FAMILY MATTERS ARE TAXING

Doug Shanks, John Handley and Jessica May discuss the tax implications of divorce

When couples and their families go through the trauma of even the most amicable divorces, throwing careful tax considerations into the mix is only going to add to the tension. With tax planning in the current anti-avoidance atmosphere, keeping things simple and avoiding the worst pitfalls is essential – while trying to be too clever, or bending the rules, is foolish in a separation, when the pressures are often feeling unendurable.

John Handley, senior tax partner at DSC Metropolitan Chartered Accountants, agrees. ‘It’s a huge subject. Tax and other related financial matters aren't going to be driving issues on divorce but if you ignore tax matters, they can come back to bite you when you least expect it, sadly all too often in areas that could have been addressed earlier. I find it isn't necessarily advisers who are to blame for a lack of foresight. We’ve seen cases where perhaps understandably custody of the designer cats is more important than capital gains tax arising on a principal private residence (what normal people call a home). You could write books about it. People have done.”

Handley takes an analytical perspective. “Tax planning is usually limited for income tax, but less so for capital taxes. A key issue is the tax year of separation. This is where there is an order, or the couple have separated ‘where it appears permanent’. It can be possible to be separated for tax, but continue to live together, which can be a distinction worth remembering in a more fluid society – or at least one that thinks it is.

IS THERE ANY FLEXIBILITY AROUND THE DATE OF SEPARATION?

"No. And yes. But no. In so many aspects of tax the general rule breaks down at the margins and we end up with the slightly trite answer to so many clients seeing rules of thumb: each case must be assessed on the facts. I'm not a lawyer, but I imagine this is even more so with a legislature dependant on case law. It's not an area we see challenged by the Revenue that often so it's important for both sides to agree the facts as they see them, then stand up for themselves – while sticking to the truth and not being too smart."

Handley reminds us that routine tax planning elections need to be considered: "For income tax purposes, couples may have made a claim to tax income not on a 50:50 basis. This election will fall away on divorce – and the separating individuals will be taxed on the actual beneficial ownership of the asset concerned."

Handley turned to issues around capital taxes: "Transfers between spouses for capital gains tax (CGT) purposes are tax neutral – what is known as on a 'no gain: no loss basis'. This applies in the tax year of separation – but is no longer the case thereafter in future tax years. However the couple do remain 'connected persons' for tax purposes – and so, when valuing transfers between them, the assets pass at open market value (MV). This is the case up to decree absolute."

WHAT IS THE TAX RELEVANCE OF THE DECREE ABSOLUTE?

"For inheritance tax (IHT) purposes, the transfer of assets is not such a problem, as the exemption between spouses continues up to decree absolute. Exemptions may even continue after that if 'non gratuitous' (for example, to comply with the terms of a court order) or the transfer is for maintenance, which, as ever will need to be on the individual merits."

"Maintenance and tax credits are more complicated than you might expect, and can cause issues. For once there is a rule of thumb: maintenance is no longer tax-allowable, and is not taxable on the recipient these days."

DOES DIVORCE GENERATE MORE REVENUE ENQUIRIES?

"I'm not sure that divorces generate more enquiries, but I imagine HM Revenue and Customs will need to investigate if a couple's returns don't match, or if one former spouse 'shops' the other. Divorce requires full disclosure to court of their income and assets – and the court is obliged, as are lawyers and advisers, to report any undisclosed income or assets to HMRC."

A FAMILY LAWYER'S PERSPECTIVE

So much for the accountant's perspective. What about the family lawyer's? Jessica May from Peters May highlights some practical concerns: "Future personal tax bills for all couples should be accounted for in divorce settlement negotiations and the final financial consent order, especially the self-employed. Tax bills due in the next six to 12 months, or beyond, are relevant to the division of capital between the parties. This might be overlooked by the unwary solicitor or client – and could lead to difficulties in implementing the terms of the final order, or the paying party being unable to meet their tax liabilities."

"In a recent case of ours, the wife received a hefty tax bill for dividends issued in her name by her estranged husband, post-separation. She received some of the dividends declared from the company which formed her maintenance, but not the full amount declared by the business in her name. The husband was reminded he needed to pay his wife maintenance net

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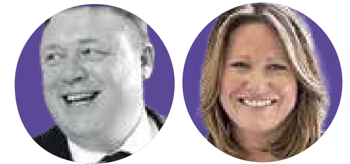
per month, but it was a difficult job for the wife and her newly appointed accountant to untangle the situation with HMRC. In this case, tax accountancy advice was needed to ascertain what her maximum tax exposure was, and for that to be incorporated into the settlement negotiations."

"Picking up on John's point, the myth that there is no CGT between spouses after separation lives on. We, as family lawyers, will always signpost clients to tax accountants to prepare a report on potential CGT exposure on the sale of the family home, as this needs to be considered in the final settlement. This is particularly so if there has been a significant passing of time since one party left the family home. Divorces can, sadly, sometimes take two or three or more years to resolve, particularly in cases where matrimonial proceedings are issued at court and CGT liabilities can change throughout the lifetime of the proceedings. It's important to keep ongoing tax liabilities under review."

"One way of speeding up the court process now is to enter into arbitration. This is growing increasingly popular – particularly with the rising pressure on the court system caused by covid and the backlog of work. Arbitration is essentially private court proceedings. The parties agree to appoint and pay a judge (usually a senior barrister) to hear the case privately, which will usually be a much quicker route to securing hearing dates and a resolution, as opposed to being at the mercy of the ram-packed family courts.

"Arbitration is particularly useful where there are complex tax affairs and reports in the proceedings. In private arbitration, as the judge is being paid privately, they will have factored in proper 'reading time' and will have read and digested all expert tax accounting reports.

"It is a sad reality that in court-based proceedings, £5k-£10k plus VAT may have been spent on a forensic accountant's report – only for the parties to get to a court hearing and the judge may not have had the time to read the report. This is due to the pressure on the court lists and the judge's time, but is a source of huge frustration to the paying parties." SJ



Doug Shanks / Jessica May John Handley

Doug Shanks, consulting partner at DSC Metropolitan llp Chartered Accountants (pictured), was speaking with John Handley, senior tax partner at DSC Metropolitan llp Chartered Accountants, and Jessica May, partner at Peters May
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