Parents Can Eliminate Child Benefit Tax

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Trying to save for your future, while bringing up a family, may seem hard to achieve but there are circumstances where making savings can increase State support for the family.

Child benefit is paid to the parents and guardians of children up to age 16, and children aged 16 to 19 if they stay in approved full- time education or training. It is £21.05 per week for the eldest child and £13.95 per week for each younger child.

It is tax free unless the parent or other adult living with the parent has taxable income of more than £50,099 pa. Those who earn over this figure are required to pay income tax on a slice of the child benefit so that its value is eroded to nil, once taxable income of one of the adults reaches £60,000. This rule applies regardless of whether the high earner is the parent of the child, whether they are married, civil partners or just living together.

It is especially problematic for those with fluctuating pay, such as the self- employed or an employee with irregular hours or significant bonuses. In response to this change many parents have chosen to forego child benefit and no longer claim it. This can however result in unnecessary loss of tax- free income.

If one of the adults is not working, not claiming child benefit can also mean a loss of credits for their State pension so Child Benefit should always be claimed even if the payments are 'turned off'.

A Solution

The tax on child benefit can be reduced or even removed, for those with income in this bracket, by making either a pension contribution or charitable donation, both of which reduce taxable income for the purpose of the high-income child benefit charge.

The following case study shows how this works.

Anna and John, parents of Amy and Jack both work. Anna earns £25,000. John earns £52,000 salary but also fluctuating bonuses, this year he expects to earn £60,000 in total. They have no other taxable income.

Child benefit of £1,820 pa is paid to Anna tax free and she earns less than £50,099 so is not taxed on it. As John earns in excess of this, he will be taxed on the child benefit. His high-income child benefit tax bill will be £1,820 and his income net of NI and tax £41,620.

They have a choice of ceasing to claim child benefit notifying HMRC of John's income each year or of completing a tax return and paying the extra tax through self- assessment. As John's earnings vary each year, he is unsure what to do.

If John pays £8,000 into a pension plan his taxable income will be below the threshold as the £8,000, he pays is grossed up to £10,000 in the pension scheme. £10,000 then reduces his income for the high-income child benefit charge to £50,000. So there will be no tax to pay on the child benefit nor the £10,000 grossed up pension savings and his net income after tax and NI would be £47,440.

So Anna and John can save for their retirement and retain the full child benefit giving them an effective rate of tax relief of over 58% on his retirement savings.

State Pension Credits

Where one of the parents is not working or claiming benefits and so not paying National Insurance, they may also gain credits for the State pension by being in receipt of child benefit for children under age 12 (17 if disabled).These credits are lost where the child benefit isn't claimed (but are kept when child benefit is claimed but the actual payments are waived). They can be restored by completing a CH2 form available from the Department for Work and Pensions website.

If the other adult is a high earner payment of the benefit can be waived. The claim must be made in the name of the non-earning parent or the credits are wasted. Claims can only be backdated three months.

To get the full State pension 35 years' credits must usually be held. Each year's credit is currently worth £260.29 per year of State pension payable from state pension age.

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