

Tax breaks for happy couples

The General Election has brought forth the hotly debated proposals of the Conservative Party for new tax allowances for married couples and civil partners. Critics claim that the proposals amount to next to nothing; supporters say that it represents a signal that marriage would be back in vogue as official policy if the party were to win.

The tax legislation does in fact contain many tax reliefs which are applicable only to married couples and civil partners. Many may seem to be completely straightforward, but as with all tax provisions, the devil is in the detail. (In this article, all references to husband and wife also include references to the parties to a civil partnership.)

Capital gains tax

The capital gains tax legislation contains a provision by which assets may be transferred between husband and wife during a year of assessment in which they live together, without any chargeable gain accruing to the transferor. Instead, the transferee acquires the asset at the original base cost to the transferor. Without this provision, the gift of an asset would be treated as being a disposal of it for market value.

It is important to appreciate that, except in two circumstances mentioned below, the transferee's acquisition is not backdated in any way. The transferee acquires the asset on the date of transfer, but at the transferor's original base cost.

The two exceptions are:

1. Where the asset transferred was held by the transferor at 31 March 1982, the transferee is likewise treated as having acquired the asset on that date. This is of particular interest in relation to the shareholdings in private companies. Take for example the situation where the husband has held 65 per cent of the shares in the company since 31 March 1982 and the wife has held 20 per cent since that date. If there is now to be a sale of the two shareholdings, it will benefit them first to transfer 10 per cent from the husband to the wife, giving the husband a 55 per cent shareholding to sell and the wife a 30 per cent shareholding. The effect of this transfer is to increase the valuation profile of the wife's shareholding as at 31 March 1982 from small minority basis to substantial minority basis.
2. In the case of the transfer of an interest in the main residence of the husband and wife, the date of acquisition for the transferee is treated as being the same as the date of acquisition of the transferor. This gives rise to interesting possibilities where the property is not the main residence of the parties, such as a holiday home. In such a case, if the property is transferred from one to the other, the acquisition date for the transferee is the date of transfer although the base cost to that person is the original base cost of the transferor. It follows that if, after the date of transfer, they

are able to switch the main residence election to the property considerable tax savings can be achieved on a subsequent sale of it..

Income Tax

Putting an asset into the joint names of husband and wife results in the income from the asset being automatically split between them in equal shares for tax purposes. It does not matter if the real ownership is largely that of one or the other. It will be appreciated therefore that with the introduction of the 50 per cent rate of income tax, this type of planning may become of greater interest.

This rule does not apply to the dividends paid on close company shares. Close companies are those which are under the control of five or fewer individuals, according to a complex formula, but most family companies are likely to be within this definition. Accordingly, there is no automatic division of the dividends on close company shares equally between husband and wife where they are held in joint names, but of course in practice most joint shareholdings are as a question of fact owned equally by the two parties so the income will in any event be equally divided between them for income tax purposes.

Inheritance tax

Probably the most significant tax exemption which married couples enjoy is the inheritance tax spouse exemption. This enables one to provide for the other on death without inheritance tax liability arising and therefore the exemption is a very significant incentive towards marriage, making the proposed new married couples' income tax allowance pale into insignificance in comparison.

It should be noted that the capital gains tax and income tax reliefs for married couples are largely confined to those who are living together, but there is no such requirement in relation to the inheritance tax spouse exemption. Furthermore, on the death of a surviving spouse, the unused proportion of the nil rate band of the first to die may be claimed on the second death, according to a formula. The transfer of the nil band is however only available on the death of the survivor and cannot be used to cover lifetime chargeable transfers.

The spouse exemption on death is however subject to an important restriction where there was a gift from a spouse who is domiciled in the United Kingdom to one who is not so domiciled. Any such gift qualifies for exemption only up to a limit of £55,000 (which limit has remained unchanged since 1982). The limit applies to all lifetime transfers, and once it has been absorbed by gifts cannot be restored by any means.

It cannot unfortunately be claimed that the lifetime gifts from the domiciled spouse to the non-domiciled spouse were potentially exempt transfers outside of the exemption. The exemption takes priority and gifts are therefore only

potentially exempt if they are not actually exempt. Accordingly lifetime gifts will be applied against the £55,000 exemption so that in many cases there will be no exempt amount available on the death of the domiciled spouse

The inheritance tax rules contain detailed provisions relating to lifetime gifts where a benefit is retained by the donor. In such circumstances, if the reservation of benefit continues until death, the gifted asset will be counted in as part of the donor's estate. This rule does not however apply to gifts between husband and wife which are covered by the spouse exemption. It will be appreciated that as the spouse exemption between a domiciled spouse and a non-domiciled spouse is only £55,000, gifts in excess of that figure, even though potentially exempt, may well be caught by the reservation of benefit rules. As a result it may be very difficult, although not impossible, for spouses of mixed domicile to avoid reservation of benefits applying in relation to any substantial lifetime gifts made to the non-domiciled spouse.

Generally

All the tax reliefs which apply specifically to married couples offer significant tax planning opportunities not detailed here and the available opportunities should not be allowed to go to waste.

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