Autumn Budget 2024 & the impact on Tax & Divorce

The Autumn Budget provided a significant number of tax changes, affecting multiple areas of family life, particularly those for international individuals.

Where those individuals are currently undertaking divorce proceedings a rethink may needed to any proposed financial settlement to ensure it remains equitable and as tax efficient as possible.

This article aims to sift through the Budgetary changes and address those that are most relevant to couples about to commence divorce proceedings, as well as those part way through negotiating their financial settlement, being;

- the changes to capital gains tax;
- the changes affecting family businesses;
- changes affecting the divorcing non-UK domicile.

Key Budgetary changes affecting divorce - Capital Gains Tax

- From 30 October, CGT rates have risen from 10% (basic rate band) and 20% (higher and additional rate bands) to 18% and 24% (matching the relevant rate on sale of residential property

Why is Capital Gains Tax so relevant to divorce?

- When negotiating a financial settlement on divorce, assets will typically either be sold to fund cash lump sums or transferred from one party to the other to provide an agreed value of post-divorce wealth.

- Since 6 April 2023, any assets transferred within either three years of separation (or Final Order if earlier) or any period where assets are transferred either pursuant to formal divorce proceedings or an agreement in contemplation of the dissolution or annulment or marriage, will be transferred from one party to the other at “no gain, no loss”.

- If an asset is transferred at “no gain, no loss” it means that there is no immediate tax liability for either party, but the recipient spouse is treated as though they acquired the asset at the original cost and at the original date that the transferring spouse acquired it (as though the recipient spouse had held the asset all along). The responsibility for any inherent gains in the assets on eventual sale therefore pass in full to the recipient spouse.

- For this reason, it is therefore important that the net of tax value of each asset is understood regardless of whether it is being sold or transferred, to determine the true “cash in hand” value of the financial settlement and identify any hidden exposure to future gains (such as periods of non-occupation of the family home, gains deferred into EIS shares etc). It is this value that must be understood when determining an equitable settlement.

What do the changes mean for divorcing couples?

- Parties will suffer a slightly higher rate of tax on any gains arising to assets sold as part of divorce proceedings, potentially leaving slightly lower amounts within the settlement “pot” than previously expected. (This excludes residential real estate, the rate for which remains the same).

- Any existing net of tax values may need to be recomputed whether on actual sales or hypothetical computations of the inherent gains at the point of transfer, otherwise the net of tax position for each party will be over-stated.

Key Budgetary changes affecting divorce & the family business

- The rate applicable to Business Asset Disposal Relief (**BADR**) which provides relief on the sale of certain business assets including the sale of a business or the sale of a qualifying shareholding in a trading company/holding company of a trading group, will rise from 10% to 14% from 6 April 2025 and then to 18% from 6 April 2026.

- Increased employment costs associated with running the family business due to a rise in employers' NIC to 15% with a simultaneous decrease in the secondary threshold plus a rise in National Minimum Wage and the National Living Wage.

- From 6 April 2026, Business Property Relief (which previously provided 100% relief on the value of family trading businesses on death of the owners) is being reduced such that 100% relief only applies to the first £1 million of value and 50% relief applies thereafter.

Exiting the family business

- Where couples have been involved in an unquoted family trading business, steps are often taken to exit one party, either in part or in whole from the company.

- The exit can be constructed through various mechanisms, such as hiving off certain parts of the business for one party to control independently of other parts of the business, or it may mean a complete exit from the business such as through the sale of the exiting party's interest to a third party shareholder or via a company share buy-back.

- In each of these cases, BADR has been a valuable relief for the exiting party since in many cases there is little or no base cost to the interest, such that often most of the value equates to a gain which, providing the relief applies, is then only taxed at 10%.

- The government has announced the gradual increase in the rate applicable to BADR over the next two tax years. As such, it would be beneficial to the exiting party that steps are taken to ensure that any scheduled exit is completed by 5 April 2025 to maximise available relief.

- Please remember that for the relief to apply, at the time of the transaction the exiting party must have held the qualifying shares for at least two years and still be an officer or

employee of the company. Too often the exiting party is forced out of their role prior to such a transaction and BADR is lost.

Other considerations

- **Company valuations** - Whilst HockneyGrey Consulting LLP are not professional valuers and do not offer valuation services, it is worth noting that the increased employment costs announced may affect any valuations provided in relation to the family business for the purpose of the divorce settlement.

- Such valuations may therefore need to be revisited prior to agreement, particularly in those businesses which typically have a lower paid, younger workforce.

- **Succession planning** - Whilst Inheritance Tax (**IHT**) planning is not generally part of divorce considerations (since assets pass free of IHT until Final Order and thereafter if part of formal divorce proceedings), the reduction in Business Property Relief means that divorce could be an opportunity to reconsider succession planning for the family business.

- It may be that the company shares are moved into trust (which equally may be a mechanism to provide for the exiting spouse, without them having any influence or control over the business itself) or that the exiting spouse's shares are passed to the next generation at that stage (either directly or indirectly). Such transactions are complex and not without their own considerations, so specialist advice is recommended.

Key Budgetary Changes affecting divorce and the non-UK domicile

Abolishment of the non-domicile regime

- **Change in regime** - As expected, the government are abolishing the current domicile-based tax regime for the taxation of arrivers to the UK and replacing it with one based on residence.

- **4- year FIG regime** - From 6 April 2025, everyone in the UK will pay tax on their worldwide income and gains on an arising basis. However, anyone coming to the UK who has not been UK tax resident in the prior ten tax years (regardless of domicile),

can claim 100% relief from tax on their foreign income and gains (**FIGs**) during their first four years resident in the UK.

- If the relief is claimed, the amount of the FIGs for which relief is sought will need to be quantified and reported on a tax return but can then be brought into the UK tax-free at any time. This can include distributions from offshore trusts.

- Claiming relief will lose the ability to claim personal allowances and annual exemptions, as well as prevent the use of foreign income losses or foreign capital losses arising in the year of the claim.

- **Temporary Repatriation Facility** - Where a current non-UK domicile is ineligible for the 4-year FIG regime, they can take advantage of the Temporary Repatriation Facility (**TRF**). This is a three-year window enabling designated amounts of pre-6 April 2025 FIGs to be taxed at reduced rates of tax (being 12% in tax years 2025/26 and 2026/27 and 15% in tax year 2027/28) which can then be remitted into the UK at any time with no further tax charge although trust distributions must be brought into the UK within the permitted timeframe). It will be a mechanism that can assist with potentially cleansing offshore "mixed accounts."

- **Rebasing** - Individuals currently not UK domiciled and not deemed domiciled who have claimed the remittance basis in any year between 6 April 2017 to 5 April 2025 can also elect to rebase assets to their value on **5 April 2017** (provided the asset was situated outside the UK from 6 March 2024 to 5 April 2025).

Offshore trusts

- **Loss of protected status** - From 6 April 2025, offshore trusts will lose their protected status meaning that UK resident settlors of such trusts who are also able to benefit from them, will be taxed on FIGs (as well as UK income and gains) arising within the trust, regardless of whether or not they receive a distribution from the trust.

- **Loss of Excluded Property Status** – foreign situs trust assets are currently exempt from IHT where a trust is settled when the settlor was not UK domiciled or deemed domiciled. From 6 April 2025, non-UK situs trust assets will be subject to UK IHT where at the date of a relevant event (i.e. on the exit of an asset from the trust, or on each 10th anniversary of the settlement of the trust), the settlor has been resident in the UK for ten out of the prior 20 tax years.

- If the settlor leaves the UK, the foreign situs assets will remain subject to UK IHT tax for between 3 and 10 years following the settlor's departure (depending on how long the settlor had been UK tax resident at the date of leaving).

What is the relevance of non-UK domicile in divorce?

- Prior to the Budgetary Changes, any non-UK domicile who had been resident in the UK for less than 15 out of the prior 20 tax years, was eligible to benefit from the remittance basis of taxation, such that they were only taxed on FIGs to the extent they brought (or otherwise enjoyed) those sums in the UK.

- However, due to rules regarding "relevant persons", if a non-UK domiciled spouse remitted FIGs into the UK to be enjoyed by their spouse and/or minor children (whether UK domiciled or not), the transferring spouse would be taxed on that remittance (even if they did not or could did not benefit from it themselves.)

- This could make transferring cash sums from offshore sources to meet a divorce settlement more expensive for the non-UK domiciled party, particularly where "mixed fund rules" meant that without offshore sums being carefully segregated, the source taxed at the highest rate was always considered to be brought into the UK first.

- A common work around is possible where timings of such a transfer are carefully considered. This is a complex technical area of remittance planning, but at a high level it requires FIGs to be transferred to the spouse offshore prior to Final Order and then only brought into the UK by the recipient spouse after Final Order when the parties are no longer "relevant persons".

- This "**relevant person planning**" enables the recipient spouse to receive a tax-free sum without causing any taxable remittances for the transferring spouse. The transferring spouse is then also left with a proportionately reduced mixed account, such that they activate the lower rates of remittance sooner.

- For such planning to work, care would also be needed to ensure that the sums remitted, even post Final Order, were not used for the direct benefit of minor children of the transferring spouse, otherwise the transferring spouse could still be taxed on the remittance.

- Tax warranties and indemnities are therefore often included within financial orders to protect the transferring spouse from situations where the recipient spouse, unknown to them, remits funds into the UK contrary to the rules of the planning.

The impact of the new rules on divorce

- Whilst there is much talk of the remittance basis being abolished, this is only applicable for those arriving from now on.

- Whilst post 6 April 2025 FIGs (not relieved under the 4-year FIG regime) will be taxed on an arising basis, pre-6 April 2025 FIGs will still be taxed as a remittance if brought into the UK by a non-dom.

- Divorce will therefore continue to provide an opportunity for a non-UK domiciled party to pass pre-6 April 2025 FIGs to the other party free of tax via the relevant person planning rules (assuming no other changes are made to legislation around these rules within the next Financial Act).

- However, particularly where sums are needed to fund the maintenance of minor children, it may be attractive (being simpler and less exposed to risk) to accept the lower rates of tax under the **TRF** then undertake the relevant person planning. This would enable an allocated sum to be brought into the UK at any time in the future with no further taxes due on it, regardless of whether the Final Order had been granted at that time. It would also relieve the need for caution on how the amounts were spent if used for the benefit of minor children.

- Whilst the particulars are not yet determined in full, it does appear that the use of the TRF could also simplify the ordering rules for mixed accounts. Known as the "**mixed fund rules",** these essentially determine that where FIGs are not clearly segregated between clean capital, income and capital gains, the highest taxed source is always treated as being brought into the UK first. Where mixed funds are transferred between spouses, the amount transferred will be a mirror image of the make up of the mixed fund (i.e. with an equal proportion of income, gains and clean capital as the original fund).

- The use of the **TRF** as part of the divorce settlement could therefore also provide a method of simplifying mixed funds, since a round sum can be designated (regardless of its source as income, gains etc) on which the TRF rate will apply. This sum will then be treated as remitted first into the UK (ahead of the normal ordering rules) with no further tax liability.

- Where a settlement is required to be sourced from offshore sources, it may therefore be worth considering delaying such a transfer until after 6 April 2025 to take advantage of the TRF.

Offshore trusts

- Those most affected by the change to the non-domicile regime are the settlors of offshore trusts who retain an interest in them. Since 6 April 2017, when the concept of "deemed domicile" was introduced, settlor who are no longer eligible to use the remittance basis of taxation were only taxed on trust income and gains to the extent that they were matched to distributions they received from the trust.
- The new changes mean that from 6 April 2025, such settlors (who are not eligible for the 4-year FIG regime) will be taxed on trust income and gains as it arises, regardless of whether or not they (or other close family members) receive it.
- The implications for this mean that any offshore trusts caught within the marital net should be reviewed further as part of more general planning for the parties, in addition to consideration of the divorce settlement. It may be that the TRF can be used to extract larger sums within the next few years that could act as a "clean break" amount to exclude one party from the class of beneficiaries. Alternatively, it may be that both parties are best excluded and that the trust continues purely for other family members.
- A further consideration for the settlor is that tax on the arising FIGs within the trust, without a trust distribution to match it, will mean other sources of income will be utilised to meet the tax liability, thereby reducing the annual income pot of that party which may be relevant to any annual maintenance payments that are required as part of the settlement.
- Offshore trusts are a highly complex area of trust and tax law. Specialist advice should always be sought on such matters.

For more information on any of the above, please contact enquiries@hockneygrey.co.uk

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