



# High income child benefit charge

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## Introduction

From 7 January 2013, the tax system has a curious provision known as high income child benefit charge (HICBC). Under it, child benefit paid to people earning more than £50,000 can be clawed back as additional income tax.

The whole amount is clawed back for someone who earns £60,000 or more a year. These limits have not changed since HICBC was introduced in 2013.

The benefit is clawed back at the rate of 1% for every £100 above this threshold. So anyone earning £60,000 or more in effect gets no child benefit. This affects about one household in seven where child benefit is claimed.

This has now been enacted as Finance Act 2012 Sch 1.

Affected taxpayers have a choice:

- they can still receive child benefit and pay this new charge, or
- they can disclaim child benefit and not pay the charge.

## Criticisms

This new charge has been widely criticised by tax commentators and professional bodies.

The main criticism is that income tax is a personal tax where each individual is assessed according to his or her income and circumstances. Social security is assessed per household. This new charge reverts to the position before 1990 when husbands were liable to pay tax on their wives' incomes. This new charge in effect prevents husbands and wives keeping their financial and tax affairs private from each other. Although a husband and wife have a legal duty to support each other, they have no obligation to disclose their finances to each other.

In some ways, this new charge mirrors the withdrawal of family allowance through the income tax system as introduced in 1968. The difference is that then husbands and wives were taxed as one taxpayer.

The second criticism is that this adds unnecessary complexity into the tax system. The 2012 Budget included provisions to end age allowance on the grounds that this would reduce the

number of taxpayers required to complete self-assessment returns and simplify the tax system. Yet this new provision requires another group of taxpayers to complete self-assessment returns and adds another seven pages of tax legislation.

Even the principle is questionable because of the anomalies it creates. For example, it means that a two-income couple can earn £99,000 a year (£49,500 each) and keep all their benefit, while a single-income on £60,000 lose all the benefit.

It also means that a couple can be better off separated than married. If a low-income mother no longer lives with the father she may be able to keep the benefit that would otherwise be lost if they were still together.

### **How the charge works**

This is charged on the higher earner. So the mother may still receive the benefit while the father has to pay it all back through additional income tax. It does not need much imagination to think of the problems this could cause.

If the mother does elect not to receive the benefit, she may at any time revoke the election and receive child benefit again.

However, there are other implications.

For 2015/16 and subsequent tax years, child benefit is £20.70 for the first child and £13.70 for the second and subsequent children. This works out at £1,076 a year for one child, £1,789 for two children. Child benefit is subject to the benefit cap, so someone receiving other benefits may not receive the full amount of child benefit. There is also now a limit of two children for whom child benefit may be claimed.

For example, a taxpayer with two children and subject to HICBC earns £54,000 a year. This is £4,000 above the limit, and 40 times the 1% for each extra £100. This means that he or she loses 40% of the £1,789. This is £715. This figure is added to the income tax that he or she will otherwise pay.

This can create marginal tax rates above 55%. For tax planning purposes, it can be advisable to keep earnings below £50,000 if this can be readily achieved. This could be achieved by increasing pension contributions or gifts to charity under Gift Aid. It may also be possible to shift income to a partner.

HMRC has provided a calculator on its website to calculate CBHIC. It can be accessed at <https://www.gov.uk/child-benefit-tax-calculator>.

## Electing not to receive child benefit

It is possible for an election to be made so that child benefit is not received in the first place. In such cases, no high income child benefit charge is made. However, the right to make this election rests solely with the person who receives child benefit. This is usually the mother, so she alone can decide whether her partner is hit with this new charge. (For this article, I shall use the example that the mother claims the benefit and that her husband pays the tax. This is for the sake of simplicity of language, and for no other reason.)

In other words, the wife can determine how much tax her husband pays. One can imagine the difficulties this could cause, particularly if the marriage is not a happy one. And how will the husband know? She may change her mind at any time and elect to receive benefit again. Again, how will the husband know? And how can self-assessment work when someone does not know how much income needs self-assessing?

Even if the couple do share information, there is still a trap. The new income tax charge arises when a person is *entitled* to receive child benefit, not when she does receive it. So if the mother simply does not bother to collect the benefit, the income tax charge is still payable because she is still *entitled* to receive it. The income tax charge can only be avoided if the mother specifically *elects* not to receive it.

There is a further trap in that entitlement requires the person to claim the benefit in the first place. An election not to receive the benefit may only be made for a benefit that has been claimed. This is a specific requirement of Social Security Administration Act 1992 s13A. In other words, a person must claim the benefit and then disclaim the benefit! It is not enough for someone simply not to bother with child benefit at all. It is easy to see how some wealthy taxpayers could suddenly find themselves paying this charge, with the inevitable penalties, because they have not declared the child benefit they are not receiving.

Any election not to receive child benefit has no impact on any other benefits being received. It will not affect any means-tested benefit. It does however make a person ineligible for a national insurance credit as a carer. This could affect entitlement to the state retirement pension and some contributory benefits.

## Risk of a new tax penalty

There is another practical aspect. It is the duty of the person who is liable to pay the charge to notify HM Revenue and Customs of this.

Most employees do not fill in a self-assessment tax return at all as their income is taxed at source under PAYE. From this tax year, all employees with an income over £50,000 where child benefit is received must notify HMRC. There will be penalties imposed if the person forgets or did not realise. No consideration seems to have been given to what happens if the mother will not tell her partner whether she is claiming child benefit or not. You could have a situation where someone believes that the mother is not claiming the benefit when she is.

## Please tell me about your sex life

The legislation applies to all forms of couples. They do not have to be married or of opposite sexes.

Cohabitation has no clear starts and finishes in the way that marriage and divorce does. The new charge is based on a **partnership test** of how many weeks a couple cohabit. The income limits are set on annual figures while the partnership test is determined on a weekly basis. So you not only have to pry into people's private lives as to what relationship they have, you must have all the dates as well.

HMRC says that this is no problem as they have definitions in place already for determining when two people are living together. They use them for tax credits and other benefits.

The Child Poverty Action Group's manual on welfare benefits points out that there are no rules as to who has the onus of proof. A person's word as to whether they are cohabiting is accepted until it is queried, then the person must prove evidence and a decision made on the facts.

Evidence for social security purposes includes showing a rent book, bills, documents and letters to each party at the same address, statements from friends and relatives. Curiously sex life is the one area that officials may not ask about, though if you offer information, they may consider it.

The fact that two people live in the same house is not evidence of a relationship. They could be widow and daughter, landlord and lodger, or two students sharing digs. The relationship must be one that they and others recognise as such, colloquially "being an item".

## Relationship starts in a new year

There can also be some anomalies when a relationship starts during the year.

Suppose Jack and Jill start living together on 1 February. Jill has an annual income of £35,000 a year. By 1 February, Jack has already earned £60,000. As the higher earner, Jack is liable for this new charge. But suppose he stops work to look after the children (and remember, they do not have to be his children) while Jill continues working. The charge will still fall on Jack, even though he has no income on which to pay it.

## Breach of confidence

Another issue is that a person simply may not know who is the higher earner. If both partners earn more than £50,000, the charge falls on the one with a higher income. So you have a man earning £52,000 married to a successful woman. What does he do?

The answer incredibly given by HMRC is that you simply ring them up and they will tell you whether your partner is earning more than you.

This new power is not contained in law. HMRC claims it has the power under their normal powers of care and management.

Yet another issue arises when one or both are running a business and they simply do not know who will have the higher income. Or what happens if one of them believes they have the higher income, and then discovers that their accounts were wrong? What happens if one elects to use the new cash accounting system and that pushes their income below their partners?

One can see all sorts of imaginative accounting and tax avoidance for someone whose income is heading above £50,000. The old tax avoidance trick of converting income to capital gains has a new market.

There is a duty to notify HMRC of who has the higher income in October of the tax year. Yet in many cases, the couple may simply not know who has the higher income, or indeed if either of them has an income sufficiently high.

### **Ménage à trois**

However the issues do not stop there. The legislation does not refer to the *higher* income but to the *highest* income. The legislation specifically considers the implications of someone having *two* partners.

An article in *Taxation* magazine of 26 July 2012 describes this scenario. Jack earns £55,000 and is married to Jill who has no income. She has a secret lover, James, with whom she also lives three days a week. He knows that he earns more than Jack and so pays the child benefit high income charge. Jack, unaware of James, also pays the charge. HMRC then writes to Jack to tell him that he has paid too much tax as someone else has paid the charge.