Tax year end planning – preserving child benefit

Everyone will normally qualify for child benefit if they're responsible for a child under 16 (or under 20 if they stay in approved education) and they live in the UK. Child benefit is effectively means tested, as a tax charge known as the high income child benefit charge may apply. This factsheet details the charge and explains how it's possible to mitigate it and retain the full child benefit.

If you only read one thing…

- It is possible with tax planning to avoid the high income child benefit charge and fully retain child benefit.
- This may be through additional pension contributions from the excess income over £50,000 or by a relative who can make a pension contribution on their behalf.
- Taxable income can also be reduced or reshaped by using alternative products such as investment bonds.
- Tax planning in this way can result in impressive tax savings – the tax charge on child benefit is mitigated, the affected individual receives pension tax relief at their highest rate, and there may be IHT savings on the gifted pension contribution.

What is the high income child benefit charge?

It's a tax charge impacting individuals who receive child benefit and their, or their partner's annual income exceeds £50,000.

When will the tax charge apply?

The tax charge will generally apply if:

- An individual or their partner get child benefit
- They or their partner's adjusted net income is more than £50,000

Partner includes those married, in civil partnerships or couples living together as if married or civil partners.

The charge may also apply if someone else gets child benefit for a child living with an individual and they contribute at least an equal amount towards the child's upkeep. It doesn't matter if the child living with them is not their own child.

Adjusted net income means total taxable income before the personal allowance and after certain allowable deductions, such as personal pension contributions and gift aid. It is the gross amounts of gift aid and pension contributions which have received relief at source that are deducted from taxable income.

The charge applies to the partner with the highest adjusted net income regardless of which partner receives the child benefit.

How much is child benefit?

There are two rates of child benefit depending on the number of children an individual is responsible for:

Who the allowance is for	Weekly rate (£)
Eldest or only child	20.70
Additional children	13.70 (per child)

Annual child benefit income amounts

Number of children	Child benefit (£)
One	1,076.40
Two	1,788.80
Three	2,501.20
Four	3,213.60

These child benefit rates have not changed since April 2015.

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How much is the tax charge?

For those with adjusted net income between £50,000 and £60,000 then the charge will be 1% of the total benefit for every £100 of income over £50,000.

If an individual's adjusted net income is £55,000 and they have two children for whom they or their partner are receiving child benefit, the charge will be:

£55,000 - £50,000 = £5,000/100 = 50

50 x 1% = 50% of £1,788.80 = £894.40

Child benefit is fully taxed where adjusted net income is more than £60,000.

How is the tax charge paid?

The charge will be collected through self-assessment or PAYE. If affected by the charge, the person claiming can either stop getting child benefit or carry on receiving and the partner liable will have to pay any tax charge after the end of each tax year.

Should child benefit be claimed?

It's recommended as the individual has a choice as to whether to receive or not. Claiming child benefit makes sure the claimant gets national insurance credits to protect their state pension. Claiming child benefit also means their child gets their national insurance number shortly before their 16th birthday.

If child benefit has not been claimed at all, claims can only be backdated three months.

If child benefit has been claimed but the non-working partner is not the child benefit claimant, it is possible to transfer the national insurance credits to count towards state pension. An application to do so should be made by 5 April following the period for which credits are to be transferred. In practice, HMRC can allow late claims provided qualifying conditions are met.

How can the tax charge be mitigated or eliminated?

If the affected partner can reduce their adjusted net income, it is possible to retain child benefit without a tax charge. So how might a client reduce their adjusted income?

Pension contributions

If the tax charge will apply because an individual's taxable income will be more than £50,000, they can consider making a personal pension contribution, in the tax year in which the charge will apply, to reduce their adjusted net income to £50,000 or less. Firstly, the affected partner should:

1. Work out their adjusted net income.
2. The excess over £50,000 is the income that triggers the tax charge.
3. Make a personal pension contribution (deduct the gross amount from their adjusted net income)

This is best demonstrated in a case study.

Claire lives in England with her partner Rob and they have two children. She will receive child benefit for their two children of £1,788.80. Her total earnings for 2018-19 which includes her salary, bonus and private medical insurance will be £58,000. Rob's income will be £45,000.

High income child benefit charge

£58,000 - £50,000 = 8,000/100 = 80 x 1% = 80% tax on child benefit

80% x £1,788.80 = £1,431.04

The child benefit has effectively been taxed at 80%.

If Claire makes a personal pension contribution of £6,400 (net) this would be equivalent to £8,000 grossed up. This gross figure is deducted from her taxable income of £58,000 to reduce her adjusted net figure to £50,000. No tax is therefore due on the child benefit. As she is a 40% taxpayer, she can claim the higher rate tax relief on the pension contribution resulting in further tax savings of £1,600 so in fact the £6,400 contribution only cost £4,800.

The total tax saving would be £4,631.04, so the effective tax relief by making the pension contribution is 72.36% (£4,631.04/£6,400).

Tax savings	£
Pension tax relief at source (40%)	3,200
Preserved child benefit	1,431.04
Total tax savings	4,631.04

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Tax planning – generational planning

This works fine if Claire has the disposable income to make a pension contribution of £6,400. But, it will often be the case that parents with young families will not have the disposable income to make a sizeable pension contribution but they may have parents who can help. This can in turn help the parent who may have an IHT problem.

Let's say Claire's dad pays the pension contribution. This will either be an exempt or potentially exempt transfer (PET) for IHT purposes. For income tax purposes the pension contribution is treated as if it were made by the pension account holder (i.e. Claire), not her dad.

This means that Claire benefits from retirement saving which she has not had to personally fund and gets 40% income tax relief on the pension contribution.

Her dad has made a gift which doesn't give rise to any immediate IHT tax charges. Where the gift is a PET, it will be IHT exempt after seven years.

The total tax savings from a net pension contribution of £6,400 would be £7,191.04 representing tax saving of 112.36%.

Tax savings	£
Pension tax relief at source (40%)	3,200
Preserved child benefit	1,431.04
Inheritance tax savings (40%)	2,560
Total tax savings	7,191.04

Please note the amount of income tax relief that can be claimed on pension contributions by Scottish and the rest of UK tax payers may not be the same given the rates and bands of tax relief have differences under the UK and SRIT (Scottish rates of income tax) regimes.

Reshaping income sources – a longer term strategy

As well as reducing income to £50,000 via a personal pension contribution, paid either by the affected partner or someone else, longer term an individual may be able to reduce or re-shape their taxable income to preserve child benefit. An investment bond is a non-income producing asset so long as a chargeable event is not triggered. Withdrawals of up to 5% of the allowable premiums can be taken for up to 20 years and the "income" which is strictly capital will not count towards adjusted net income. This could be facilitated by a parent – though a larger sum would be required – to make the purchase of the investment bond. A gift between individuals to the extent that it is not covered by an IHT exemption will be a potentially exempt transfer by the parent. It may also be possible to make investment portfolios more geared towards growth rather than income producing.

Case study summary

- This tax charge has long been criticised on a number of fronts.
- Take a couple receiving child benefit and earning £50,000 each. Neither will be subject to the charge and so will fully retain child benefit. Contrast this with a couple with one single earner, earning £60,000 who will be subject to 100% of the charge and lose all their child benefit.
- Furthermore, the threshold of £50,000 is also unchanged from the introduction of this charge in 2013. The Institute of Fiscal Studies estimates that "…around 36% or 370,000, more families will lose some Child Benefit in 2019-20 than in 2013-14". In 2019-20 the higher rate threshold increases to £50,000 for non Scottish taxpayers. If this rises, this would mean increased numbers of families without a higher rate taxpayer will lose some child benefit.
- The case study here shows that with tax planning, it is possible to retain child benefit and make some fairly impressive tax savings.

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