Finance (No.2) Bill – Implications For Separation/ Divorce

Until April 2023 separating couples are only able to mitigate capital gains tax ("CGT") liabilities on the transfer of assets on foot of settlement if the transfer(s) was(were) effected within the first tax year of the date of separation under the 'no gain, no loss' principle. The Finance (No.2) Bill (colloquially known as the Spring Finance Bill 2023), however, will, following its coming into force, extend this time limit to the last day of the third tax year following separation, which will be welcomed by both practitioners and clients.

> *"This extended time limit will give separating parties and their legal advisors (alongside any financial experts) welcome breathing space to ensure that the right, fair and equitable settlement occurs without the peril of a CGT liability arising immediately upon disposal by the transferor..."*

This is also likely to be welcomed by divorcing business owners because it was often the division of shareholdings which fell foul of the previous time limits and regularly caused problems in reaching settlement between the parties; whilst also dragging commercial businesses into the family law arena.

Certainly, matrimonial lawyers were waiting anxiously for the announcement of the Spring Budget 2023 to ensure that there was no U-turn by the government in relation to these proposals. This was confirmed by Resolution 33 of the Budget Resolutions on 15 March 2023 and the Bill is currently going through the Parliamentary process. Although the Bill has not yet been enacted, section 41(6) states that *"The amendments made by this section apply in relation to disposals made on or after 6 April 2023"*. It is therefore hoped that this will continue to be the operative date and separating parties can rely upon same for any transfers post-6 April 2023, albeit the legislation is not yet passed.

The Pre 2023 Regime:

Prior to 6 April 2023, under Section 58 of Taxation of Chargeable Gains Act 1992, if parties separated on 1 August 2021 and under terms of a matrimonial agreement were able to transfer any assets, or portions of assets, to one or each other before 5 April 2022, they would be able to take advantage of the 'no gain, no loss' principle. This is not a form of CGT relief – the liability is simply held over from the point of disposal by the transferor until the time when the transferee disposes of the assets in the future. Thus, the clock begins to tick on the day that the parties separate.

This gave rise to a number of practical problems, including:

1. **What is the date of separation?** It is often the case that this date is not easily defined and the water can be muddied by the parties attempting

reconciliation or both continuing to reside in the matrimonial home after relations have broken down.

2. **Delays in seeking legal advice.** There is often a delay between the parties separating and seeking legal advice. Understandably the immediate practical considerations of where the parties will live, the living arrangements for any children and the parties' immediate financial provisions which take centre stage in the days and weeks before and immediately after separation. This can, however, start to run down the clock.

3. **What is within the first financial year?** In practical terms this could be a period of anywhere from 1 day to 355 days, depending on the date of separation.

4. **The legal year.** Non-legal practitioners may consider a year, even several months, plenty of time to reach agreement. However, we are often dealing with complex issues and assets which require expert advice, independent valuations etc. In many cases, in the early months one party or both of them are still dealing with the emotional fallout from their marriage and are not yet ready to discuss a final financial arrangement. Further it is not possible to 'pluck' some assets out of the pot and transfer them within the first financial year and then deal with other matters in their own time. A clean break agreement will require dealing with all financial assets and debts.

The clock begins to tick on the day that the parties separate so the pre-2023 regime gave rise to a number of practical problems, including:

- *What is the date of separation?*
- *Delays in seeking legal advice.*
- *What is within the first financial year?*
- *The legal year.*

Finance (No. 2) Bill – Light at the end of the tunnel?

It seems that HMRC have recognised that the previous time limit for settling all matrimonial financial affairs within the first financial year of separation was unreasonable and unworkable. The government therefore propose to extend this period out to 'no gain, no loss' disposals within:

"the last day of the third tax year after the tax year in which A and B ceased to live together" or, if earlier, "the day on which a court grants an order or decree for A and B's divorce, the annulment of their marriage, the dissolution or annulment or their civil partnership, their judicial separation or, as the case may be, their separation in accordance with a separation order" (section 41(2)(1C)(c) of Finance (No. 2) Bill).

The amendments are proposed to apply in relation to disposals made on or after 6 April 2023. Thus, if parties separated on 6 April 2023 (tax year 2023/24), they have until 5 April 2027 (tax year 2026/27) to take advantage of the 'no gain, no loss' principle. As set out above, it should be noted that this time limit can be superseded by the granting of the Decree Absolute so the parties must ensure that in circumstances in which they are deferring the actual transfer for one reason or another, they must hold off applying for Decree Absolute.

This extended time limit will give separating parties and their legal advisors (alongside any financial experts) welcome breathing space to ensure that the right, fair and equitable settlement occurs without the peril of a CGT liability arising immediately upon disposal by the transferor; a peril which may very well negate the option of transference of assets as part of a settlement agreement due to the illiquidity of the assets. It should, however, always be remembered that this does not constitute a tax relief – it is simply transferring the tax liability from the transferor to the transferee who will have to discharge this following their date of disposal on some unknown date in the future. Both parties must therefore in all such circumstances seek detailed advice from a tax specialist regarding the monetary implications of the same.

By way of an example, under the terms of a 2023 agreement, Spouse A transfers to Spouse B their interest of the former matrimonial home valued at £1 million. As this is Spouse B's principal primary residence, they will have the benefit of a £500,000 net transfer. In consideration of this, Spouse B transfers their interest in a shareholding to Spouse A also valued at £1 million. Under the 'no gain, no loss' principle, Spouse B is not liable for CGT at the date of transfer in 2023. Spouse A will have the benefit of this transfer at £500,000. However, if Spouse A later disposes of these shares, CGT will be applied at the full value at the date of disposal to include the benefit transferred to Spouse A in 2023. His/her benefit is therefore subject to tax and the net benefit will likely be significantly lower. Parties and practitioners alike must take account of this when formulating the terms of any agreement.

In essence, the Spring Finance Bill 2023 does not make the process of splitting assets on separation/dissolution of marriage any less complex or reduce the tax burden on transference of assets between spouses. Rather it will allow the parties to facilitate the transfer of assets in a measured manner for often very compelling personal or commercial reasons, without giving rise to an immediate tax liability which can often prevent the parties in moving forward. As long as the parties are made fully aware of what the tax liabilities may be and with whom they will lie under the terms of any agreement, this should ease the process significantly.

Guidance:

If you require further information about anything covered in this briefing, please contact **Rachael McKee** or your usual contact at the firm on **+44 (0)28 9099 8207**. This publication is not designed to provide legal or other advice and does not deal with every important topic or cover every aspect of the topics with which it deals. Publication date: May 2023.

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