Capital gains simplification on the cards for divorce settlements

New legislation is set to simplify one aspect of tax on divorce or dissolution.

Marriage is not what it used to be. In 2020, 46% of births in England and Wales took place outside of a marriage or civil partnership, according to the Office for National Statistics. Even so, UK tax law still draws sharp lines between married and civil partners, and the unmarried:

- Gifts and bequests between married couples and civil partners are generally free of inheritance tax (IHT), regardless of their size. The unmarried enjoy no such favourable IHT treatment and must plan accordingly.
- Married couples and civil partners can benefit from a marriage allowance of £1,260, if one partner is a non-taxpayer and the other pays no more than basic rate (intermediate rate in Scotland).
- A married couple or civil partners can only have one private main residence for capital gains tax (CGT) purposes, but the unmarried can have one each.
- Transfers of investments and other assets between couples and civil partners are deemed to take place on a no-gain-no-loss basis, meaning there is no CGT involved.

That last tax break currently requires the transfer to be made during a tax year in which the couple are living together. This condition can create complications for divorcing couples or dissolving civil partnerships, as in 2020, the average time between applying for and securing a divorce in England and Wales was 53 weeks.

In its second report on simplifying CGT, the Office of Tax Simplification (OTS) recommended that the CGT-free transfer period should be extended to at least two tax years after the tax year of separation. Although the government rejected many of the reform proposals in the OTS's reports, it did accept that the CGT-free window on separation should be increased.

That decision has now reached the stage of draft legislation, the most important part of which will increase the CGT-free period to up to least three tax years after the tax year of separation. The new rules will take effect from 6 April 2023.

The change is long overdue, but it is only one simplification in a process where financial technicalities abound, and advice is vital.

Is your interest getting too interesting?

Rising interest rates could mean you may start to pay tax on interest.

Since 2009, deposit interest rates have been so low that the income generated has been minimal. That fact, combined with the introduction of the personal savings allowance (PSA) in April 2016, means you may well not have had to think about tax on your interest.

As a reminder of the PSA, broadly speaking:

- If you are a basic rate taxpayer (based on English tax bands, regardless of where you live) then £1,000 of interest is free of tax.
- If you are a higher rate taxpayer (again English-based), then £500 of interest is tax free. The difference is a cliff edge – even if you pay only 1p of higher rate tax, your PSA is £500.
- If you are an additional rate taxpayer, then all of your interest is taxable.

Although the PSA has the word allowance in its name, in practice it operates as a 0% tax band on the first £1,000/£500 of interest, which can complicate tax calculations.

In some circumstances, the starting rate band for savings can mean no tax is paid on interest. However, this tax band generally only applies if your total earnings, pension and rental income are below £17,570.

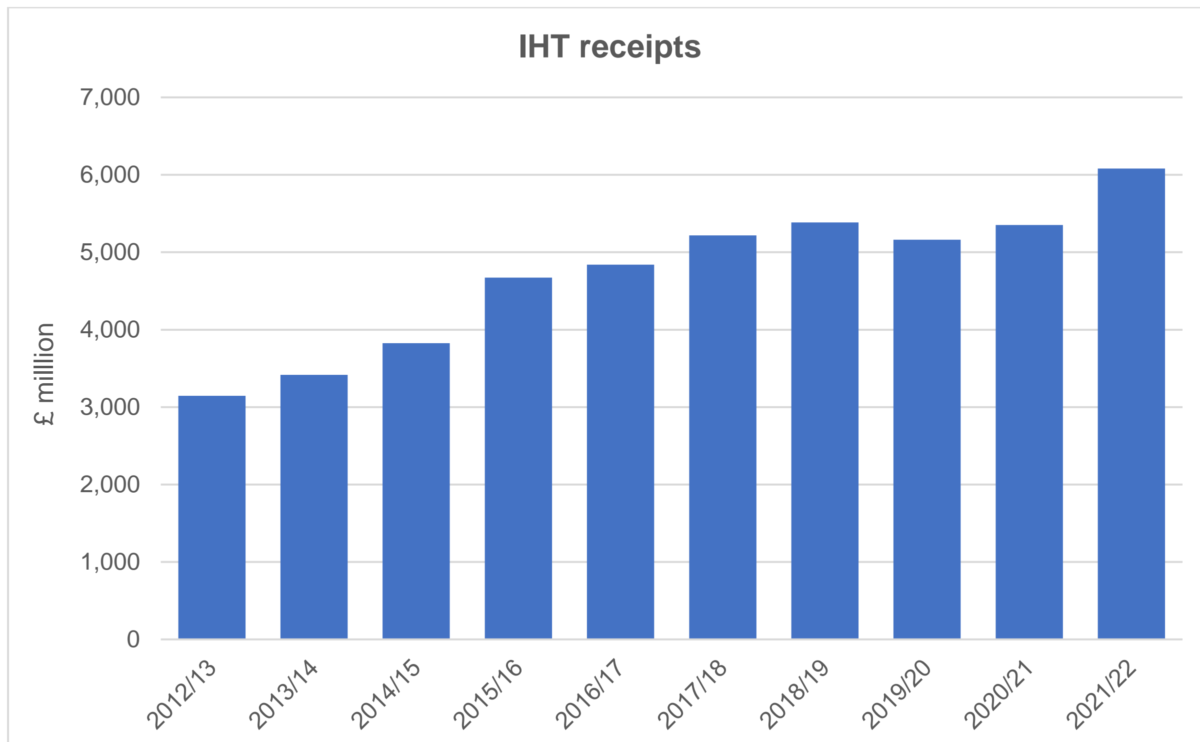
For some years, basic rate tax has not been automatically deducted from most interest payments because to do so would theoretically have meant HMRC having to deal with millions of small income tax reclaims. As rates rise and more interest is paid, however, the number of people who will have to pay tax on some interest is set to increase.

If you think you might be one of those new interest taxpayers, then:

- Check whether you are making the most of independent taxation – your spouse or civil partner may have unused PSA or otherwise pay a lower marginal rate of tax.
- Consider using cash ISAs, which offer tax-free interest. However, the rates on offer can mean ISA returns are less than what you can achieve after paying tax.
- Consider premium bonds as an alternative to quick access deposit accounts if you are a higher rate taxpayer.
- Ask yourself whether the reason you are paying tax on interest is because you have too much on deposit. At a time when inflation is forecast to exceed 13%, your deposits are rapidly losing purchasing power.

Inheritance tax receipts double in a decade

New data from HMRC show the Treasury's inheritance tax (IHT) receipts have doubled since 2012/13.



Source: HMRC.

Of all the various taxes levied in the UK, IHT is one of the most peculiar:

- For a start, its name is misleading. In other countries that levy inheritance taxes, the tax is usually based on the inheritor and the amount that they inherit. In the UK, the tax would be more accurately described by its former name, capital transfer tax. Think tanks regularly suggest IHT should change from a levy on donors to a tax on recipients. In theory, the switch would encourage a wider distribution of assets. It could also raise considerably more revenue.
- IHT is often described as the UK's most hated tax. However, the amount of tax it raises for the Exchequer is small change: it is worth about 1% of the total produced by the three main taxes – income tax, national insurance (yes, that is a tax) and VAT.
- The great majority of estates do not pay any IHT. For married couples and civil partners who are homeowners with children, IHT is usually not an issue until their wealth exceeds £1 million. Statistics from HMRC show that in 2019/20, only 3.76% of estates suffered the tax. In practice, nearly half of estates will escape IHT simply because there is generally no tax on transfers between married couples and civil partners. However, this exemption does not apply to unmarried couples – in IHT there is no such concept as a common-law spouse.

New figures from HMRC show that in 2021/22 the IHT receipts rose by nearly 14%, with the average IHT bill faced by that small minority of taxpaying estates with a value of just over £250,000. One reason for the increase is the fact that the nil rate band is frozen. The freeze started in 2009 and its term has regularly been extended – the "thaw" is not now due to arrive until April 2026. With inflation surging, over three more years of freeze will drag more estates into the IHT net.

If IHT is a concern for you, there are a variety of ways to reduce its impact on what your children or grandchildren will inherit. It will not surprise you to learn that with such a misunderstood tax, the starting point is professional advice.

Tricky teens: inflation set to soar beyond 13%

The Bank of England has said that inflation could reach over 13% before the end of the year. But that's the lower end of the speculation.

The inflation figure in July 2022 reached an eye-watering 10.1%, as measured on the consumer prices index (CPI) yardstick. That was the highest level in 40 years, a reminder that much of the current population has never experienced such a rapid rise in prices. However, 10.1% is not the end of the story.

In early August, the Bank of England said that it expected inflation to be "just over 13%" in the final quarter of the year. Alas, even that figure may now be an underestimate of the peak as it was produced before new – and still higher – projections for the utility price cap in October and January emerged. For example, Citi, the US investment bank, thinks the new year utility increase could mean inflation reaching 18.6% in the first month of 2023.

If there is any comfort to be found in the inflation forecasts, it is that the Bank of England believes that after a tough 2023, inflation should move back down to the official target figure of 2% in the following year. The mathematics of inflation suggest the Bank of England could be correct, even if its forecasting record has been poor of late. For inflation to remain at elevated levels requires prices to rise at the same pace as over the last twelve months, a period marked by post-Covid-19 supply chain problems and the economic fallout from the war in Ukraine.

Whether or not the Bank of England is right this time, in the near term the inflationary pressure on incomes will remain. Research is already showing that people are considering a variety of ways to help make ends meet. Examples include drawing on savings and investments, stopping or reducing pension contributions or accessing retirement benefits earlier than previously planned.

If you are contemplating a raid on your investments or pensions, you should only take any action once you have sought financial advice. Drawing on investments could attract tax and possibly other charges, while triggering early retirement benefits has its own tax issues and could limit your scope to make future contributions.

Three financial lessons from the Covid-19 pandemic

The pandemic taught us many things, but some of them are already slipping away.

The Covid-19 pandemic is now beginning to fade from the collective consciousness, despite the best efforts of the Omicron variants to snare those who had previously avoided the virus. It is understandable that we do not want to linger on that dark period of lockdowns, social isolation and, until the vaccines arrived, considerable fear. However, by upturning our lives, the pandemic provided many lessons: some already have had a clear impact, while others have been forgotten.

In the first camp is the realisation that technology has made the traditional commute to the office for five days a week unnecessary for many workers. A recent survey revealed that the average time spent in the office is now 1.5 days a week. With desks left empty nearly two thirds of the time, there are profound implications for not only the office property market, but also for the retailers who relied on the footfall of office workers.

In the slipped away category, three lessons stand out:

1. **You need to have an up-to-date will.** The necessity became all too obvious when the possibility of a sudden death arrived. That risk has thankfully largely disappeared but keeping your will up to date – or making a will if you do not have one – should still be a priority.
2. **Timing the investment markets is next to impossible.** The arrival of Covid-19 prompted sharp falls in world markets in February 2020, followed by rapid recoveries, starting at what looked the grimmest time – March 2020. Anyone who claims to have got that timing right is probably flexing the truth.
3. **The UK's social security net is not fit for purpose.** Many benefits had to be bolstered and/or supplemented during the pandemic because they were simply inadequate. For example, Universal Credit was increased by £20 a week (withdrawn in September 2021) and both the furlough scheme, and the self-employed income support scheme were introduced (both of which have now also ended). The social security system has been weakened further since, as the lagged mechanism for index-linking has allowed inflation to erode the benefit values. If you were considering saving money by cutting out the premiums for your life and health protection policies, think again.

While it's understandable that we all want to put the last couple of difficult years behind us, some issues, and fault-lines, are worth remembering and factoring into your resilience planning.