss a situation and consider whether detailed (chargeable) input is advisable.

Will the divorce be completed within the tax year that the couple separated?

- YES → **Do both parties currently live and intend to continue living in the UK?**
  - YES → LOW RISK
- NO → **Is there a business in the marriage?**

Is there a business in the marriage?

- YES → Seek advice
  - How will the business be valued? How will the value be realised?
  - Has Business Asset Disposal Relief been considered? (BADR is the new name of Entrepreneurs' relief)
  - Has Investors Relief been considered?
  - Could a company purchase of own shares be appropriate?
  - What will be the CGT consequences be of transferring or selling shares?
- NO → **Do either parties own investment properties?**

Do either parties own investment properties?

- YES → Seek advice
  - If the transfer takes place after the tax year of separation there may be Capital Gains Tax payable
  - Would Rollover/Investment Property Relief be available to remove the immediate charge to CGT?
- NO → **Do either party currently or intend to live abroad or intend to do so?**

Do either party currently or intend to live abroad or intend to do so?

- YES → Seek advice
  - Check the residency & domicile position of the client. If they are non resident and/or non domicile they may have a different tax position in the UK.
- NO → **Will either of the parties have been absent from the main home for more than 9 months prior to sale or transfer?**

Will either of the parties have been absent from the main home for more than 9 months prior to sale or transfer?

- YES → Seek advice
  - The absent party may have a capital gains tax exposure.
  - Confirm if they will qualify for a s225B exemption.
- NO → LOW RISK

Key Tax Updates

- CGT is payable within 30 days from date of disposal on all UK property (6 April 2020)
- Main home relief only extends for 9 months once the person has left the home (6 April 2020)
- Entrepreneurs relief is now called Business Asset Disposal Relief (BADR) and is only available on gains on up to £1 million (20 March 2020)
- HMRC guidance updated to say Holdover relief unlikely to be available on divorce (2020)
- Penalties of up to 200% of tax due for failure to declare offshore income
- Payment on Account payment holiday means additional taxes will be due by 31 Jan 2021 & VAT deferrals will fall due early in 2022.
- Increased focused on small businesses by HMRC to close the Tax Gap

Updates from the Summer Statement (8th July 2020)

- SDLT at 0% up to £500,000 from now until 31 March 2021 in England and Northern Ireland– additional 3% will still apply
- Consider timing of settlements
- Furlough scheme to be phased out and end in October 2020

Key Tax & Family Law Cases

Crowther V Crowther & Ors [2020] EWCA Civ 762 – Possible Tax Evasion
Issues – bringing assets into the scope of division of assets can also bring them into the scope of tax.

Para 24: She did so contending that the arrangements entered into in 2012 and described above were a sham. She acknowledged that "on paper it looks like Castle Ship Management have owned their ships since 2012", **but said that this was not the reality and was only done to "reduce our tax liabilities**", the reality being that "100% of the shareholding in Castle Ship Management Ltd is held on trust for us". Although she did not put it anything like so bluntly, what her evidence came to is that her husband conspired with Mr Knight to conceal from HMRC that ultimately the vessels were beneficially owned by the Crowthers**; that this was done in order to evade tax; and that what Mr Knight gained from this arrangement was a relatively modest annual fee**. Mr Charles Howard QC for Mrs Crowther confirmed in argument before us that Mrs Crowther's case is indeed that this was unlawful tax evasion as distinct from legitimate tax avoidance, albeit that her case will be that despite being a partner in the business and responsible for financial matters, and despite having attended the November 2012 meeting, she was not a participant in unlawful activity.

Key Tax & Family Law Cases

ABX v SBX [2018] EWFC 81 (31 July 2018) – Remarkable tax loophole

Issues – Non domiciles face tax charges when remitting earned income into the UK

Both H & W were non UK Domiciled. It was agreed that maintenance would be paid in the following way. H's offshore income would be paid to W's offshore account. W would bring the money into the UK and use the money. If H bought the money into the UK directly, tax would be payable at 45% but through this offshore structure 0 tax is payable.

Para 48: The wife then asserts that no tax is payable on these funds when realised. This is because she says that if these funds are paid offshore to her, she is able to remit them onshore without incurring a tax liability. It seems to me that this is a remarkable tax loophole but given that both parties accept that, on advice, it exists and is legitimate, then I would not stand in the way of the wife receiving lump sums into an offshore account. Any part of the funds remitted onshore will be taxed at the husband's marginal rate of 45%.

Para 55: It is also agreed by the parties that such lump sums as I order to be paid to the wife can be paid offshore with the tax liability being avoided. In other words, every pound received by the wife is worth a pound and every pound received by the husband is worth 55p.

Key Tax & Family Law Cases

AS v Secretary of State for Work and Pensions (CSM) [2018] UKUT 315 (AAC) CCS/706/2017 1
Issues – Attaching maintenance to dividends and the shareholding subsequently being reduced

The father is a businessman and sole shareholder in a particular company. In the initial order it was decided that dividends received by him which could not be brought into account under the base order, should be the subject of a variation and included as income.

- The father re-married. He claimed to have transferred 40% of his shares in the relevant company to his new wife on 1 May 2012 and that only 60% of the dividends of the company should be treated as income from 1 May 2012.
- The father wanted the child support child maintenance payments reduced to take into account 60% of the dividends and not 100%.

Para 18 of the Judgement states 'The question of what is reasonable for the purposes of regulation 19(4) must be considered in the context of the purpose of the provision and, indeed, the purpose of the whole child support regime. It is expected that parents will support their children and regulation 19(4), … is obviously intended to prevent non-resident parents from avoiding that liability. An action that might be quite reasonable in the absence of any potential liability to support children may, for the purposes of regulation 19(4), be unreasonable if it has the effect of reducing a parent's ability to pay child support maintenance.

As such as there was no reasonable explanation for the transfer of shares, in so far as the decision to divert the income was voluntary and not forced upon the appeal was dismissed.

When to use a tax expert

- Main home
- Investment properties – sharing assets
- Pension sharing
- Business, transfer of shares
- Selling of assets

Future tax implications

sale or transfer

Tax implications of a past action

- Previous planning
- Tax avoidance schemes (DOTAS)
- Loan Charges
- R&D Tax Credits
- HMRC Investigations

- Incorrect filing of tax returns
- Dividends reported and not paid
- Annual allowance charge not computed
- Failure to declare income (overseas income)

Correcting previous positions

Quantifying net values

- Net income of sole trader/partnership
- Net value of rental income (interest relief restrictions)
- Allowances
- Possible reliefs
- Net gain

What is the desired outcome?

- Planning may be considered here
- Reliefs and elections
- Different ways to divide the assets

To understand options

Tax efficiency

- Different structures can be looked at
- What is the timescale:
  - May need to move quickly
  - May to spread out over multiple years
- May be better to be exposed to one tax which is a lower rate

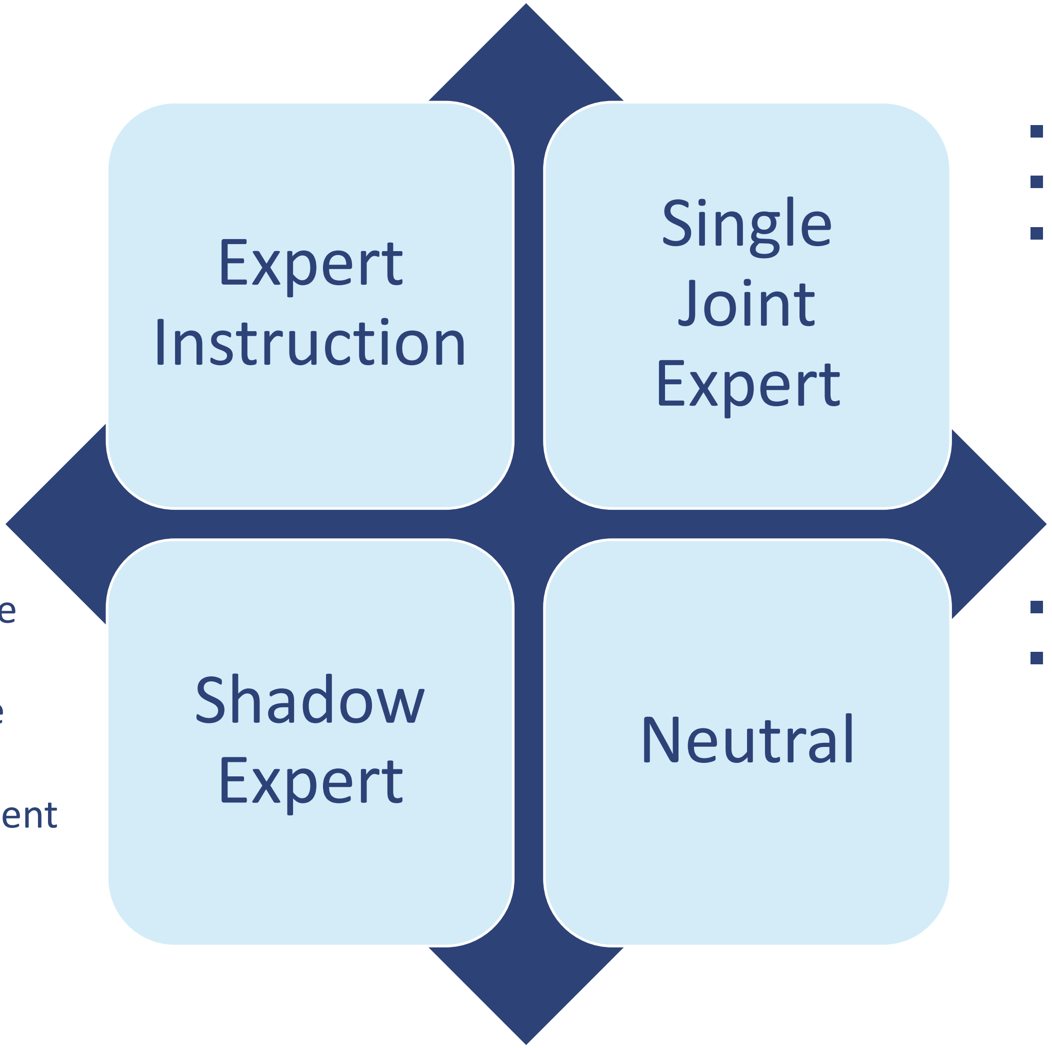
- Compliment other advice
- Pension report
- Overseas tax advice

Holistic picture

Quantify the tax

- Consent order drafted
- Parties agree
- Need to know the figures
- What net figures are needed?

What is the best capacity?



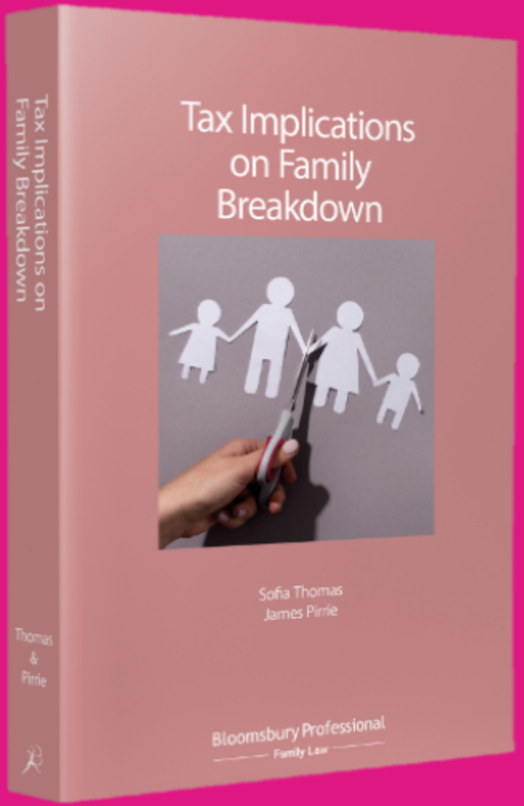
- Working with one party
- Helpful if one party has an ongoing HMRC investigation

- Permission through courts
- Formal instruction
- Both parties agree on who to appoint

- Help to craft questions for the SJE report
- Help to review and digest the report
- A personal support for the client

- Working with clients in mediation
- Less formal but still working for both parties.

Thank You!



“Sofia Thomas and James Pirrie have written an interesting, informative and very readable book. It deserves to be on every family lawyer’s bookshelf.”

- Hon Mr Justice Mostyn,
From the Forward of
Tax Implications on Family Breakdown

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