

The taxing issues of divorce



The New Year is reportedly the most popular time to file for divorce. With many individuals waiting until after the festivities before commencing divorce proceedings.

The process of a divorce will inevitably impact the lives of children, lifestyles, living arrangements and finances. It is therefore essential for spouses to include in their asset splitting decisions, the impact of taxation. In particular where there are US citizen spouses resident in the UK, both US and UK tax implications of divorce should be considered.

Below is a brief insight into some of the common areas to consider in a divorce for both UK and US tax purposes.

UK: Areas to consider

Capital Gains Tax (CGT)

In a divorce there are often Capital Gains Tax implications to consider when dividing marital assets. Normally within a marriage transfers of assets between spouses occur on a no gain/no loss basis. For example, if a husband transferred property to his wife it would not be a disposal for tax purposes, and the wife would take on the husband's original purchase price in the property which essentially defers the capital gain until she sells the property in the future. Once a divorce is finalised, no gain/no

loss transfers can no longer be made between spouses. Instead they are regarded as independent persons, and transactions made between them are considered to be made at arm's length, thereby potentially giving rise to Capital Gains Tax.

It is important to bear in mind that couples will generally go through a period of separation prior to divorce and that care should be taken when looking at transactions in this period. The no gain/no loss rule applies for spouses who are living with each other during the tax year. This means that spouses will have until 5 April following their separation to still make transfers on a no gain/no loss basis (unless the divorce is completed before the 5 April at which point no gain/no loss transfers will end then). This is an important deadline for those wishing to transfer assets without incurring a UK tax liability.

Often married couples will own a home together. Principal Private Residence (PPR) relief means that as long as the spouse disposes of their share of the home within 18 months of moving out, they will not have any taxable gain (assuming that they meet the rules for private residence relief for the period of

ownership before then). Alternatively, if the period of absence is beyond 18 months it may be worth considering a provision in the legislation for the former residence to attract tax relief. The situation where this election could be made is where the property is being transferred to the former spouse as part of the financial settlement, the property continues to be the former spouses main residence and the transferor has not elected another home to be his main residence for PPR purposes during the period of absence.

For UK tax purposes the date the contract is made is the date of sale, which is different from the US date of sale.

Stamp Duty Land Tax (SDLT)

Normally mortgaged UK property that is transferred to a spouse who takes over the responsibility for the mortgage gives rise to Stamp Duty Land Tax on the mortgage debt assumed, unless covered by the £125,000 threshold. This will not apply if the spouse who is transferred the property undertakes to pay the mortgage. If the transfer to the spouse is due to the break-up of a marriage or civil partnership, no Stamp Duty Land Tax (or in Scotland, Land and

Buildings Transaction Tax) is payable.

Income Tax

Maintenance payments do not constitute taxable income for the recipient. However, there is a small tax reducer available to the payer if one of the spouses was born before 5 April 1935.

Inheritance Tax

Transfers between married couples are not subject to inheritance tax. Divorcing couples can make transfers to each other without being subject to inheritance tax up to the date of decree absolute.

US: Areas to consider

US Income Tax - Capital transactions

No gain/no loss treatment applies to transfers between US spouses or between former spouses where the transfer is incident to a divorce. In order for a transfer to be considered incident to a divorce it must either occur within a year from when the marriage ceases or be related to the cessation of marriage. The transferee spouse takes on the same basis as the transferor.

However, these normal tax free rules don't apply where the transferor is a US person and the transferee is a 'non-resident alien' (not a US citizen, green card holder or tax resident in the US). This may be the case if the divorcing

couple consists of a US spouse and non-US spouse, living outside the US.

This can prompt some unfortunate tax consequences - for example:

Mr A is a US citizen, and his spouse Mrs A is a non-resident alien. They both live in the UK. On divorce it is intended that Mrs A keeps the jointly owned family property with Mr A transferring his ownership to Mrs A.

In this case, there could be a taxable gain for Mr A, assuming that the value of the property has increased since the time it was purchased. The consideration that Mr A receives is regarded as being settlement of marital right. This is the case whether or not Mr A has received payment from Mrs A.

There is potential planning that can be done to avoid this. It may be possible for an election to be made for the year of transfer to treat Mrs A as a resident of the US for that year. This can be done if the couple are not legally separated on 31 December of the year of transfer.

For US tax purposes, the completion date is the date of sale for tax purposes on the sale of real estate.

US Income Tax – Cash transactions

Alimony payments are normally tax deductible for the payer and taxable income for the recipient. For US tax purposes, most cash payments that are

specified under a divorce agreement

would fall under the definition of alimony, which includes maintenance payments. Therefore, express wording in the divorce agreement to treat such maintenance payments as not being alimony can be crucial where a non-resident alien spouse is making these payments to a US citizen spouse.

US gift tax

There are no gift tax issues as long as property is transferred under a written agreement within a specified time to divorce. The time period is where the divorce occurs no greater than one year before, or two years after the agreement is made.



How we can help

Buzzacott's 50-strong **Expatriate Tax Services team** of dual-qualified US and UK tax advisors can guide you in making decisions that work in both the short- and long-term, while avoiding pitfalls and unexpected consequences.

For further guidance and advice tailored to your situation, please reach out to your usual Buzzacott contact or:

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