

PUMP COURT  
TAX CHAMBERS

# **Divorce: the tax issues to be aware of**

Sadiya Choudhury  
Laura Ruxandu

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# Marriage: Rules and Reliefs

- Income Tax
  - Concept of independent taxation but some exceptions
  - Application of settlements legislation: Ch. 5, Pt. 5, ITTOIA
  - Jointly-owned property: ss. 836 and 837 ITA 2007
- Capital Gains Tax
  - S. 58 TCGA 1992 will apply, otherwise the market value rule
  - Potential uses of s. 58 TCGA 1992
- Inheritance Tax
  - Spouse exemption under s. 18 IHTA 1984
  - Transferable nil rate band

# Stages in a divorce and examples of ancillary relief orders

## Divorce Stages

- Petition for Divorce
- Decree Nisi
- Decree Absolute

## Ancillary Relief Orders

- Periodical payments
- Lump sum payments
- Transfer of property
- Settlement of property
- Variation of a settlement

# Divorce: Rules and Reliefs (1)

## Capital Gains Tax

- Date of disposal crucial
- No automatic CGT roll-over or exemption on divorce
- Either s 58 or s 17 TCGA 1992 will apply
  - Were the spouses “living together” in the year of disposal?

# Divorce: Rules and Reliefs (2)

## Income Tax

- No UK income tax liability for maintenance payments
- Limited UK income tax relief for maintenance payments
- Tax treatment may be different in other jurisdictions
- Settlement provisions do not apply (s 627 ITTOIA 2005) but could apply to a settlement on divorce for benefit of children

# Divorce: Rules and Reliefs (3)

## Inheritance Tax

- HMRC accept that the s 10 IHTA 1984 exemption normally applies
- S 11 IHTA 1984 may also apply but this exemption is more limited
- If neither exemption applies, the transfer will most likely be a PET

## SDLT

- Usually no charge to SDLT as FA 2003 Schedule 3 para 3 will apply

# Matrimonial Home: Tax Consequences of Typical Orders (1)

- **Availability of PPR relief as extended by s. 225B TCGA 1992**

- ***Mesher Orders***

Jointly owned property held upon trust for sale for both spouses under which one spouse occupies and sale postponed until children reach a specified age or cease full-time education

# Matrimonial Home: Tax Consequences of Typical Orders (2)

## *Mesher Orders cont.*

- **No major adverse CGT consequences**
  - PPR relief available on initial disposal
  - S 71 TCGA 1992 applies when order terminates but PPR relief under s 225
  - PPR relief only available to occupying spouse on further sale
- **Creates an IHT relevant property settlement**

# Matrimonial Home: Tax Consequences of Typical Orders (3)

## Postponed interest or deferred charge arrangements

- Consider a house owned jointly by A and B whose initial value was £500,000 which had increased to £1.5m at the time of the divorce. The house is sold a few years later after a triggering event for £2.4m. At the time of the divorce, A's interest would be worth £750,000.

# Matrimonial Home: Tax Consequences of Typical Orders (4)

## Postponed interest arrangement

- A gives up interest for a 1/3 interest in the eventual sale proceeds
- PPR relief available on transfer of A's interest to B and no CGT when postponed interest realised: "an allocation of sale proceeds"
- No deduction for B for proceeds allocated to A but PPR should be available

## Deferred charge arrangement

- A gives up interest for a charge for £750,000 or 1/3 of the equity
- If for fixed sum, no CGT liability when realised: s 251 TCGA 1992
- If for percentage, potential CGT liability when charge realised

# Holdover Relief

- Available under TCGA 1992 s 165 (business assets) and s 260 (chargeable transfers for IHT purposes e.g. gifts to discretionary trusts)
- HMRC's long-standing view was that relief under s 165 would be available on a disposal of assets under a court order or court-ratified agreement based on *G v G* [2002] EWHC 1339 (Fam)
- View changed last year: HMRC's CGT Manual at CG66886 citing *Haines v Hill* [2008] Ch 12

# Using Offshore Income or Gains to Fund a Divorce Settlement: Remittance Issues(1)

- Both A and B are UK resident but non-UK domiciled for tax purposes. A has substantial unremitted foreign income and gains and wishes to use them to fund a cash lump sum for B. No other relevant person (such as a minor child) would receive a benefit except incidentally.
- HMRC have confirmed that no taxable remittance would arise if, *"the capital payment is made overseas after decree absolute and no relevant person benefits from the capital payment in the UK"* (2012 correspondence with CIOT)

# Using Offshore Income or Gains to Fund a Divorce Settlement: Remittance Issues (2)

## Overseas payment made after decree absolute

- Remittance on the grounds that made in respect of a relevant debt?
- Relevant service?

## Overseas payment made before decree absolute

- Is B a “gift recipient” because payment made for no consideration?
- *G v G* and *Haines v Hill*

# Using Offshore Income or Gains to Fund a Divorce Settlement: Remittance Issues (3)

## Using remitted funds for the benefit of the children of the marriage (1)

- No remittance if only receive incidental benefit from funds
- Money or property remitted to the UK directly to the children or for services provided to them (e.g. allowances and school fees) is a taxable remittance: CG25341
- Also applies if payments made by B out of funds B receives for his/her own use under the financial provision order or out of funds provided by A for this purpose as they are used for the benefit of a relevant person
- Maintenance should therefore be provided out of clean capital

# Using Offshore Income or Gains to Fund a Divorce Settlement: Remittance Issues (4)

## Using remitted funds for the benefit of the children of the marriage (2)

- B should agree guidelines for use of the funds in the UK and agree to indemnify A in respect of any breach of those guidelines which result in a tax charge for him/her
- Carries risk for A as would have to recover funds, may not know correct amount and could even give rise to a further taxable remittance if B pays him/her out of the funds he/she received

# Using Offshore Income or Gains to Fund a Divorce Settlement: Remittance Issues (5)

## Summary

- Can make overseas payment either before or after decree absolute
- If made under court order, best to make after DA
- B must undertake not to bring funds to the UK until after DA and not to let them be used so as to give rise to a remittance
- Should provide an indemnity in respect of any tax charge arising to A if he/she does so

# Making Provision for Tax Risks

- Settlement will need to deal with unrealised tax liabilities for previous years to avoid unfairness
- Assess the realistic tax risk and then discount the amount payable which may be inaccurate but makes a clean break
- B would indemnify A and pay him/her a reverse contingent lump sum if risk materialises
- Will need to consider time limit for indemnity based on level of risk

# Dividing Assets Owned by Trusts- Issues

## Various complex issues especially if offshore trusts or EBTs involved

- Attribution of untaxed relevant income and/or gains to UK resident and domiciled transferee
- If transferee is non-UK resident/domiciled but not the transferor, the latter treated as receiving “benefit” under s 720/731 if payment made following court order, even if made by trustees
- If both A and B subject to UK tax, consider a settled appointment creating a separate settlement or sub-fund for B & his/her family

# Varying the terms of a Foreign Settlement

- Critical to consider view taken by trustees' jurisdiction of the effect of an English Court order varying the terms of the settlement
- Relevant to enforcement and the tax analysis
- If the local jurisdiction does not recognise the legal effectiveness of such an order it will be difficult to convince HMRC
- E.g. if a transfer of assets to B ordered, who never was or stops being a beneficiary, HMRC may argue that this is a capital payment constructively received by A, who has always been a beneficiary

# Tax Consequences of Setting Aside Transactions Intended to Defeat Ancillary Relief

- The Family Courts have a wide power to set aside transactions made by a party to a marriage if it is a main or subsidiary purpose of that transaction to defeat a claim for ancillary relief by the other party to the marriage: Matrimonial Causes Act 1973 s37 (2)-(4)
- Such an order held to be fully retrospective for CGT purposes: see *AC v DC* and *ors* [2012] EWHC 2032 (Fam)

# Tax Implications of Recent Divorce Cases (1)

## ***Radmacher v Granatino* [2010] UKSC 42**

- Previous rule that pre-nuptial ancillary relief agreements were unenforceable was obsolete.
- Implications:
  - Does a party to a pre-nuptial agreement acquire contractual rights which are an “asset” for CGT purposes?
  - No, because Court remains the final arbiter of the financial arrangements.
  - Transfer of value by party who chooses not to rely on favourable terms of agreement?

# Tax Implications of Recent Divorce Cases (2)

## ***Petrodel Resources Ltd v Prest* [2013] UKSC 34**

- Family wealth held as UK real property by non-UK companies beneficially owned by H
- SC upheld CA ruling that the UK real properties could not be the subject of a transfer order against the companies if they were not beneficially owned by H. No justification for piercing corporate veil.
- However, order could be made on grounds that properties held by companies upon presumed resulting trusts for H

# Tax Implications of Recent Divorce Cases (3)

## ***Petrodel Resources Ltd v Prest* cont.**

- **Implications:**

- Tightening up of FD's approach to general law requirements/consequences before making certain orders
- HMRC and others could now assert that companies hold assets upon bare trusts for transferors
- Extraction of properties from companies more likely to be analysed as an exercise of shareholders' rights than an exercise of the Court's powers.
- However, see *DR v GR* [2013] EWHC 1196.

## ***Akhmedov v Akhmedova* [2018] EWFC 23**

- Proceeding in six jurisdictions

# Tax Implications of Recent Divorce Cases (4)

***Sharland v Sharland* [2015] UKSC 60 and *Gohil v Gohil* [2015] UKSC 61**

- Supreme Court allowed the appeal of a wife to re-open financial provision proceedings on the basis of fraudulent non-disclosure by the husband
- If financial settlement can be re-opened, will HMRC re-open the tax issues as well?

# Tax Implications of Brexit on Divorce Settlements

- The appropriate forum for divorce proceedings: the UK or the EU?
- Enforcing financial orders post- Brexit

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**Q&A, moderated by Ronan Magee**

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