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CHILD'S PLAY? THE NEW RULES ON CHILD BENEFIT



From 2013, changes to the rules on child benefit mean that higher or additional rate taxpayers will be liable to a tax charge. The reforms will affect an estimated 1.2 million households, while thousands of people will be required to complete a self assessment tax return for the first time.

Here we consider how the new tax charge will work, along with some key strategies to help you preserve your entitlement to child benefit and minimise, or even eliminate, a potential tax liability.

BACKGROUND TO THE CHANGE

Under the current rules, most people can claim child benefit for children aged under 16 and, in some cases, until they reach the age of 20. One parent can claim £20.30 a week for their first (or only) child and £13.40 a week for each subsequent child, irrespective of their annual income.

However, from January 2013 the Government will 'claw back' child benefit from individuals whose income exceeds £50,000 a year. The controversial move is designed to help reduce the budget deficit.

The policy to withdraw child benefit from higher/additional rate taxpayers was set out in the Spending Review 2010, but it was not until the 2012 Budget that the mechanism was made clear.

Child benefit will continue to be paid as a universal benefit and will not be made taxable. However, there will be a new High Income Child Benefit Charge (HICBC) where the income of the claimant, or their partner, is between £50,000 and £60,000, after which the benefit will be fully eroded.

HMRC has predicted that the average loss to families will be around £1,300 per year.

WHO IS AFFECTED?

The tax charge applies both to taxpayers whose income exceeds £50,000 and who are in receipt of child benefit, and to taxpayers with income exceeding £50,000 and whose partner is in receipt of child benefit. If both partners have income in excess of £50,000, the charge applies to the partner with the highest income.

You will not be affected if both you and your partner have individual incomes below £50,000 for a tax year, or if neither of you are entitled to receive child benefit payments.

Another person is regarded as your partner if you are:

- a married couple living together (or have lived together during a tax year and are not permanently separated)
- civil partners living together (or have lived together during a tax year and are not permanently separated)
- a man and a woman who are not married to each other but who are living together as if they were married
- a man living with a man or a woman living with a woman who are living together as if they were civil partners.

This means that potentially someone may suffer the tax charge in respect of the child benefit paid for children who are not theirs. Also, the person who receives the child benefit may not be the person who suffers the charge.

WHEN WILL THE NEW RULES COME INTO EFFECT?

The measure comes into effect from 7 January 2013. In November 2012, HMRC started contacting people earning over £50,000 to alert them to the possibility of their being affected by the new charge.

For the tax year 2012/13, the first year of the charge, the amount of income taken into account will be the full amount of income for the tax year, and the charge will apply to the amount of child benefit paid in the period from 7 January 2013 to 5 April 2013. The amount of the HICBC will be collected either through Pay as You Earn or self assessment.

HOW IS THE TAX CHARGE CALCULATED?

Where a person in receipt of child benefit or his or her partner has adjusted net income of between £50,000 and £60,000, the HICBC is levied at 1% of the benefit for every £100 by which income exceeds £50,000. Once adjusted net income reaches £60,000 the charge is equal to the full amount of child benefit received for the tax year. Where it is certain that the charge will bite, claimants can elect not to receive their child benefit (see below for further details).

Example

Jenny and Michael are married and live together. They have two children in respect of whom Jenny receives child benefit. Based on current figures, Jenny receives child benefit of £1,752 a year.

For the tax year in question, Jenny has adjusted net income of £15,000 and Michael has adjusted net income of £55,000. As Michael's income exceeds £50,000, he will be liable for the child benefit charge. The charge will be 50% of the child benefit received. Based on current figures, this will be £876 ($(£55,000 - £50,000/£100 \times 1\%) \times £1,752$).

Adjusted net income

As we have already seen, the new HICBC rules focus on 'adjusted net income'. Broadly speaking, this is total taxable income less certain tax reliefs, such as:

- Trading losses and payments made gross to pension schemes
- Gift Aid donations to charity and pension contributions which have received tax relief at source.

In certain cases it may be possible to minimise or avoid the HICBC by reducing your adjusted net income – please refer to the section 'Preserving your entitlement to child benefit' for more details.

WHAT HAPPENS NEXT?

Those affected by the new rules will need to calculate their liability to the HICBC before deciding whether or not to continue receiving child benefit payments. We can calculate your tax charge on your behalf – please contact us for assistance.

Continuing with child benefit payments

If you or your partner choose to continue receiving child benefit, you will need to register for self assessment (unless you have already done so) and complete a tax return. You will need to register by 5 October 2013 or you may incur a penalty.

Stopping child benefit payments

Child benefit claimants will be able to elect not to receive the benefit if they or their partner do not wish to pay the new charge. Stopping child benefit payments will also remove the need to complete a tax return (unless you need to do so for other reasons). Child benefit payments can be stopped at any time, although halting payments before the 7 January 2013 commencement date means that you or your partner will avoid the tax charge.

Individuals who choose not to receive their child benefit may revoke this election if their circumstances subsequently change, i.e. their annual income falls.

Note that while you can elect not to receive child benefit payments, it is still important to complete a child benefit claim form for any new children in order to qualify for national insurance credits and thus preserve your entitlement to the State Pension. It also ensures that your child will automatically receive a national insurance number ahead of their 16th birthday.

PRESERVING YOUR ENTITLEMENT TO CHILD BENEFIT

Couples affected by the changes may want to consider strategies to reduce or equalise income in order to avoid or reduce their exposure to the HICBC.

Transferring income

Where combined income is less than £100,000 it may be possible to transfer income to a partner to prevent the child benefit charge from impacting.

In the example, Jenny and Michael have combined income of £70,000. By moving income from Michael to Jenny, for example by transferring income producing assets, the charge will be reduced. If Michael's income is reduced to less than £50,000 they will be able to keep the full amount of their child benefit.

Pension contributions

Pension contributions are deducted before 'adjusted net income' is calculated. Therefore, if you or your partner are affected by the HICBC, you might want to consider making or increasing contributions to a registered pension scheme. Such contributions will reduce your adjusted net income, potentially minimising your liability to the HICBC and preserving your entitlement to child benefit.

Other options

There are other options available to reduce income without losing it entirely and, in doing so, retain your child benefit. These include swapping cash salary for tax-free benefits, such as childcare vouchers, under a salary sacrifice arrangement.

In a family company scenario, the parties might want to consider reviewing the way in which income is taken out of the company. Charitable giving provides another alternative.

To discuss these and other strategies which may be available, please contact us.



We can help! For more information on the changes to child benefit, and for advice tailored to you and your family, please do not hesitate to contact us. We would be delighted to assist you.