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FACT FILE

PROFIT EXTRACTION

Is shifting income to your kids really a no no?

HMRC has tough anti-avoidance rules to prevent parents shifting income to their kids to dodge tax. How can you work within these rules and still gain a tax advantage?

Gifts for your youngsters

Over the years there have been many attempts by parents to transfer shares in their companies to their minor children to gain a tax advantage by making use of their tax-free allowances and lower rate bands. Invariably the plans have been thwarted by HMRC which can rely on tough and wide ranging anti-avoidance rules, known as the settlement legislation, to cancel out any income tax advantage.

Trap. Where the settlement legislation applies, the dividends received by the children count as the income of the parent who gave them the shares.

Another tax problem

Other anti-avoidance rules mean that where you give shares in your company to your youngsters it counts as if you had sold them at market value , i.e. the price you would expect an outsider to pay for them. If the market value is greater than your annual capital gains tax (CGT) exemption plus unused capital losses, you'll be liable to CGT on the excess.

A good plan

Despite the rules, giving shares to your children is not a bad idea. While you'll pay the tax on the dividends this will be no more than it would have been had you kept the shares. Plus, you can invest the money on your children's behalf tax efficiently as the interest etc. generated isn't caught by the anti-avoidance rules. When your children reach 18 the rules cease to apply so you will no longer have to pay tax on the dividends. This might fit in nicely with everyone's financial needs.

Example. In 2018 John gives his one-year-old son, Will, 4% of the shares in his company when the market value is £4,000. That's within John's annual exemption so there's no CGT for him to pay. Dividends on the shares average £1,500 per year on which John picks up the tax bill. By the time Will reaches 18 and heads off to university the accumulated dividends plus growth add up to £30,000. Will can put this towards his tuition. John no longer has to pay tax on Will's dividends, and neither does Will.

Tip. If possible, give shares to your children while your company is young. That way the market value of the shares will be relatively low meaning you can give more of them away without triggering a CGT bill.

Selling the shares

After finishing further education the chances are your children won't want to return home. The shares you gave them can be sold and the money used towards the cost of a starter home.

Tip. If your company is successful, your youngsters' shares will increase in value. They can turn this into tax-free cash by selling enough of them back to you at market value to use their annual CGT exemption. Alternatively, they can sell the shares to your company. In that case what they receive will be tax free as long as, when added to their other income, it doesn't exceed their tax allowances plus basic rate band. At current rates that could be over £40,000.

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