Capital Gains Tax: Separation & Divorce

Published on Alvarez & Marsal | Management Consulting | Professional Services
(https://www.alvarezandmarsal.com)

November 14, 2022

BACKGROUND

During the breakdown of a relationship, Capital Gains Tax ("CGT") rules concerning the distribution of assets between married couples or civil partners may be unlikely to be at the forefront of the unhappy couple's minds. However, the timing of the transfer of certain assets between separating spouses can make a significant difference to the financial outcome of the separation for both parties.

To allow couples more time to deal with the financial aspects of their separation, the government has announced proposals to increase the window in which couples are allowed to transfer assets between themselves without incurring a CGT charge. The proposed rule changes will not only benefit those high-net worth individuals with many capital assets, but are also designed to provide relief to those whose main asset is their family home.

CURRENT CGT TREATMENT OF TRANSFER OF ASSETS BETWEEN SEPARATING COUPLES

When married couples or civil partners separate, current rules only allow the transfer of chargeable assets (e.g. property, shares, etc.) between each other on a 'no gain, no loss' basis until the end of the tax year in which separation occurs. This means that any gains or losses arising from the transfer are deferred until the disposal of the asset by the receiving spouse or civil partner, who will be treated as having acquired the asset at the same original cost as the transferring spouse or civil partner.

For example, a couple that separated in January 2022 could only transfer assets without realising a disposal for CGT up to 5th April 2022. Transfers made after the tax year (i.e., 6th April 2022 onwards) of separation would be subject to the CGT regime. In many cases, especially when divorce and financial settlement negotiations are protracted, the timeframe to transfer assets before the end of the tax year is unachievable and may lead to CGT and a reduction in the overall marital assets for division.

PROPOSED TREATMENT OF TRANSFER OF ASSETS BETWEEN SEPARATING COUPLES

From 6 April 2023, a more favourable tax treatment for separating spouses or civil partners will be introduced. The new rules include:

- A three-year extension of the 'no gain, no loss' basis tax treatment for the transfer of assets after the end of the tax year of separation.
- An unlimited period to transfer assets if the transfer is made as part of a formal divorce settlement.

- An extension of the scope of Private Residence Relief (“PRR”) to allow separating couples to claim relief when one spouse or partner moves out prior to the sale of the matrimonial home. Similarly, if one spouse or partner transfers the property to the other but maintains financial interest, the share of proceeds from the sale of both parties will be eligible for PRR.

Assuming that the legislation is passed, couples who separate on or after 6 April 2023 will be able to benefit immediately from the new rules. For couples who are in the process of separating, they will be able to benefit if they are willing to delay their transfer of assets until 6 April 2023. However, in many circumstances, this may not be appropriate or possible. It is also important to note that these changes do not provide provisions for couples who are unmarried, even if the couple is cohabiting.

It is worth noting that the proposals do not anticipate any material impacts on the wider economy, suggesting that they do not anticipate a major loss of CGT from the reforms.

OUTSTANDING ISSUES AND CONSIDERATIONS

While the proposals provide a number of positive changes, there remains a number of outstanding issues which have not been addressed. These issues may be of concern to higher and additional rate taxpayers:

- The withdrawal of capital from a family company, through income, dividends or bonuses, to fund a settlement will still trigger tax liabilities.
- The new ‘no gain, no loss’ provisions, are unlikely to allow asset transfers to benefit from any CGT reliefs to which the transferor may be entitled to, such as the use of Business Asset Disposal Relief or capital losses. Similarly, the recipient may realise a significant tax charge if they choose to sell the asset as the asset is acquired at its original acquisition value.
- The treatment of overseas assets - tax liabilities could still arise in the overseas jurisdiction on a transfer of an asset between a couple.

For further information or any questions regarding the content covered in this insight, please contact a member of our experienced Tax Team.

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