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Child benefit and the high income child benefit tax charge

Child Benefit is a flat-rate State Benefit that is available to UK residents that have responsibility for any children. Typically it is the parents that claim Child Benefit in respect of their own children, but it can be claimed in respect of adopted children, foster children, or even the children of friends.

The flat-rate State Benefit for families with children was first introduced in 1946 and was intended to reduced child poverty. Since then it has been overhauled a couple of times, but the concept of a flat-rate benefit paid in respect of children has been around since that date. In 2013 it was announced that for any household where any individual earns more than £50,000 the benefit will be reduced. If any individual earns more than £60,000 the benefit is eliminated. This is achieved through the High Income Child Benefit Tax Charge (HICBTC).

How the restriction works

Child Benefit is paid to an individual, not to a household. To determine whether any Child Benefit needs to be clawed back HMRC look at the highest earning parent's income. If that individual's income is between £50,000 and £60,000 the amount of Child Benefit that is clawed back will be between 0% to 100%; if the individual's income is more than £60,000 the whole amount of Child Benefit is clawed back.

So, if an individual's income is £57,000 the amount of Child Benefit that will be clawed back will be 70%. The clawback is paid by the highest earner, not by the individual to whom the Child Benefit is paid.

Problems with the system

There has been widespread criticism of this system since its inception.

Independent taxation was introduced in the UK from 6 April 1990. This meant that the tax affairs of married couples were dealt with independently and confidentially by the Government. No longer were women a mere chattel of their husbands; they were taxpayers in their own right. This system undermines this concept, meaning that any couples living in the same household will need to co-operate on whether there is a Child Benefit clawback, even where they are not married and operate completely independent finances.

Where couples operate independent finances it would typically be the lower earning parent that would claim Child Benefit. The higher earning parent is then liable to repay that Child Benefit to the Government, even though they never received it.

We also have the inequity of only looking at one individual's income. A couple with one working parent earning £60,000 with the other looking after the children will receive no Child Benefit. However, a couple who earn £50,000 each are able to have a household income of £100,000 and receive full Child Benefit. This problem is exacerbated by pension contributions reducing income for Child Benefit clawback purposes. A couple could earn £70,000 each, pay £20,000 each into their pensions, and receive more Child Benefit than a couple with £60,000 of income and no ability to save for their retirement. This is a nonsensical outcome from a system that was conceived to combat child poverty.

These flaws in the system we can do little about.

Child Benefit planning

We can, however, look to maximise the amount of Child Benefit that a couple can claim. This can be achieved with income sharing, income planning or making sure that pension contributions are paid by the right individual.

Income sharing

Income sharing between spouses is still possible. HMRC attacked income sharing in the landmark Arctic Systems case back in 2007. Further to losing this case the Government promised legislation to combat income sharing, but it never materialised.

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Sharing income can be achieved by forming a partnership, or issuing shares to each spouse. Income sharing is typically done between married couples. While it is possible for co-habiting, unmarried couples to share income, it needs to be considered more carefully.

Income planning

If you are self-employed or in a partnership all taxable profits or losses of the business are taxable on you personally, regardless of how much you draw from the business. However, if you run your business through a company you can control the amount of taxable income that you receive. Further, the amount of taxable income does not need to be the same as your drawings from the business. As you may imagine there are tax consequences to consider if your drawings exceed your taxable income, but the prospect of preserving the Child Benefit claim may make it worthwhile.

Allowance planning

Both gift aid donations and pension contributions reduce an individual's income for the purpose of calculating the amount of Child Benefit to be clawed back. Ensuring that pension contributions and gift aid donations are paid by the right individual can help preserve a Child Benefit claim.

To claim or not to claim

With Child Benefit there are 3 choices:

- Claim Child Benefit, and pay any clawback on your Tax Returns,
- Claim Child Benefit, but elect to stop receiving payments, or
- Do not claim Child Benefit

If no Child Benefit is received, either because it is not claimed or you elect to stop receiving payments, you will not have the hassle of making sure that Child Benefit is on your Tax Return and paying it back to HMRC. However, if your income unexpectedly drops below £60,000 you will not have the opportunity to claim any Child Benefit for that year. If you do not receive any Child Benefit it is lost forever.

Since 2013 many families have decided to not claim Child Benefit at all, doing away with the hassle of completing the forms, electing to stop payments or paying back overclaimed Child Benefit. However, it seems that there are some unexpected consequences to this too. Firstly, an individual claiming Child Benefit will receive a qualifying year for National Insurance purposes, perhaps increasing their State Pension entitlement when they come to retire. This qualifying year is still received even if an election to stop the payments is made. Secondly, any child registered for Child Benefit will automatically receive a National Insurance number just before their 16th birthday. If no Child Benefit claim is made a National Insurance number will need to be applied for, and currently the only way to process an application is to visit your local Jobcentre.

Conclusion

As well as a lesson in awful initialisms, the High Income Child Benefit Tax Charge is a lesson in how a relatively simple concept (a means tested Child Benefit) can be made unfair and overly complex by shoehorning it into an already complex tax system.

But with planning and an understanding of the rules the amount of Child Benefit due can be increased, and the fringe benefits associated with Child Benefit can be enjoyed.

To find out more about what they can do for you, visit: wilsonwright.com or call 020 7832 0444

MEET THE TEAM

If you require further information or guidance on any of the matters in this guide, do not hesitate to contact the Wilson Wright team.

For full details of our services please visit wilsonwright.com or call 020 7832 0444.

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