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This is no fairy tale - A guide to the Child Benefit charge

Changes ahead - How many people are affected?

The impact of the new tax charge in connection with Child Benefit will according to HMRC affect approximately 1.2 million families. Specifically they have stated that:

'Approximately 70 per cent of these households will lose all of their Child Benefit, and 30 per cent will only lose a portion. The average loss for those that lose will be roughly £1,300 per year. 90 per cent of families in the Child Benefit population will continue to benefit from some or all of their Child Benefit.'

This Briefing sets out the main points of the new charge and illustrates a couple of the practical problems likely to be encountered in its implementation.

Will this affect my family?

Finance Act 2012 imposes a new charge (the High Income Child Benefit charge) on a taxpayer who has 'adjusted net income' (explained later) over £50,000 in a tax year where either they or their partner, if they have one, are in receipt of Child Benefit for the year. Where there is a partner and both partners have adjusted net income in excess of £50,000 the charge will apply to the partner with the higher income.

And when does the new charge apply?

The charge will have effect for any week beginning on or after 7 January 2013 and for 2012/13 will apply to the Child Benefit paid from that date to the end of the tax year. The income taken into account will be the full income for 2012/13 not just the income for that part of 2012/13!

Share and share alike

For couples who do not share their financial details this is clearly a problem as it will be difficult to accurately complete their tax return (or know if they need to contact HMRC to request one) if their own income is over £50,000 and Child Benefit is being claimed. Only the highest earning partner is liable so this will need to be determined.

Some couples with fluctuating income levels may also have an unexpected situation.

Example

Nicola who receives Child Benefit is employed as a teacher and earns £52,000 a year. Her husband Alan is a self- employed solicitor and his accounting year end is 31 March. He is late in submitting his books and records to his accountant for the year ended 31 March 2013. His results for that year will form his taxable profit for 2012/13 which is the first year that the new charge arises. Nicola and Alan do not have any other income other than their earned income but his profits are generally in excess of £60,000. On this basis Nicola assumes that Alan will be liable for the charge.

In January 2014 Alan's accountant completes his tax return, files this in advance of the 31 January deadline and advises that his profit has reduced to £48,000 as he had experienced a number of bad debts.

As a result Nicola has the highest income for 2012/13 and is therefore responsible for paying the charge by 31 January 2014 and she will need to contact HMRC about this.

Changes in circumstances

As the charge is by reference to weeks, the charge will only apply to those weeks of the tax year for which the partnership exists. If a couple breaks up, the partner with the highest income will only be liable for the period from 7 January (for 2012/13) and 6 April thereafter to the week in which the break up occurs.

> **Example**
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> *Jess and Howard live together, have two children and Jess receives child benefit in respect of them. Jess earns £25,000 a year and Howard earns £55,000 a year. They split up in March 2013. Howard will be liable to the charge from 7 January 2013 to the week in which they split up. Jess will not be liable to the charge as her income is below £50,000 a year.*

Conversely, if a couple come together and Child Benefit is already being paid, the partner with the highest income will only be liable to the charge for those weeks from the date the couple start living together until the end of the tax year.

> **Example**
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> *Ellie who is a widow has 2 teenage boys and claims Child Benefit in respect of them. She earns £25,000 a year. She has been seeing Vincent for about 18 months. Vincent is single, has no children of his own and generally earns around £70,000 a year as a self-employed consultant. On 1 September 2012 Vincent moves into Ellie's house and the couple start living together. Vincent meets with his accountant in October 2012 and is very surprised when his accountant advises him that, assuming there are no changes to Vincent's income levels or his living arrangements, Vincent will be liable to the new charge for the period 7 January 2013 to 5 April 2013, and annually thereafter. Vincent argues that Ellie's children are not his children and that in any respect the Child Benefit is paid to Ellie and not him. How can the charge possibly be levied on him? Unfortunately, this is how the rules are to be applied.*

Is this fair?

One of the main criticisms with the original proposals when they were outlined in 2011 was that the withdrawal would be automatic where one person's income level meant that they were a higher rate tax payer. Household income was not taken into account.

On this basis it was possible that a household with 2 earners, neither of whom were higher rate taxpayers with household income of say £60,000 would not have had their Child Benefit withdrawn. However, a household with one person earning £60,000 (and therefore being liable to higher rate tax) would have had all their benefit withdrawn.

Inequity still applies under the revised rules as household income is still not taken into account.

> **Example**
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> *Mr Hutchinson earns just under £30,000 and his wife Mrs Hutchinson earns £60,000 and their earnings are their adjusted net income. The Hutchinson's will lose all of their Child Benefit via the charge. Whilst having a barbecue with their neighbours Mr and Mrs Jones they are surprised to discover that although their neighbours' total joint household income is identical to theirs the charge will not apply to them and they will effectively retain all of their Child Benefit. This is because neither Mr nor Mrs Jones individually has adjusted net income in excess of £50,000.*

Therefore, equalising income for those who have the flexibility to do so such as in family partnerships or family owner managed businesses becomes important.

So what is the adjusted net income of £50,000 made up of?

It can be seen that the rules revolve around 'adjusted net income', broadly:

- net income (total income subject to income tax less specified deductions e.g. trading losses and payments made gross to pension schemes)
- reduced by grossed up Gift Aid donations to charity and pension contributions which have received tax relief at source.

In some cases it may be that a couple would want to donate more to charity or make additional pension contributions for example, to reduce or avoid the charge.

Who is a partner?

A person is a partner of another person at any time if any of the following conditions are met at that time; the persons:

- are a man and a woman who are married to each other and not separated or
- are a man and a woman who are not married to each other but are living together as husband and wife.

Similar rules apply to same sex couples.

The charge

An income tax charge will apply at a rate of 1% of the full Child Benefit award for each £100 of income between £50,000 and £60,000. The charge on taxpayers with income above £60,000 will be equal to the amount of Child Benefit paid.

> **Example**
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> *The Child Benefit for two children amounts to £1,752 per annum.*
>
> *The taxpayer's adjusted net income is £55,000.*
>
> *The income tax charge will be £876.*
>
> *This is calculated as £1,752 x 50% (£55,000 - £50,000 = £5,000/£100 x 1%).*

How will the administration operate?

There is an existing rule that individuals are required to notify HMRC if they have a liability to income tax and capital gains tax by 6 October following the tax year. This requirement is amended to include situations where the person is liable to the Child Benefit charge.

In addition, the charge is included in PAYE regulations so that it can be collected through PAYE, using a reduced tax code. It is also included in the definition of tax liability, so that it could potentially affect payments on account and balancing payments.

There are concerns about how HMRC will be able to effectively administer this change. Initially it is expected that HMRC will write to all taxpayers earning over £50,000 alerting them to the possibility of them being affected by this tax charge. Letters will be sent from November 2012 onwards.

So should you continue to claim?

It is important to appreciate that Child Benefit itself is not being made liable to tax and the amount that can be claimed is therefore unaffected by the new charge. It can therefore continue to be paid in full to the claimant even if they or their partner have a liability to the new charge.

On the other hand Child Benefit claimants will be able to elect not to receive the Child Benefit to which they are entitled if they or their partner do not wish to pay the new charge. However, this will not affect the credit available (for state pension purposes) to certain people who stay at home to look after children.

An election can be revoked if a person's circumstances change.

But I don't receive a tax return?

It may well be that you and/or your partner do not currently receive a tax return but this may well change for 2012/13. Remember the need to tell HMRC by 6 October 2013 if you think a charge may be due.

Further help

HMRC have released a series of FAQs at www.hmrc.gov.uk/childbenefitcharge/ to explain the charge, essential reading for many families.

However, if you are unsure about anything to do with this new charge or would like to discuss the matter further including how we might be able to minimise the tax charge which may apply to your family, please do not hesitate to get in touch.