



Jackie Clifford MA (Cantab) FCA
Forensic Associate
Email: jclifford@dtigroup.com



Peter Whittam BSc (Hons) FCA MAE
Forensic Associate
email: fsurname@dtigroup.com



Nick Fail BA (Oxon) FCA MAE
Forensic Director
email: nfail@dtigroup.com



George Lovell BSc ACA CTA
Tax Partner
email: glovell@dtigroup.com

For more information on DTE
Forensic Accounting Services
visit: www.dtigroup.com

The Exchange, 5 Bank Street
Bury, BL9 0DN
DX 711400 Bury 6

t: 0161 767 1200
f: 0161 767 1201

SPOTLIGHT ON..... taxation issues in matrimonial settlements

Practitioners involved in matrimonial cases will often need to consider the impact of taxation on financial settlement which is likely to involve the transfer of assets between the parties. This bulletin provides an overview of some of the potential issues that divorcing couples could face. These issues apply equally to married couples as well as those in a civil partnership.

Date of separation

The date of separation is important as it is that date, rather than the date of divorce, that is relevant for income tax and capital gains tax purposes for the divorcing parties. Spouses are treated as living together unless they are separated under a Court order, by deed of separation or in such circumstances that the separation is likely to be permanent.

Capital gains tax

As a general rule transfers between spouses are exempt from capital gains tax (CGT). These exemptions are extended to cover the period to the end of the tax year (ie up to 5 April) in which the parties separate, but transfers after then are subject to specific rules, particularly in respect of the matrimonial home.

The matrimonial home

Given the general rise in property prices over the course of the marriage a substantial tax liability could arise if a disposal of the matrimonial home falls outside the scope of various exemptions that are available.

Gains on the disposal of a person's principal private residence (PPR) are exempt from CGT and the owner is deemed to be resident in that property during the last 18 months of ownership. This usually allows sufficient time for any transfer between the parties, but clearly it is possible that a protracted dispute over the division of the matrimonial assets could mean that this period is exceeded. In these circumstances provision is made via s225B of the Taxation of Chargeable Gains Act 1992, which allows a tax free transfer, but such a transfer has to be between the spouses, not an external sale. Furthermore the departing spouse cannot claim PPR relief on another property during the extended period.

Transfers of business assets

In some cases, former spouses or civil partners will have worked together in a family business. In these situations, it is often the case that one of the parties will take the business over. It is imperative that tax advice is sought where a business asset forms part of a divorce settlement, as the capital gains tax treatment of any transfer can vary depending on how it is undertaken.

Where transfers of business assets are concerned it is possible to avoid CGT crystallising at the date of transfer by obtaining a joint holdover election. This election effectively transfers the future CGT implications of owning the asset to the recipient. However, be aware that any CGT liability that has accumulated up to the date of the transfer to the spouse should be netted off the gross value of the business asset when considering the overall value of the matrimonial assets.

It must also be noted that holdover relief is not always a given and its availability very much depends on how the assets are divided. The principle of holdover is that it provides relief where gifts of business assets are made outright, or at undervalue. However, in divorce situations, the business assets are likely being transferred in return for another asset of a similar value. Therefore a holdover election cannot always be made in these circumstances.

Where a court makes an order for the transfer or formally ratifies an agreement between the parties by consent order, the transfer is not regarded as being for consideration and holdover relief can apply.

However, if the courts are not involved, no holdover relief can be claimed after the decree absolute or final dissolution order.

Transfers of other assets

Other assets can include anything from a second (or holiday) home, rental property and business assets to cars, works of art or jewellery.

Other assets transferred as part of a matrimonial settlement for which no consideration is paid will be treated for CGT purposes as being transferred at their open market value which could trigger a CGT liability depending on the circumstances.

Where jointly owned assets are concerned, care should be taken when valuing the interest being transferred. This is because the market value of an interest is not necessarily the same as a proportionate share of the full market value and a discount might be appropriate.

Do not forget that each person is entitled to an annual CGT exemption which currently stands at £11,100 for the 2015/16 tax year. Consideration should be given to transferring assets in different tax years to minimise the level of CGT payable. However, it should be borne in mind that the general rule for CGT purposes is that an asset is disposed of or acquired at the date of a contract and not the date on which ownership of the asset is transferred.

The position regarding the date of transfer is not always clear where transfers under Court Orders or consent orders are concerned. HMRC's view is that the relevant date is that of the Court Order whether or not it is before or after the decree absolute. However, where a consent order is made before the decree absolute then HMRC will generally accept the parties' agreed date.

Conclusion

The above notes are not intended to be a comprehensive consideration of all aspects of taxation that a divorcing couple could face, but they indicate some of the areas that most commonly need to be considered. The impact of taxation will vary for each couple and it is therefore necessary to take appropriate professional advice to ensure that proper steps are taken to cater for a couple's individual circumstances.

If you consider that you might require assistance in any matrimonial matter, then please do not hesitate to contact Jackie Clifford, Peter Whittam, Nick Fail or George Lovell, who will be more than happy to discuss matters on a no obligation basis.



Income tax

There were significant changes to income tax legislation concerning maintenance payments and married couples allowances which took effect from 6 April 2000. Unless individuals were over 65 at that date there is little ongoing impact as a result of those changes on maintenance payments which are now largely exempt from income tax or on personal allowances.

Otherwise, income tax generally causes no problem for separating couples as individuals will continue to pay tax on their own income. Separating spouses have a duty to support one another financially until the divorce is finalised. Sometimes the court will order that this maintenance continues after divorce, or it can be ascertained as part of an agreement. The spouse making the payments will be taxed on their gross income from the initial income received. However, maintenance payments received are not taxable for the spouse receiving the payment.

Pension sharing

Where pension attachment and sharing is concerned, pension commutation lump sums are paid free of tax and so attachment has no tax consequences. Under a pension sharing order the member spouse suffers a debit in respect of their rights under the relevant pension scheme and the non-member spouse receives a credit of the percentage fixed by the Court. Accordingly the member spouse's pension entitlement is diminished and if the pension is already in payment the income that he or she loses will no longer be theirs and so they will not pay tax on it. Instead it will be taxable in the hands of the non-member spouse when paid to them.

Inheritance tax

Unlike income tax and capital gains tax the date of divorce (decree absolute) is the date up to which transfers between spouses are exempt.

In general transfers between spouses are exempt transfers for inheritance tax purposes. Thus they are not potentially exempt transfer and it does not matter whether the transferor survives 7 years, which is the usual timescale relating to inheritance tax. However if the recipient spouse is not domiciled in the UK the exemption is limited to the nil rate band (currently £325,000).