Saffery

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Divorce - tax implications

When a marriage or civil partnership breaks down it is likely that tax will not be at the top of the agenda. However, the tax impact should not be underestimated. Advice should be sought early on to ensure that there are no unexpected tax consequences, including those which might arise from recent changes in legislation or HMRC interpretation, and to mitigate any resulting tax liabilities.

When a married couple separate it is likely that the matrimonial assets will need to be divided between the divorcing parties. Depending at what point in the divorce proceedings the assets are transferred or disposed of, this division of assets could give rise to capital gains tax (CGT) liabilities.

Capital gains tax

Transfers of assets between spouses or civil partners do not usually give rise to a CGT charge. Instead, the assets are deemed to be transferred at a value that gives rise to neither a gain nor loss. However, prior to 6 April 2023 this rule only applied to spouses or civil partners that were living together at some point during the tax year. At any other time, transfers between spouses or civil partners would have been deemed to have been made at market value.

From 6 April 2023 the rules have changed to extend the time limit to three years following the tax year of separation, or the date of the decree absolute if earlier. If the assets are subject to a formal court order, there is an unlimited timeframe in which the no gain/no loss treatment will apply.

Spouses or civil partners are treated as living together unless they are separated under a court order, by deed of separation or where the separation is likely to be permanent.

Following the end of the three years after the tax year of separation, any transfers will be deemed to be at market value unless the transfers are as mandated by a court order, as the divorcing couple will still be 'connected persons' up until the date of divorce (decree absolute). It is also worth noting that special rules apply to losses arising on assets transferred to a recipient spouse in this period. Such losses are referred to as 'clogged losses' and can only be utilised against capital gains realised on assets transferred to the same individual while they remain connected, eg up until the decree absolute. It is therefore important that tax advice is sought early in the divorce process in order to mitigate any exposure to CGT and avoid capital losses being wasted.

The family home

In many cases, the family home will form a significant part of the overall family wealth, but an immediate sale in order to realise capital may not be possible or practical. Consequently, it is important to consider the potential tax consequences when the asset is later sold or transferred, particularly where the transferring spouse or civil partner has already left the marital home following separation.

In general, gains arising on the disposal of an individual's main residence are exempt from CGT and the same applies for a divorcing couple where that property has been their main residence throughout their period of ownership. Under the new rules, where one spouse moves out of the matrimonial home and buys or rents a new property, the departing spouse will still be able to claim exemption from CGT when the property is sold to a third party.

Transfers between spouses is subject to the CGT rules outlined above.

In addition, where the property is subject to an arrangement whereby the departing spouse has transferred their share of the house but retains a right to some or all of the proceeds on a subsequent sale, the disposal date for the departing spouse is treated as being the date of the original transfer and the disposal is treated as being on a no gain/no loss basis.

The changes coming in from 6 April 2023 significantly simplify the CGT treatment on the disposal of a main home.

Inheritance tax

Transfers between spouses are exempt from inheritance tax (IHT), and this continues throughout the period of separation up until the decree absolute. This is in contrast to the CGT position noted above. For couples where one of the spouses is not UK domiciled, the maximum that can be transferred from the UK domiciled spouse to the nonUK domiciled spouse is £325,000. Any transfers over that amount or made after the decree absolute will be treated as 'potentially exempt transfers' in the absence of any other IHT reliefs being available.

Transfers made after the decree absolute may not be 'transfers of value' if they are between, or for the benefit of, the spouses and either the gift was not intended to confer any gratuitous benefit or was made for the maintenance of the transferor's family. Likewise, transfers made following a court order, including the creation of settlements, are not usually 'transfers of value'. Specific advice should be obtained before any action is taken in relation to this area.

Income tax

Married couples are taxed independently of each other and so divorce should not have any particular impact on an individual's income tax position. However, careful consideration will be required on the income tax consequences of any income generating assets transferred as part of the divorce settlement.

Maintenance payments generally fall outside the UK tax system and so are not taxable on the recipient, but at the same time they are not tax relievable for the payer.

The tax implications arising on divorce can be diverse and will largely depend on when assets are transferred. Seeking advice early on in the divorce process is recommended to ensure assets are transferred as tax efficiently as possible and to avoid any unexpected tax liabilities.

If you have any queries on the points raised, please speak to your usual Saffery contact, or get in touch with Jason Lane.

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This factsheet is based on law and HMRC practice at 1 March 2023.