Low Incomes
Tax Reform
Group

A voice for the unrepresented

Couples in the tax and related welfare systems – a call for greater clarity

A research report by the
Low Incomes Tax Reform Group of
The Chartered Institute of Taxation

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A large print version of this report is available from The Chartered Institute of Taxation upon request. Please write to the Low Incomes Tax Reform Group, The Chartered Institute of Taxation,1st Floor, Artillery House, 11-19 Artillery Row, London, SW1P 1RT.

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Foreword

A subject that is increasing in complexity is the whole question of couples and how they are dealt with in the tax and related tax credits systems. Originally, the tax system only recognised married couples; with the advent of the children's tax credit and now the high-income child benefit charge (HICBC), it is beginning to take notice of cohabiting couples; the Civil Partnership Act 2005 provided for same-sex partners to be accorded a tax and tax credit status that corresponded to that of married and unmarried couples; polygamous units were first recognised in a set of tax credits regulations in 2003; and the advent of same sex marriage introduces yet another dimension. In reality, even that extensive classification seems inadequate in the light of growing numbers of couples living 'apart together' (that is, committed couples who live physically separately due to work or other reasons) or those forced to remain physically living together whilst emotionally separated (usually out of financial necessity), and different shades of togetherness or separation in between.

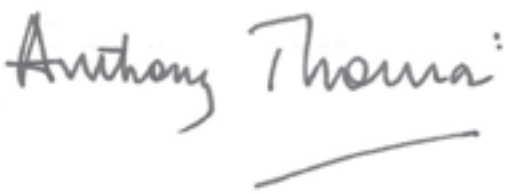
Attempts by tax credits compliance teams to strike down single claims where there is a faint whiff of an 'undisclosed partner' – often a separated partner who still uses the former joint address for purely practical purposes, or who has simply forgotten to register a change of address – show that these distinctions are more than purely academic. Getting them wrong – whether the mistake is made by the citizen or by a state official – can have devastating financial consequences for individuals, particularly as reliable information on the true legal distinctions is sometimes seriously lacking. Unseemly wrangling between HM Revenue & Customs (HMRC) tax credit compliance teams and individuals is likely to spill over into the tax system once the HICBC has bedded down and HMRC begin to enquire into the composition of households and the financial circumstances of individuals within them for income tax purposes.

This report therefore delves into the categories of living together, the compliance activities surrounding them and the problems that arise for the unrepresented taxpayer. In a Utopian world, we might wish to recommend that there is a single, consistent and clear definition of couple status for all tax and related state benefits purposes; yet it is clear that such a sweeping change could create large numbers of winners and losers.

Our recommendations are therefore made with the intention of opening up further debate in this area, perhaps prompting the immediate removal of some obvious areas of unfairness and difficulty where change is already in train – such as the new bereavement payment and move to universal credit (UC).

We also hope that we can prompt further review of information on GOV.UK and some means of providing more certainty for couples to understand their status in order that they comply correctly with their obligations – making the right choices when submitting claims or notifying changes of circumstances something most citizens are more than happy to do in order to comply.

Signed



Anthony Thomas
Chairman, Low Incomes Tax Reform Group

1. About this report

Scope

This report summarises the findings of a study by the Low Incomes Tax Reform Group (LITRG) into the position of 'couples' in the tax and benefits systems. We consider the various definitions of a couple in general terms in Section 3 below.

This report looks at these areas:

1. How the law and practical rules relating to key income tax charges, allowances and state benefits (in which term we include tax credits) apply to couples – focusing primarily on how couples are defined for each purpose.

2. Identification of some obvious areas of unfairness, inconsistency and uncertainty.

3. How the rules are explained and enforced by the various Government departments that administer them, picking up on areas of particular compliance activity.

In looking at these issues we have examined what we consider to be the main taxation and benefit provisions that affect couples, and we examine the introduction of the transferable allowance for married couples.

The primary focus of the LITRG is to represent those on a low income who are not otherwise represented and the topics included in this report are, we believe, significant for that constituent group for four main reasons:

- The nature of close relationships between members of couples and their domestic arrangements is infinitely varied and often defies categorisation.

- The law that attempts to categorise different types of couple for tax and tax credit purposes is inconsistent, vague, and nearly always complex to apply.

- Attempts by official sources to explain the law to the public, or those branches of tax and related law that turn on whether or not a couple exists and if so what type, are inadequate and individual advice given by Government helpline advisers often ill-considered.

- Those who fall foul of the statutory definitions, or whose own perception of their relationship differs from that of the authorities, can find themselves caught up in a compliance nightmare which is exacerbated by the inadequacy of official information accessible to the unrepresented.

We have sought in this report to identify and include comment on various areas where the law may differ in the different parts of the UK.

Purpose

We do not seek to examine or enter into arguments of a political or ethical nature about whether one form of couple is intrinsically more or less desirable than another. Rather we are concerned to see a fairer tax system for all those on the lowest incomes and it is on this basis that we examine these issues.

The main purpose of this report is to expose the difficulties facing low-income, unrepresented taxpayers and claimants in couple relationships whose tax liability or benefit entitlement turns on the nature of that relationship. In making our recommendations, we aim for greater clarity in the law and better explanations. The more closely the law reflects the reality, and the better it is understood by those whom it most affects, the less will be the need for expensive and distressing compliance interventions that often proceed from misconceptions on the part of officials or ignorance on the part of taxpayers and claimants.

From our day-to-day work, we have become aware that the definitions of couples in the taxation and benefits legislation are sometimes inconsistent and we have noted differences between the treatment of (on the one hand) married couples and civil partners and (on the other) those who might be part of a couple but without any formal registration of their relationship. Accordingly, our recommendations in this report also seek to encourage debate and further investigation by the Government into the issues we raise.

Limitations in scope

We appreciate that this report does not cover all tax and benefits issues relating to couples, but we aim to discuss the key areas of direct relevance to those on low incomes. We also cover some areas of less direct relevance generally to those of low means (such as capital gains tax (CGT)), but with a particular focus on those aspects that might affect low-income people.

With the exception of some discussion of the settlements legislation as it might apply to family businesses, we have not discussed business taxation to any great extent. Though we note that couples working in business together or alongside one another might have to consider other tax issues – for instance whether they have exceeded the UK Value Added Tax (VAT) registration threshold and therefore have to be registered for VAT and in connection therewith 'business splitting'.[1]

One area affecting low-income individuals is council tax and the availability of council tax support from the local authority. This report has not covered this area in detail, given the practical difficulty of a single council tax benefit having been abolished in favour of local council tax support with each local authority operating a different regime. Nevertheless, we would stress that there is a need for adequate and clear guidance from local authorities on what constitutes a couple – by way of an example, we have included at Appendix 5 to this report some notes from a brief review of one local authority's online council tax support calculator.

Our research and analysis of the current system also brought up some interesting, if slightly tangential to our main focus, discussions of impacts on and potential unfairness for single-earner couples. So as not to lose sight of these important points, we have included them as Appendix 11 to this report.

1 HMRC have power under Schedule 1 Para 2(1) of the Value Added Tax Act 1994 to direct that more than one person each carrying on a business may be treated as a single taxable entity for the purposes of VAT registration. HMRC might use this power to challenge an assertion that there are two separate entities (each below the VAT registration threshold), on the grounds that in reality the two constitute a single entity. This might occur where members of a couple each carry on a business which have common factors such as shared premises and equipment and similar trading activities (or where activities might be different but considered to be part and parcel of an overall business). In passing, we note that we believe such a challenge could be made equally against unmarried, civil partner or married couples.

2. Executive summary

Here we summarise some key points from the main body of this report. Our recommendations are detailed in Chapter 6.

- There are a number of potential relationships that could warrant the label of a 'couple'. The easiest to identify and agree in terms of definition are married couples and civil partners, and those physically and emotionally living together as if they were a married couple or civil partners. But increasingly, people are living in other ways including 'living apart together' (that is, a couple who are emotionally committed but physically live separately either some or all of the time). There are also those who used to be part of a couple but whose emotional relationship has ended, yet they remain living under the same roof (usually enforced for practical reasons such as sharing childcare, or financial constraints). These additional categories make defining who is and is not part of a couple more complicated.

- While it is possible to define various potential categories of couple, within each category of couple there are nevertheless shades of grey, making it difficult to determine the boundaries of the various categories. These include the differing degrees to which people share their lives together, and a particular difficulty as to timing – when does a couple's relationship become sufficiently cemented such that they are 'living together as a married couple'; and when have a couple finally become separated at the end of their relationship? Often there is no clear start or end date.

- For the lay person attempting to deal with their affairs, it is important that they are able to establish quickly and easily their own status – that is, are they or are they not part of a couple? This is far from an easy question to answer given that the definitions are different depending on the benefit or tax provision being considered. There is a clear need for increased guidance to enable people to properly assess whether they are part of a couple for various provisions.

- Generally the provisions we have examined start from the presumption that a married couple or civil partners are to be treated as a couple unless they are permanently separated (even if they are not physically living in the same property). For unmarried couples, the presumption is that they are not a couple unless they are shown to be living together as a married couple or civil partners. So the starting point is different depending on whether the couple are married (or in a civil partnership) or not.

- From a fairness perspective, it might be considered that unmarried couples who physically live apart and are in a committed emotional relationship should be treated the same as married couples in similar circumstances. But it seems that such couples who are unmarried are less likely to be investigated and found to be a couple than their married counterparts. This is because from an evidentiary point of view it is unlikely that the unmarried couple's relationship would ever come to light.

- There are inconsistencies in definition of the term 'couple' across tax and benefit provisions. For example, some provisions include both married couples and unmarried couples, whilst others define couples as only those who are married or in a civil partnership. For some benefits, couples need to be members of the same household whereas in tax credits there is no household requirement. With the eventual full introduction of UC, consistency between benefits generally should be easier to achieve, since there will no longer be two departments involved with lower income claimants, each with slight differences in the rules. But HMRC will continue to be involved for those with higher incomes in relation to the HICBC.

- Some aspects of the tax system such as tax rates and personal allowances (PA) are targeted at individuals. But when the conditions to be satisfied widen from being satisfied by an individual to being satisfied by a

couple, so the scope for uncertainty also widens.

- It is also necessary to separate the theory of the legislation from the practical reality of establishing couple status. This is made difficult by poor guidance on what a couple means for different tax and benefits purposes, and a lack of clear information about the role evidence plays.

- For the benefits and tax provisions we have examined, there is generally very little, if any, guidance available on what the term 'couple' or 'partner' means; nor at what point two people become a couple or when separation occurs. This means couples are left in an extremely difficult position; unable to really understand their status and how it will impact on their benefit and tax position with any degree of certainty.

- Nor is there guidance on the types of evidence that might usefully support a particular status, despite the important part it plays in determining couple status. Even if the couple are clear about their status, it may be the case that Government departments make a different determination based on available, or lack of available, evidence. This leaves people unable to defend their position in the event of a compliance investigation. It could also be the case that different departments might reach different determinations for the same couple, based on inconsistencies in the rules and practice.

- There can be significant financial impacts flowing from a determination of being part of a couple (usually for unmarried couples, as matters tend to be much more clear cut for married couples, except perhaps in the case of separation). Usually this impact is negative, for example where benefits for a couple are less than the total for two single individuals; or where a prima facie low-income claimant's child benefit is lost due to them having a high-earning partner (regardless to what extent that partner is prepared to support the lower income partner financially).

- There can also be significant financial consequences where people's own categorisation of their couple status differs from that of the authorities. For example, two people who have submitted tax credits claims as if they were single can have significant overpayments if an HMRC compliance investigation determines that they should, in fact, have made a joint claim as a couple.

- The financial consequences can drive people to make decisions in relation to their living arrangements and relationships that they may not have made otherwise. For example, an unmarried couple might make the decision to marry if one of them received a poor health prognosis, simply to minimise inheritance tax (IHT) or to ensure that pension savings or death benefits were paid to their partner.

- The financial consequences can also lead to fraudulent behaviour when people fail to declare or acknowledge their couple status to authorities. The tax credits system generally pays less to couples than to two single claimants. This is one element of the so-called 'couple penalty'. Accordingly, there may be a financial incentive for those two people to argue that they are not a couple and therefore they should claim as two single people.

- This report does not condone fraudulent behaviour in any respect, but we would note that HMRC (and the Department for Work and Pensions (DWP)) in their 'error and fraud' statistics and strategies do rather tend to confuse the two.[2] This is unhelpful, as the remedies for error are quite different to those for tackling fraud. Our examination of available guidance (or rather lack of it) clearly illustrates how claimant error can occur.

- Although there are some variations in the law applicable to couples in different parts of the UK, the

2 We have commented extensively on error and fraud in the past. See for example: www.litrg.org.uk/News/2014/PR-nao-report-high-levels-error-raud-in-tax-credits

problems identified in this report are common to all parts of the country – principally the fact that couples lack any certainty (or means of achieving certainty) of their status. There is no mechanism by which a couple can 'register' or 'deregister' their relationship for tax and benefits purposes.

- Even if a couple is able to marry and chooses to do so, they may still encounter a grey area if they live together or to some extent share financial responsibilities prior to the marriage – such that the state might view them as a couple for various purposes. And on separation, there might similarly be a period of confusion – for instance if a temporary separation later proves to be permanent, or if the couple are unable to obtain a formal deed of separation due to the costs involved or failure to agree its terms between them.

- Our conclusions and recommendations in Chapter 6 of this report seek to address the above issues.

3. What is a couple?

Introduction

The purpose of this section is to set out the range of potential relationships that could possibly form part of the definition of a couple that is used for tax and benefit purposes. Before we can analyse the rules, consider whether they are fair and consistent and look at how they are enforced by the various Government departments involved, we must first establish an understanding of what we mean (and do not mean) by the term 'couple'.

As a starting point, one might consider a dictionary definition, for example, "A couple consists of two people who have a romantic or sexual relationship, for example a husband and wife or boyfriend and girlfriend"[3] or "Two people who are married or otherwise closely associated romantically or sexually".[4] These definitions, unfortunately, do not provide enough detail for the range of tax and benefit provisions that we need to explore.

Various permutations of couples

Married couples and civil partners

The most obvious couples are married couples and civil partners. In this paper any reference to marriage should be taken to include civil partnerships and same sex marriages.[5] Similarly any reference to living together as a married couple should be taken as referring also to living together as civil partners. Further, we use the generic term 'spouse' to describe a member of a couple in a marriage, a same sex marriage or a civil partnership.

Those living together as if they were a married couple or civil partners

Another type of couple is those who are living together as a married couple or civil partners. This is a more difficult group to identify consistently. First, they require to be living together. This phrase, in itself, may be confusing. It certainly implies that the two people would live in the same property, but provides no further guidance on the proportion of time they would have to live in the same place. For example, at two extremes, one couple might live together permanently while another (equally committed) couple might live in the same property only for short periods of time, for example during holidays, for personal reasons.

The second part of that definition requires the couple to live as a married couple or as civil partners. This is a subjective test. Even if two people live together permanently in the same property, they may not be living as a married couple or as civil partners. For example, they:

- may have a blood relationship that means that marriage is impossible;
- may be friends rather than having a relationship akin to marriage – living together for friendship and/or financial reasons rather than having a romantic relationship;
- may have come together for mutual support;

3 The Free Dictionary

4 The Oxford English Dictionary (online)

5 Same sex marriages may take place in England and Wales from 29 March 2014 – and commenced in Scotland from 31 December 2014. No same sex marriage provisions are in place in Northern Ireland (but it is possible to register a civil partnership in Northern Ireland).

- may have a romantic and/or sexual relationship but not feel their commitment is yet adequately strong to be treated as equivalent to marriage;

- may have previously lived together as a married couple, but their relationship has now changed and although they still occupy the same property, they now regard themselves as two individuals rather than as a couple; or

- indeed each member of the couple may view the relationship in a different way.

Those 'living apart together'

The final type of couple that we consider in this report are those who 'live apart together'. This term is used to describe those couples who are in a long-term emotional relationship, and who might share some financial commitments, but who either choose to live in different properties or for whom living together is not practical. Examples of such couples might include:

- couples where one member of the couple works overseas;

- couples where there are children from previous relationships and it is considered undesirable to merge the families into a single property or for schooling reasons it is undesirable to merge the families;

- couples where one or both members has other caring responsibilities – perhaps for elderly parents.

According to the Office for National Statistics, there are 390,000 married couples living apart together and a further 500,000 unmarried couples living apart together in the UK (see Appendix 3). It is not clear how many of these couples may be living apart temporarily – for example, only because one partner is working away from home. Where one member of the couple establishes another home somewhere temporarily, then for the purposes of this report we would consider them to be 'living together' (cohabiting); but where they have established a second home (perhaps most frequent for those on long-term contracts overseas), we would consider them to be living apart together.

Married couples living apart together might be easy to recognise, but those who are unmarried may be more difficult to identify from the outside looking in, even if the members of the couple themselves are clear as to their status.

Those living together, but not as a couple

There is a final group of people who are sometimes confused with couples. These are people who live in the same property but do not have a romantic or sexual attachment. Often these are two people who used to be a couple, but no longer regard themselves as such. They remain living in the same property for practical reasons – perhaps it is easier to manage childcare, or financial constraints mean that living in two properties is unachievable, for example. It might also include, classically, an elderly couple who share a home for economic advantage, but with no current emotional ties.

This group may find their interactions with Government departments particularly difficult when, for example, an assumption might be made that they are a couple due to their joint occupation of a property. Even where the two individuals are quite clear on the facts of the matter, it can sometimes be difficult to show the evidence that they are not a couple. This is exacerbated by the lack of official guidance that may be available on the type of evidence that might be requested and the fact that HMRC seem reluctant to visit such individuals at home, even when invited to do so. DWP officials still do visit people at home sometimes and that can be useful to demonstrate the precise living arrangements.

Recognising a marriage

Because marriage is a legal contract, establishing that a couple is married is usually not difficult (other than possibly polygamous marriages that are not considered in any detail in this report – see Appendix 6). There can be difficulties with marriages contracted overseas, but these are generally recognised in the UK provided that two conditions are satisfied:

1) that the individuals had the capacity to marry,[6] and

2) that the marriage was carried out formally in the overseas territory. This means that the marriage must have been executed so it was valid in that other country.[7]

This ability to recognise a marriage is important as the status of marriage brings with it consequences for both taxation and state benefits (as well as rights within family law, succession and inheritance, for example). Of course, marrying in the UK also requires that certain formalities are adhered to. It was reported[8] a few years ago that certain religious 'marriage' ceremonies in the UK were not legally recognised without an additional civil ceremony taking place, meaning that some couples may themselves be unclear as to their legal status.

Until the Family Law (Scotland) Act 2006, under Scots law there was no need for an actual marriage ceremony to take place to create a marriage. A marriage could take place "by cohabitation with habit and repute". To prove such a marriage existed, it might have been necessary to make a declaration before the Court of Session, but lack of such a declaration did not mean that a legal marriage did not exist. Such marriages were stopped by the Family Law (Scotland) Act 2006 that came into effect on 4 May 2006: no relationships commenced since that time may take advantage of those provisions. Nevertheless there will still be such marriages in existence.

The Civil Partnership Act 2004 granted civil partnership couples in the UK the same rights as married couples. This became law from 5 December 2005, at which point couples who had entered civil partnerships in other parts of the world also found that their relationships were now legally recognised in the UK.

Under the Marriage (Same Sex Couples) Act 2013, with effect from 13 March 2014, marriages between two people of the same sex are possible in England and Wales. In addition, overseas marriages between same sex couples that took place legally overseas before this Act came into force are recognised as valid in England and Wales with effect from 13 March 2014. Similar provisions have been introduced in Scotland by means of the Marriage and Civil Partnerships (Scotland) Act 2014,[9] but not in Northern Ireland.[10] In Northern Ireland, same sex marriages that have taken place legally in other countries are recognised as civil partnerships.[11]

What is living together?

There seems to be no clear definition of 'living together' or cohabitation. For the purposes of this report, we assume there has to be an emotional relationship in order to be a 'couple'. In most cases, there must also be a

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6 Marriage Act 1949, Sections 1 & 2, but capacity is generally considered relative to the domicile of the individuals at the time the ceremony takes place.

7 https://www.gov.uk/marriage-abroad

8 http://news.bbc.co.uk/1/hi/8493660.stm

9 This Act received Royal Assent on 12 March 2014, though the Scottish Government anticipated it would be near the end of 2014 before the first same-sex marriage ceremonies would be able to take place. See http://www.scotland.gov.uk/Topics/Justice/law/17867/samesex

10 The Northern Ireland Assembly has voted several times against introducing same-sex marriage provisions. See for example: http://www.bbc.co.uk/news/uk-northern-ireland-27201120

11 Civil Partnership Act 2004, section 215

substantial degree of living in the same property – broadly calling the same property 'home'.

What is separation?

Certain tax and benefit issues depend upon the couple not being separated, but separation is not always defined (and may be defined differently for the purposes of different taxes or benefits). Human relationships being as they are, often there are grey areas, such as:

- Is a separation temporary or permanent?
- Even if hindsight shows the separation to be permanent, was it always perceived that way by either or both members of the couple?
- Did a temporary separation turn into a permanent one?
- Is it possible to pinpoint the exact time that separation occurred, or that it became permanent?
- What if a reconciliation is attempted?

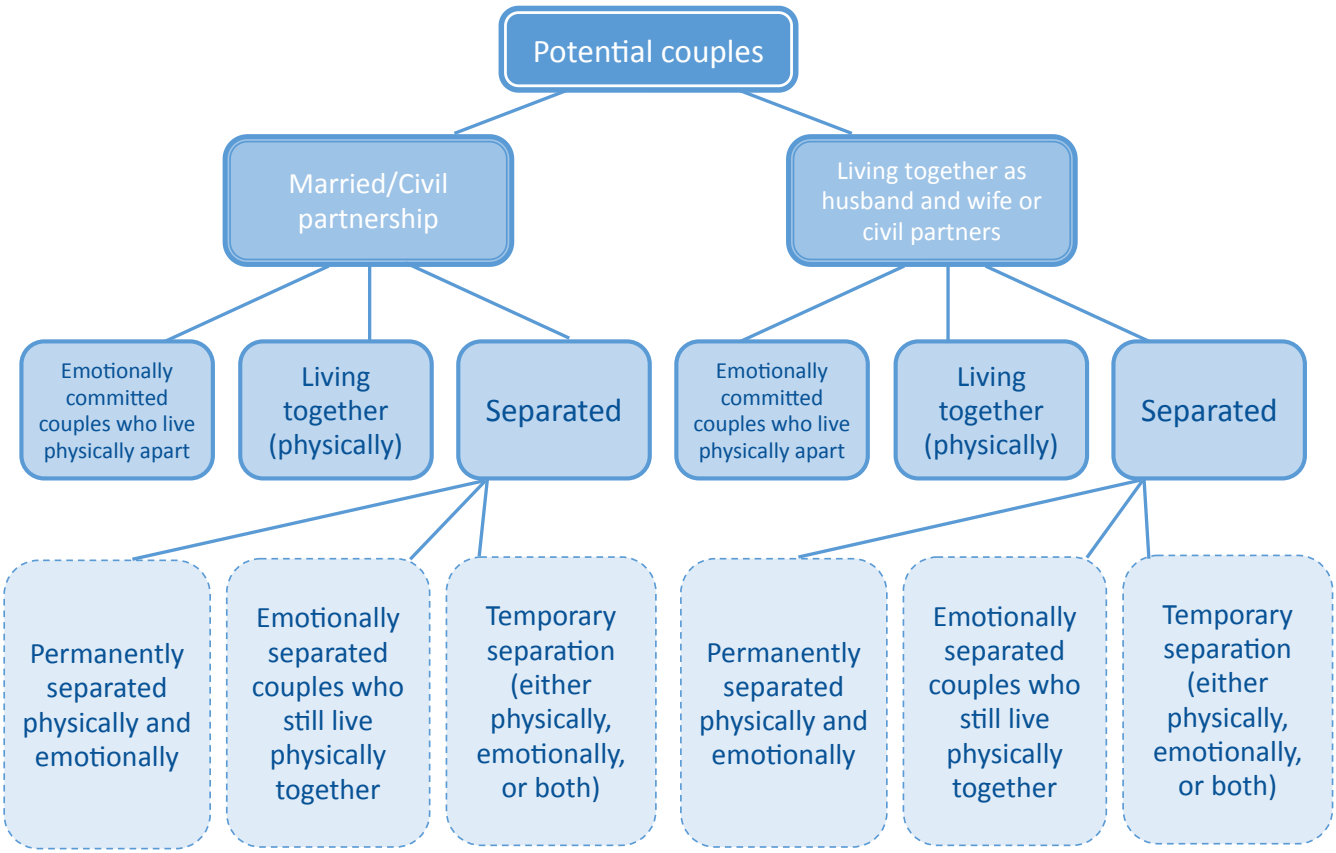
These questions are intrusive for the couple and debating them is not going to be high on the priority list when a relationship is faltering, but the answers may have significant financial impact on the couple – especially if they disagree with the authorities on the matter. It may even be the case that the couple themselves have different views, for example the separating member may think the separation permanent while the one who is left thinks that it is only temporary.

Even if the couple are very clear about their status, and their relationship status from outside looks to fall neatly into one category or another, it may be the case that Government Departments make different determinations based on available (or lack of available) evidence.

A deed of separation would appear to be conclusive, but such legal documents are expensive. For the low-income taxpayer, obtaining one will not be top of their spending priorities. And if emotions are tense, it may be difficult or impossible for both parties to agree signature of such a document, particularly if it seeks to agree division of finances or childcare responsibilities, for example.

Further dicussion on couples

But in our ever-developing society there are variations within these two broad categories which require further consideration. We have summarised the potential range of couples in the diagram below:



There are couples within both broad headings who are living together physically (in the same property) but not emotionally, and there are those who have chosen to live separately while maintaining an emotional relationship. The latter are sometimes referred to as 'living apart together'.

The categories outlined in the diagram above show only the potential situations where two people may or may not be deemed to be part of a couple. Whether they are in fact a couple for specific tax provisions or benefits depends on the definition of a couple for that purpose. We examine this in more detail throughout this report and also the evidence needed to support a particular status determination.

Grey areas around couple status

We have already mentioned some areas where it may be difficult to determine couple status, for example where the two people do not agree on their status. But there are cases where, despite the fact the two individuals can agree whether or not they are a couple, the state takes a different view. This can be difficult for the individuals to accept – the more so because in practice it seems that the state only intervenes in cases where it is in its interest to do so. We examine this issue further in Section 5 below.

What reason might two people have to dispute that they are, in fact, a couple? In Section 4 below, we look in more detail at some of the provisions where being two individuals rather than a couple might change the imposition of tax or entitlement to benefits. In terms of the low-income community, the amount of tax credits and other state benefits payable is one of the main reasons why two individuals might wish to claim they are not a couple when, in fact, they are. Of course, such deliberately incorrect assertions constitute fraud. We do not condone such behaviour in any way, but seek to highlight in this report where people might legitimately take a different view

of their status to the state's view; and where problems are caused due to the lack of state guidance as to what constitutes a couple, or the couple's inability to provide supporting evidence for their status.

The consequences of couple status

Tax credits and some benefits available to couples are sometimes less than those for two single people in otherwise comparable circumstances, with the result that there can be a disincentive to be regarded as a couple – the so-called 'couple penalty'. The Institute for Fiscal Studies (IFS)[12] notes three possible reasons for the couple penalty:

1) some benefits provide support to one adult, but if that adult is part of a couple, the support may be reduced due to consideration of the couple's joint income;

2) in nearly all cases maximum entitlement for benefits for a couple is less than twice that for a single person;

3) benefits associated with living/housing costs often assume that a couple will not incur twice the costs of a single person.

There does seem to be a widespread belief that there is a couple penalty. A couple penalty would exist if, in some way, "two people are significantly better off (economically) living apart than living together as a result of the way the government transfers income to and from different types of household" according to research published in 2012 by the Joseph Rowntree Foundation.[13]

Where one person lives in a property, apart from the personal costs of food and so on, there are housing costs. Accommodating an extra individual in the same property would increase some of those housing costs, but they would be very unlikely to double. It is on this basis that housing benefits for a couple take account of equivalisation factors: in reality, housing costs for a couple are not double those of two individuals living separately. Indeed, on this basis the couple penalty may be illusory in some situations.

For individuals claiming tax credits, though, the couple penalty may appear to be very real. We consider tax credits further in Section 4 below, but note here some pertinent details. If two people are a couple, they are required to make a joint claim for tax credits, meaning that the income of both parties is taken into account in determining any claim; on the other hand if two people are not a couple, each may make a separate claim based on their individual circumstances. Where a claim is made as a couple, the assumption is that household bills will be lower than for two single people (hence a lower award), but also that household bills will be paid by the couple in a fair manner. Of course, this will not always be true.

It is not difficult to see why a couple might be tempted to commit fraud and deny that they are part of a couple where one member of the couple has significant income while the other individual has very little income. In this case, as a couple it is likely that no tax credits might be payable; on the other hand if they are not a couple then the individual with little income of their own might receive a significant award of tax credits. Thus, if a claim for tax credits was made, the low-income individual in the couple would be reliant on the higher earning partner to provide some financial support. In some couples, that support might not be forthcoming and hence the temptation to commit fraud by claiming tax credits as an individual increases.

An additional complication is that for tax credits purposes the couple element of any award is the same as that for lone parents as noted below.

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12 http://www.ifs.org.uk/bns/bn102.pdf; page 3

13 http://www.jrf.org.uk/sites/files/jrf/benefits-tax-families-full.pdf; page 5

There are also situations where the position may not be clear – for example, two people in an emotional relationship may share a house for a short period of time before one moves to a new residence. These two individuals might not perceive themselves as living together if the arrangement is only temporary. Would the state come to the same conclusion?

A case might be made for suggesting that the couple penalty is excessive for those on a low income and indeed the Coalition Agreement[14] suggested that it would be reduced, saying:

"We will bring forward plans to reduce the couple penalty in the tax credit system as we make savings from our welfare reforms."

It is difficult to identify anything that has been done in the tax credits system to show that the Government has met this commitment – but what they have said is that the couple penalty will be reduced with the introduction of UC.[15] This is because the personal element will be higher for couples than for single people, which is not always the case for tax credits where the couples element is the same as that for lone parents, but not the same as a childless single person. Nonetheless, there will still be a significant couple penalty even when UC is fully in place.[16] On balance, it remains financially better within the tax and benefits system for low-income taxpayers not to be treated as part of a couple.

When we look at the variations in treatment of couples, for tax purposes the general rule seems to be that unmarried couples are not recognised – and that generally leads to increased exposure to taxation. The exception to this is the HICBC where unmarried couples are recognised and increased taxation results.

For state benefit purposes, though, including tax credits, unmarried couples are generally treated in the same way as married couples so that a couple receives less benefits than two individual claimants. Some state benefits rely on marriage, though, and those are not available to unmarried couples – for example, certain bereavement benefits.

It is difficult to escape the conclusion that, where there is a difference in treatment, the state is more generous to married couples when compared to their unmarried counterparts.

For example, consider two couples in identical jobs, each with two children. One of the couples is married, but the other is not (this might not be through choice – for example, it might be due to a prior marriage not yet having ended).[17] Both couples are equally liable to the HICBC (charge raised); but if the high earner died, the unmarried couple could find themselves worse off due to the inability of the surviving partner to claim state benefits based on their late partner's National Insurance contributions (NIC) (benefit limited). This may well be exacerbated by an inability to receive a pension from their deceased partner's employer (depending on the terms of the pension scheme).

There are notable exceptions, for instance where being a couple might give rise to opportunities for artificial

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14 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/78977/coalition_programme_for_government.pdf; chapter 14, third bullet point

15 "Universal Credit takes the first steps to address the penalty on couples imposed by the benefits system by rewarding families with children." Universal Credit Impact Assessment, DWP, December 2012, para 38. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220177/universal-credit-wr2011-ia.pdf

16 Roll out of Universal Credit is being increased from early 2015, see https://www.gov.uk/government/news/plans-announced-for-accelerated-rollout-of-universal-credit-after-success-in-north-west

17 Divorce is not available at will: instead a reason needs to exist, see: https://www.gov.uk/divorce/grounds-for-divorce. Even if there appear to be grounds for divorce, the other party may not agree. In addition, there may be religious reasons why a divorce is unacceptable to the parties, or one of them.

reduction of a charge or enhancement of a benefit. In these situations, an unmarried couple may be acting as a married couple but not be caught by the definition of a couple or by any alternative provisions such as 'connected persons'.

For example, consider four individuals, each owning a property in which they live. They form two couples, one married and one unmarried. The married couple may only have one principal residence ('home') between them, whereas the unmarried couple may have one such residence each. Thus, with care, the unmarried couple could sell either property free of CGT while the married couple might be liable to taxation on the sale of one of the properties (see further discussion at Section 4.1.2 below).

Guidance on what is a couple and evidencing status as a couple

Much of this report is spent assessing whether the potential couples identified in Section 3 fall within the legal definition of a 'couple' for each tax and benefit provision. However, much of that discussion is theoretical as it presumes that the status of the couple is clear and accepted. In practice, classifying the status of the couple is often the most problematic area.

It is worth noting at this point that for most of the benefits we have looked at, there is very little guidance for claimants on:

- how a couple is defined;
- what separation means and the difference between permanent and temporary separation; or
- the types of evidence that might usefully support a change of status.

While part of the rationale for this is to avoid giving people who wish to commit fraud information on what authorities look for, it means that couples are left in an extremely difficult position – unable to really understand their status and how it will impact on their benefit and tax position with any degree of certainty. Where there is a lack of guidance, it would seem fair to give people the benefit of the doubt where they believe they have complied with the requirements. Further, where there are grey areas, it seems to be part of the human psyche to choose the most beneficial interpretation. Where there is a lack of guidance it would seem to be very difficult for the authorities to prove fraudulent intent.

Evidence also has an important role to play in the distinction between married and unmarried couples. Some of the benefits we have looked at start from the presumption that a couple who are married are to be treated as a couple unless they are permanently separated. This is generally the case even if they are not living in the same property. For unmarried couples, the presumption is that they are not a couple unless they are shown to be living together as if they were a married couple. Even though this should apply equally to those living in the same property and those who do not, from an evidentiary point of view, it is probable that those who are not married and do not live in the same property are less likely to be investigated and found to be a couple than their married counterparts. If they have always used different addresses, it is unlikely their living apart together status – that is maintaining an emotional relationship as a committed couple but living physically separately – would ever come to light.

The position of the authorities also needs to be considered. Generally speaking, they will not query a couple's status unless it is in their interest to do so – most often because claims have been made for a benefit on a single basis rather than a joint basis which has resulted in a higher award than would otherwise have been the case.

As far as the authorities are concerned, they will seek to establish whether a couple are living together by reviewing data such as:

- the postal addresses of the two parties;
- in whose name(s) are bills to the house addressed;
- address used by the DVLA for driving licences;
- joint financial commitments, for example loans, mortgages, bank accounts and so on.

This data is readily available to HMRC but many individuals may not have similar access to the information, not only because of the cost of obtaining it, but also because they may not realise its importance. In addition, individuals may have no rights to obtain information about bank accounts and so on in the name of their partner. Similarly they will have no control over the address used by their partner for their bills or other documentation, whether or not the partner lives in the same property.

4. Main areas of tax and benefit rules affecting couples

Introduction

This section of the report analyses several tax and benefit provisions where a couple might need certainty as to their status. Each such provision is analysed with a short overview of the relevant legislation demonstrating how couples are defined and the treatment that flows from the classification as a couple. Appendix 7 provides further legislative background for those with a specific interest. In Section 5 below we consider the relevant departmental guidance and consider how this is applied in practice.

We cover the following tax and benefit provisions:

4.1 Tax provisions

- 4.1.1 Transferable allowances, including:
  - 4.1.1.1 Married couple's allowance
  - 4.1.1.2 Blind person's allowance
  - 4.1.1.3 The transferable allowance introduced by Finance Act 2014;
- 4.1.2 Capital taxes
  - 4.1.2.1 Capital Gains Tax;
  - 4.1.2.2 Inheritance Tax;
- 4.1.3 Provisions affecting family businesses (settlement provisions)
- 4.1.4 Statutory residence test
- 4.1.5 High Income Child Benefit Charge

4.2 Benefit provisions

- 4.2.1 Tax credits
- 4.2.2 State benefits

4.1. Tax provisions – An introduction

Many couples will come into contact with the income tax system – most as a result of their earned income, but also as a result of receiving pensions or savings income.

When income tax was first introduced in 1799, single women were taxed on their own income in the same way as single men, but all the income of a married woman was treated as that of her husband. From its earliest days, therefore, income tax has recognised the marriage relationship and the fact that a couple might be taxed differently from two individuals. Although the current tax system no longer treats married women in the same way as it did in 1799, married couples continue to be treated differently in some respects to their unmarried counterparts and we consider this further in the sections that follow.

As we have observed in Section 3 above, there are other types of couple as well as married couples. In some cases, both tax and benefits legislation struggles to define those couples that are subject to specific provisions. We examine some of those issues in this section.

4.1.1. Transferable Allowances

Personal reliefs are intended to be just that – available to the individual and not able to be transferred. But in some cases, special treatment is given to married couples, enabling them to transfer certain allowances to their spouses in order to reduce the couple's overall tax bill. We established at Section 3 above that it should not prove difficult to establish whether a couple is married – but in some cases that is inadequate and it is necessary to establish if the couple have separated and under what circumstances.

Below we examine three transferable allowances and comment on the provisions that a married couple would need to be aware of. Further narrative on some of these provisions is contained in Appendix 7, where appropriate.

4.1.1.1. Married couple's allowance (MCA)

Introduction

If two people are married and at least one of them was born before 6 April 1935, they may be entitled to claim the MCA which can reduce their tax bill. There is only one MCA per couple. The maximum allowance for 2014/15 is £8,165 – with tax relief at 10%, this equates to a maximum potential tax saving of £816.50. The minimum allowance is £3,140 at 10% – that is, a potential tax saving of £314. It is important to note that the allowance operates as a tax deduction from the recipient's overall tax liability, but the tax deduction itself is not repayable (although applying the deduction may mean that other tax deducted from an individual's income may become repayable).

The MCA is restricted from the maximum amount (as noted above) once the adjusted net income [18]of the recipient spouse for the year exceeds £27,000 (2014/15 level), but not below the minimum amount. For this reason, and because one party to the marriage/civil partnership has to have been born before 6 April 1935, this allowance is of limited benefit to married couples.

MCA is generally payable to the husband (for marriages in existence at 4 December 2005 – the 'old' regime) or to

18 S58 Income Tax Act 2007

the spouse with the higher income (for marriages on or after 5 December 2005 – the 'new' regime). For couples who would otherwise fall under the old regime, an irrevocable election[19] is possible to place them in the new regime.

If the recipient spouse has insufficient income to use the full tax deduction, it is lost unless it can be transferred, by way of an election, to the other spouse (see below).

It is possible for each spouse to claim one half of the minimum allowance,[20] without requiring the agreement of the spouse to whom the allowance would normally be awarded. Indeed, all of the minimum allowance may be transferred to the other spouse, but that requires a joint claim[21] by both spouses. Should the recipient spouse be unable to use their allocation of allowance, then any unused portion may be transferred to the other spouse via an election.

Legislation

The relevant legislation is found in sections 42 to 55 Income Tax Act 2007. There are two main requirements in the legislation that are relevant to claimant couples:

1) The individuals must be married or in a civil partnership for the whole or part of the tax year; and

2) The individuals must be living together.

Is the couple married?

One might assume from our discussion at Section 3 that this was easily decided: indeed there have been very few cases in this area, but the leading case as far as MCA is concerned is *Rignell (Inspector of Taxes) v Andrews – [1990] STC 410*.

Mr Andrews had lived with his 'common law'[22] wife for a long period of time, but they were unable to marry because of her agoraphobia. The case held that for the purposes of the Income and Corporation Taxes Act 1970 (a predecessor enactment to the Income Tax Act 2007), the term 'wife' was confined to a woman with whom the taxpayer had entered into a relationship of marriage recognised by the civil law of England. (Note that this then excludes polygamous marriages.)

Mr Andrews was a taxpayer resident in England. The position in Scotland was slightly different, as can be seen in the discussion above at Section 3.

Are the members of the couple living together?

Section 1011, Income Tax Act 2007 explains further what constitutes 'living together' for MCA (and indeed this same definition is used to define living together for other tax purposes, as referred to later in this report):

> "References to married persons, or civil partners, living together
>
> Individuals who are married to, or are civil partners of, each other are treated for the purposes of the

19 S44 Income Tax Act 2007

20 S47 Income Tax Act 2007

21 S48 Income Tax Act 2007

22 We understand there is no legal status of 'common law spouse', but use the term here as it will be widely understood in this context.

Income Tax Acts as living together unless –

(a) they are separated under an order of a court of competent jurisdiction,

(b) they are separated by deed of separation, or

(c) they are in fact separated in circumstances in which the separation is likely to be permanent."

This means that married couples are not obliged to live in the same property in order to be eligible for the MCA; those who live apart together, maintaining an emotional relationship as a committed couple but not living under the same roof, but who are not separated in one of these three ways will be entitled to the allowance. The term 'separated in circumstances likely to be permanent' therefore appears to refer to emotional separation or emotional and physical separation together but not physical separation alone.

The situation is slightly more complicated for those who are living together in the same property, but no longer have an emotional connection. If such a couple is separated under a court order, separated by deed of separation or separated in circumstances likely to be permanent then they will not qualify for the allowance even if they are still married. However, if the emotional separation is temporary so that it falls short of 'circumstances likely to be permanent' then they will be treated as living together for MCA purposes and entitled to claim the allowance.

Fairness, consistency and certainty

It seems unfair that the MCA is restricted to couples who have a legal document. For many benefits purposes, including the HICBC (a tax charge based on eligibility for a state benefit), couples who live together as if they were a married couple, or as civil partners, are treated in the same way as married couples. Thus it appears unfair that such couples are denied what is a small reduction in their tax bill. Also, because of the age required to make the claim, ever fewer couples will be eligible for the allowance in any case.

The MCA was introduced to continue within the independent taxation system the favourable treatment of married couples; but, other than for political motives, it seems inconsistent that the benefits system and the HICBC treat all couples similarly while the MCA favours only those couples who have entered a legal arrangement. Even for a couple qualifying for the MCA, the legislation is 'untidy' in that only a proportion of the MCA is available in the year of marriage while the full allowance is available in the year of separation. Given the number of new marriages taking place in this age group, it seems like an unnecessary complication.

What is clear is that eligibility to the MCA is certain – albeit that dates of separation may become blurred. Nevertheless, it would appear that a claim to MCA would be unlikely to be questioned where a married couple continued to occupy the same property, even if they were separated. Such a claim might be negligent, if made in error or continued without question, or fraudulent if made knowingly.

Further commentary on MCA including the entitlement to MCA in the year of marriage, separation and death and eligibility for it by EEA nationals is included in Appendix 7.

4.1.1.2. Blind person's allowance (BPA)

Introduction

BPA was introduced in the Finance Act 1962. It appears that blind people were given preferential treatment above people with other disabilities only because there was an existing system for registration as blind, which made it easy to check eligibility.

The allowance was given to the man if he was married, even if it was his wife who was blind, since at that time he was taxed on his wife's income. Hence, it seems, the allowance has been in one sense or another transferable from the start – and that did not change with the introduction of Independent Taxation in 1990, which broadly intended that individuals should each be taxed on their own income and gains.

Legislation

The legislation is found in sections 38 to 40 Income Tax Act 2007. In order to be able to transfer unused BPA to a spouse, the spouse needs to be living with the blind person for the whole or part of the tax year, and the same test s used to determine eligibility as for the MCA (see section 4.1.1.1 above). Thus it seems likely that couples that live apart together such that they have an emotional relationship but do not necessarily share the same postal address would have no difficulty in claiming that they were married for this purpose. For couples who were separated, similar arguments apply as for the MCA above.

Only any balance of the allowance that is unable to be used by the blind person themselves may be transferred to their spouse.[23] This contrasts with the MCA where all of the minimum allowance may be transferred to the other spouse with the consent of the spouse who is eligible to receive it.

There are very few individuals who claim BPA, although it is likely that more would be eligible. It seems that there are about 360,000 eligible registrations,[24] although it is not clear how many of them would be able to use the extra allowance. Even if all those eligible were to claim, and many of those may be in unmarried relationships, the cost of extending transferability to all couples is likely to be minimal. The maximum tax cost is £446[25] a head for a basic rate taxpayer. This is unlikely to be the cost in the majority of cases, since many blind people would have no net tax liability or no partner to whom to transfer unused allowance or where both have no net tax liability and so cannot make any use of it. It is true, though, that the relief is not restricted to the basic rate, so that some higher rate taxpayers might benefit from it.

These first two transferable allowances, the MCA and the BPA, thus use the same definition for determining eligibility to transfer allowances to a spouse. The third allowance we consider below uses a different definition for separation.

4.1.1.3. Transferable Allowance for Married Couples (TAMC)

Introduction

The Conservative think tank, the Centre for Social Justice, produced a paper in 2007 recommending the "transferring of tax allowances between married couples…… to support the institution of marriage because of its proven advantages to children and the wider society."[26]

The Conservative Party manifesto in 2010 suggested an allowance of £750: "We will recognise marriage and civil partnerships in the tax system: basic rate taxpayers will be able to transfer £750 of their tax free PA to their partner in order to reduce their partner's income tax bill. This will be worth up to £150 a year per couple. We will end the couple penalty in the tax credits system as we make savings from our welfare reform plans."[27]

23 S39 Income Tax Act 2007

24 http://fightforsight.org.uk/sight-loss-facts

25 BPA for 2014/15 is £2,230. Basic rate tax is 20%, so max cost is £446.

26 Social Justice Policy Group, Breakthrough Britain: Volume 1 Family Breakdown

27 Modern Conservatism: Our Quality of Life Agenda (Manifesto 2010)

As can be seen from the language used, politically this allowance was to be used to support marriage and civil partnerships as distinct from cohabiting couples.

The Autumn Statement of 2013[28] confirmed the above proposal, recommending a transfer of £1,000 of unused allowances be possible from April 2015 provided that two conditions were satisfied:

1) the recipient spouse was not a higher or additional rate taxpayer; **and**

2) the couple did not claim the MCA.

The Budget in March 2014 confirmed this intention and increased the amount that might be transferred to £1,050 – 10% of the PA for the 2015/16 tax year; subsequently the Autumn Statement in 2014 increased the PA to £10,600 and, accordingly, the maximum amount that might be transferred increased to £1,060. That would still only provide a modest benefit of a maximum of £212 to married couples and civil partnerships who qualify, still less than the minimum amount that might be obtained for older couples via MCA (see section 4.1.1.1 above).

Legislation

The legislation, contained in sections 55A to 55E Income Tax Act 2007 (introduced by section 11 Finance Act 2014) refers to spouses and civil partners. Elections are made 'for the tax year' so no splitting of the tax year is envisaged. In other words, even if you marry on 5 April, the full amount of transferable allowance for that year is available to you or your spouse, subject to the other conditions being satisfied.

The legislation does give specific guidance on what happens when a marriage comes to an end:

> "A marriage comes to an end if any of the following is made in respect of it—
>
> (a) a decree absolute of divorce, a decree of nullity of marriage or a decree of judicial separation, or
>
> (b) in Scotland, a decree of divorce, a declarator of nullity or a decree of separation."

This is an interesting departure from other definitions: it establishes a definite date for when a marriage ends – and does not depend on the intention of the couple, nor where they physically live. Instead it is based on a legal document. The amount of tax at stake is very small in this case, but it does give a precise definition. For low-income taxpayers, being able to provide such a legal document may prove to be beyond their means, but of course the transferring spouse may choose to withdraw the election that would otherwise transfer the unused allowance.

This definition of when a marriage comes to an end is different from other tax provisions, particularly those in relation to the MCA, so it may cause confusion. Nevertheless it provides certainty for the couples involved. We refer below (at appendix 10) to an administrative option to establish 'couple' status for all tax and benefits purposes.

Scotland and the new transferable allowance

The SNP published its White Paper, 'Scotland's Future, your guide to an independent Scotland', in late 2013. It contained the following paragraph:

> "**Ending the Westminster Government's proposals for tax allowances for some married couples.** This scheme will effectively discriminate against many families where both partners work, unmarried couples,

28 www.gov.uk/government/uploads/system/uploads/attachment_data/file/263942/35062_Autumn_Statement_2013.pdf; page 63

widows, widowers, single parents and women who have left abusive relationships. Under the proposed system, around two-thirds of all married couples will not benefit and analysis of the proposals suggest that couples with children are much less likely to receive the full allowance and that many low and middle income married couples are likely to have much of the tax break clawed back through the benefits system. The Institute for Fiscal Studies has noted that because of the way the scheme will operate some people will be worse off after a pay rise and that even if a government wanted to reward marriage through the tax system there are simpler ways of doing so. With access to tax and benefit powers the Scottish Government will make a different choice from that made by the current Westminster Government. Our priority is to help families with children by expanding childcare provision."

Although Scotland did not vote to become an independent country, terms of the additional powers to be made available to the devolved Scottish Parliament have yet to be finalised. Accordingly, it is possible that at some point in the future this allowance may be treated differently in Scotland than in the rest of the UK – possibly leading to disputes depending on where each member of a couple lives and works.

Final comments on transferable allowances

The definition of when a couple separates is inconsistent among these allowances. Further, although all three are called allowances, only the BPA and the TAMC operate as a straightforward deduction from income; MCA is a tax deduction from an individual's tax liability. Both of these complications may confuse couples. And while we note that a married couple cannot claim both the MCA and the TAMC, it would not be difficult to conclude that they might confuse the two – particularly a lay person searching for guidance on the internet on their allowances, for example.

4.1.2. Capital Taxes

It is in the area of capital taxes that the differences in tax treatment between married and cohabiting couples may be most apparent. Low-income taxpayers might not be assumed to be significantly affected by these provisions; nevertheless many pensioners might be asset 'rich' (often due to the fact that they own their own home) while having low incomes. We therefore consider this to be an integral part of the report.

The two areas we discuss are CGT and IHT.

4.1.2.1. Capital Gains Tax (CGT)

Introduction

CGT is chargeable on the disposal, during lifetime, of any chargeable asset, whether by way of gift or sale.[29] Each individual has an annual exemption from CGT amounting to £11,000 for 2014/15.

Any gain that is chargeable to tax is treated as the highest slice of an individual's income: to the extent it falls within the basic rate band, it is chargeable at 18%; while to the extent the gain falls into higher rates, it is charged at 28%.[30]

Gifts between spouses are free of CGT, enabling significant tax planning to take place for married couples. For example, a transfer of assets from one spouse to the other may result in income arising from the gifted asset to

29 Disposal can also include the damage, loss or destruction of an asset, but those circumstances are outside the scope of this report.

30 Certain qualifying gains are subject to a potential claim for a special relief, entrepreneurs relief, and those gains are chargeable at the rate of 10%.

arise to that other spouse (but see the section on settlements below); or a sale of the asset by the recipient spouse might enable them to use their annual CGT allowance or to pay CGT at a lower rate than the other spouse.

Although there is a General Anti-Abuse Rule[31] (GAAR), designed to stop abuse of the tax system, updated guidance[32] provided by HMRC does not state explicitly, as was expected to be the case, that such tax planning between spouses would not normally be subject to those provisions and so could proceed without fear of incurring an unexpected tax charge. This omission from the guidance may be of no consequence, but in any case of doubt, professional advice should be sought.

Gifts between spouses

As noted above, such gifts take place on a no gain, no loss basis[33] while the couple are married and this continues for the tax year in which separation takes place. This means that the recipient spouse acquires the asset with a 'cost' in their hands equal to the 'cost' in the hands of the transferring spouse. The legislation requires a member of the couple to have been 'living with his spouse or civil partner' in any year of assessment. Section 288 Taxation of Chargeable Gains Act 1992 then provides that Section 1011 Income Tax Act 2007 applies to decide whether the couple are living with each other. This is the same test as for the MCA (see section 4.1.1.1 above), which is consistent with other allowances considered above but still leaves doubt as to when separation actually occurs.

Assuming they are not permanently separated, a married couple can freely move assets between them, enabling them to take advantage of any annual exemption, lower tax rate, losses or other reliefs available to one spouse rather than the other.

For example, consider a wife who owns shares that she wishes to sell. There is a gain arising of around £20,000. She can simply transfer some to her husband. Then both she and her husband sell the shares, using both annual exemptions and could avoid paying CGT. Of course, the husband is then free to use the sale proceeds as he wishes. An unmarried individual would have had to suffer the CGT or sell part of the holding now and wait until the next tax year to use another annual exemption, assuming no losses were available. Thus an unmarried individual may be at a disadvantage as compared to a married one.

Marriage breakdown

Since the ability to gift assets between spouses free of CGT ceases in the tax year following separation, it is important to arrange any such transfers in the period to 5 April in the year of separation. This might not leave much time for such tax planning – and indeed tax planning might not appear to be very important at such an emotional time.

Residence of spouses

The ability to transfer assets between spouses free of CGT continues even where the two parties are resident in different countries. This was established by the case of *Gubay v Kington [1984**] STC 99***. Mrs G had left the UK before the start of the tax year. During the tax year Mr G transferred shares to her. The case held that the transfer did qualify for no gain/no loss treatment because the couple were still 'living together' as they were not separated. HMRC's guidance[34] reflects this.

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31 Part 5, Finance Act 2013

32 http://www.hmrc.gov.uk/avoidance/gaar-part-abc.pdf, at B4 does not specifically exclude transactions between spouses.

33 Section 58 Taxation of Chargeable Gains Act 1992

34 http://www.hmrc.gov.uk/manuals/cgmanual/cg22300.htm

Gifts between unmarried cohabitees

There are special provisions[35] that deem gifts between connected persons[36] to take place at market value. It might seem that transfers between cohabitants could take place at any value since they would not be connected persons in terms of the legislation (which refers to family and business relationships in the main). This is not the case, though, since there are special provisions[37] to apply market value to any transfer that takes place 'not at arm's length'. This means that transfers between cohabitees might result in either a gain or loss arising to the individual who makes the gift.

Private Residence Relief (PRR)

Normally the disposal of one's only home is completely relieved from CGT, whether one is married or not. A married couple is permitted to have only one such home between them, even if they 'live apart together' (maintaining separate homes) as discussed earlier.

Particular issues arise where a couple separate, though, and one of them remains resident in a family home that is wholly or partly owned by the other member of the couple who is no longer resident there. The PRR relief stops after the person has vacated the house for 18 months (previously 36 months for gains arising before 6 April 2014). After that, any gain arising is assessed on a time-apportioned basis.[38]

Example – restriction of private residence relief for a separated couple

Thus if a couple, married or unmarried, have jointly owned and lived in a property for 4 ½ years before they separate and one of them moves out, any gain on the property may not be fully relieved for the person who has left. If the property was sold at the end of year 8, say, with a gain of £80,000, then the proportion of gain chargeable would be calculated thus:

Total gain	£80,000
Gain attributable to individual	£40,000
Gain able to be relieved	
$\frac{4\frac{1}{2} + 1\frac{1}{2} \text{ X } £40,000^*}{8}$	£30,000
Gain chargeable	£10,000[39]

**Note: 4 ½ is the number of years actually in occupation, 1 ½ years is the final 18 months' relief due in all cases and 8 is the total years of ownership.*

35 S18 Taxation of Chargeable Gains Act 1992

36 S279 Taxation of Chargeable Gains Act 1992

37 S17 Taxation Chargeable Gains Act 1992

38 There may be ways to avoid this situation, for example by payment of rent to the spouse who has left the property so that the relief under section 223(4) Taxation of Chargeable Gains Act 1992 applies, but that is outside the scope of this report.

39 The annual exemption, if available, or any available losses may be set against this.

The advantage for separating married couples

Accordingly, special relief[40] was introduced for married couples who separated with one spouse remaining in the family home that was owned, at least in part, by the departing spouse. The relief allows full PRR relief to be obtained by the departing spouse if various conditions are satisfied, the most important of which are:

- The property is disposed of to the spouse who remains in the property.
- No other property becomes eligible for PRR for the departing spouse.
- The disposal to the spouse who remains in residence is in connection with arrangements to end the marriage.

This is a clear advantage for married couples. An unmarried person who left such a property and allowed their family to live there could not benefit from this relief.

Unmarried couples – more than one private residence

However, unmarried couples do have one great advantage in relation to the PRR, although it is unlikely to affect many of those on low incomes. While spouses may only have one principal private residence between them, unmarried individuals may each have such a principal private residence.

Application of the legislation to potential couples

CGT is charged on an individual, but that individual's membership of a couple might affect the operation of any charges. For married couples who separate, it will be important to recognise the actual date of separation since that affects the time at which their ability to transfer assets between them free of CGT ends.

For married couples living apart together such that they each maintain their own residence to some degree, the extra issue affecting them might well be a second home that they own. A married couple may only have one property between them to qualify for PRR, so a couple with two homes needs to decide which property is to qualify for PRR. They have only two years from the time of acquiring an extra property to make that election[41] – or the matter will be decided on the facts including, for example, address used for correspondence, where any children live and attend school, where they are on the electoral register, and so on.

Although the definition of separation is the same as that for the MCA, CGT does provide extra reliefs for separated couples beyond the date of separation. This is inconsistent with other tax provisions.

As long as a married couple can identify the date of separation, they should be able to apply the rules with certainty. For unmarried couples, the position is less clear since many of them will not be aware that gifts of capital assets between them might result in a charge to CGT.

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40 Section 225B Taxation of Chargeable Gains Act 1992, introduced with effect from 6 April 2009.

41 But a recent consultation suggested that the ability to make such an election might be removed www.tax.org.uk/Resources/CIOT/Documents/2014/03/140620%20Implementing%20a%20CGT%20charge%20on%20non-residents.pdf, page 15. In the response to the Consultation, it appears that the ability to make such an election will not, in fact, be removed but instead restrictions will be made on the ability for non-UK residents to claim PRR relief and for UK residents to claim PRR relief on an overseas property www.gov.uk/government/uploads/system/uploads/attachment_data/file/380397/Implementing_a_capital_gains_tax_charge_on_non_residents_disposing_of_UK_residential_property-_summary_of_responses_FINAL.pdf, at 2.10 on page 10.

Explanation and enforcement of the rules

This is a complex area, and probably one in which unrepresented taxpayers might be non-compliant simply due to ignorance of the rules. If one delves deep enough into the HMRC area in the GOV.UK website, a whole section[42] can be found in HMRC's Capital Gains Manual dealing with transfers between spouses.

Unmarried couples might find it more difficult to find relevant information in HMRC Manuals applicable to their circumstances, as they would need to look at the section dealing with gifts. This can be found in the contents page under the general heading of Reliefs. Given that a relief may not be available, that is unhelpful.

4.1.2.2. Inheritance Tax (IHT)

Introduction

IHT is a tax that normally only arises when an individual dies. On the death of an individual, the value of his estate is calculated and, added to that total is the value (after using any reliefs or exemptions available) of all gifts he has made in the previous seven years, possibly subject to some relief by way of tapering the tax charge for gifts that took place more than three years before death.[43] It is this total amount that may be subject to a charge to IHT at the rate of 40%, subject to a nil rate band and certain other reliefs and exemptions.

Gifts between spouses domiciled (or deemed to be domiciled[44] for the purpose of IHT) in the UK, whether during lifetime or on death, are fully relieved from IHT. This means that spouses[45] may freely transfer assets between themselves without any fear of an IHT charge. This is a major advantage for married couples, particularly when combined with the transferable nil rate band (see below).

The current nil rate band for IHT purposes is £325,000 – but in many areas of the UK that may only cover the value of a modest house so this ability to transfer larger sums, without IHT consequences, to one's spouse is very important. We consider some of the main IHT implications for couples below.

Ability to transfer assets between spouses free of IHT

Taken together with the ability to transfer assets between them free of CGT, this IHT relief enables spouses to transfer assets freely. This can have important consequences – for example, it can enable assets to be held in one part of a family rather than another (perhaps where there are step-families or children of mixed parentage) and it can prevent or minimise prior or legal rights claims in Scotland.[46]

This ability to transfer assets free of IHT remains while the couple are married, whether separated or not, since

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42 At CG22000c onwards

43 But only to the extent that the total value of lifetime gifts, after deduction of various lifetime gift exemptions, exceeds the nil rate band. This is because the nil rate band is allocated first to lifetime gifts before the remainder is applied to the estate.

44 Broadly someone not of UK domicile is deemed to be domiciled in the UK for IHT purposes when they have been present in the UK for 17 out of the last 20 years, or they were domiciled in the UK within the last three years [Section 267 Inheritance Tax Act 1984].. Under general law, an individual would be domiciled in one of the constituent countries of the UK, but IHT treats domicile in any one of those countries as being domiciled in the UK.

45 We do not cover the situation for non-domiciled individuals in any detail, but note that there is a restriction of £55,000 on the total value transferable free of tax to a non-domiciled spouse. Over and above this value, transfers to a non-domiciled spouse might be 'potentially exempt' and the nil rate band could therefore apply to them.

46 In Scotland, regardless of the contents of a person's Will, certain family members can claim parts of the deceased's estate as a right. http://www.hmrc.gov.uk/manuals/ihtmanual/IHTM12201.htm

the legislation[47] refers only to transfer of "… property which becomes comprised in the estate of the transferor's spouse or civil partner…". No further explanation of the term takes place, so that polygamous relationships might also benefit (see Appendix 6.1). Thus until a couple are divorced, assets may be freely transferred for IHT purposes, although transfers from 6 April following the end of the tax year in which separation occurred may incur a charge to CGT (see above).

For unmarried couples, transfers of assets between the two partners during lifetime will be potentially exempt transfers (PETs) to the extent they are not covered by other reliefs. Such PETs attract a charge to IHT should the donor die within seven years of making the gift if the donor's IHT nil rate band has already been used up. Thus a bereaved unmarried partner might find that gifts made by their deceased partner during lifetime have used up a significant part of their nil rate band, meaning that assets passing to them on their partner's death might attract an IHT charge. Where the asset attracting the charge is the family home, this can have undesirable consequences for the family. Although the laws of succession and inheritance fall outside the remit of this report, given a law introduced in Scotland in 2006 relating to deaths of cohabitees, more unmarried couples may find themselves facing such a charge to IHT.

Death of cohabitee in Scotland

The Family Law (Scotland) Act 2006 introduced a statutory definition of cohabiting for the purposes of that Act. This definition is to be used in deciding whether a claim might be made against the estate of the deceased cohabitee, if they die intestate (that is, without making a Will). These provisions came into force on 4 May 2006.

> "***25 Meaning of "cohabitant" in sections 26 to 29***
>
> 1) In sections 26 to 29, "cohabitant" means either member of a couple consisting of—
>
> (a) a man and a woman who are (or were) living together as if they were husband and wife; or
>
> (b) two persons of the same sex who are (or were) living together as if they were civil partners.
>
> 2) In determining for the purposes of any of sections 26 to 29 whether a person ("A") is a cohabitant of another person ("B"), the court shall have regard to—
>
> (a) the length of the period during which A and B have been living together (or lived together);
>
> (b) the nature of their relationship during that period; and
>
> (c) the nature and extent of any financial arrangements subsisting, or which subsisted, during that period.
>
> 3) In subsection (2) and section 28, "court" means Court of Session or sheriff."

It should be noted that the past tense in the definition is used so that the survivor of a cohabitee might make a claim against their estate: it does not include cohabitees who have separated. Such surviving cohabitees have the right to claim against the estate of their deceased partner up to the amount they might have claimed if they had been married.

Note that this is an evolving area of law in Scotland and the Scottish Law Commission have already suggested some changes. The effect, though, is that an unmarried surviving cohabitee may make a claim on the estate of their

47 Section 18(1) Inheritance Tax Act 1984

deceased partner – and that could lead to IHT charges that would not have arisen if the couple had been married. As well as making claims on death, cohabitees might also make claims where they separate. Bearing in mind that there is no relief from CGT for such transfers, it is possible that tax charges might arise.

Because this provides a statutory definition of cohabiting, it is worth spending a little time examining some of the cases that have already appeared before the Scottish courts as well as the proposals made for changes.

The first case to come before the courts was *Savage v Purches*.[48] In this case, Mr Savage made a claim against the estate of his late cohabitee. Although the judge agreed that a claim might be brought, he awarded nil on the basis that Mr Savage had already received part of a pension lump sum and an adult dependant's pension.

In cases[49] involving separation, the courts have focussed on whether the relationship has caused economic advantage or disadvantage to the claimants.

The Scottish Law Commission has made the following recommendation regarding claims on cohabitee's estates:[50]

> "The court has to be satisfied that the applicant was the deceased's cohabitant immediately before the deceased's death. This means that immediately before the deceased's death, the applicant and the deceased were living together as husband and wife or as civil partners. In determining whether they were living together in this way we think that it would be useful to direct the court to the most important relevant factors. These are:
>
> (a) whether the parties were members of the same household,
>
> (b) the stability of the relationship,"

The Commission suggested also taking into account the following factors in determining a cohabitant's status following the social security case of ***C**rake v Supplementary Benefits Commission [1982] 1 All ER 498:*

> "(a) whether the parties had a sexual relationship,
>
> (b) whether the parties had children together or have accepted children as children of the family, and
>
> (c) whether the parties appear to family, friends and members of the public to be a married couple, civil partners or cohabitants. This will cover two situations. First, when a couple pretend to be married or in a civil partnership but are not: and secondly, couples who state openly that they are not married or have not registered a civil partnership but nevertheless live together."

In addition,

> "there should be an express provision that a person does not cease to be a cohabitant of another person by reason only that they are separated by hospitalisation, imprisonment, service overseas and other similar reasons."

Accordingly, the Scottish Law Commission proposed that the statutory definition of cohabitee in Scotland be amended to incorporate the factors that are used for tax credits purposes (see definition of cohabitee in Scotland).

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48 This was a case heard in Falkirk Sheriff Court on 19 December 2008 – see http://www.scotcourts.gov.uk/search-judgments/judgment?id=0b9287a6-8980-69d2-b500-ff0000d74aa7

49 See, for example Gow v Grant [2011] CSIH 25: http://www.scotcourts.gov.uk/opinions/2011CSIH25.html and Harley v Robertson [2011] http://www.scotcourts.gov.uk/opinions/A41_11.html

50 http://www.scotlawcom.gov.uk/publications/reports/2000-2009/; report 215 on succession; page 66 et seq

Use of deceased spouse's nil rate band – the transferable nil rate band

In the past, many couples undertook significant planning to try to ensure that maximum benefit was taken of each spouse's IHT nil rate band. More recently, legislation[51] allows a spouse's unused nil rate band to be used by their surviving spouse. Thus, in the common situation where a large part of an estate is left to a surviving spouse, the second spouse may use both nil rate bands to mitigate IHT on their subsequent death.

Such opportunity is not available to unmarried couples: any assets transferred on the first death will be within the scope of IHT and on the second death only one IHT nil rate band will be available. This is a very significant advantage to married couples, allowing, as it does, significant assets to flow, free of IHT, to their chosen beneficiaries.

Example – contrasting a married couple against an unmarried couple

Thus imagine two couples, one of whom is married, while the other is not. The four individuals each own property worth £200,000 and on the first death, in each case, the property is left to the surviving member of the couple. On the second death, then, each person could be assumed to have an estate of £400,000, while the current nil rate band for IHT purposes is £325,000. For the couple who were not married, the survivor's estate will pay IHT on £75,000 at 40%, ie £30,000. Contrast that with the widow/er who can use their deceased spouse's nil rate band as well as their own. Their joint estate could be up to £650,000 (at current rates) before any IHT would be paid.

Pensions

Spouses often (but not always) have the opportunity to 'inherit' pension rights that had accrued to their deceased spouse – so-called widow's pensions. In addition, on divorce, the value of pension rights can be taken into account in dividing the assets of the couple. In either of these situations, such transfers of benefits take place without IHT charge.

Unmarried couples generally have no such rights. Moreover, where an individual dies with undrawn pension benefits, the trustees of the pension scheme will often have the ability to 'choose' to whom death benefits might be paid, unless the deceased had expressed a specific request for benefits to be paid in a particular manner. Many schemes, for example the Civil Service Classic Scheme, would pay the death benefits to the personal representatives of the deceased. Unless the unmarried partner was a beneficiary under the deceased's Will, they may receive nothing. This pension scheme would recognise illegitimate children, however, for the purposes of paying a dependant's pension. The NHS pension scheme operates similarly. Both schemes note that even if the scheme member was separated, the death benefit lump sum would be paid to the surviving spouse unless the deceased had nominated someone else to receive that benefit; that entitlement would end only on divorce.

Application of the legislation to potential couples

Again married and unmarried couples are treated differently, but there is no need to examine whether a married couple is separated or not: as long as they remain married, regardless of separation, the IHT regime continues to treat them as married.

This definition of a couple that ignores separation is different from other areas examined in this report.

As it is easy to establish whether a couple is married or not, the legislation does provide certainty to the individuals concerned.

In the main, IHT compliance will only become an issue on the death of an individual. At that time, his personal

51 Sections 8A to 8C Inheritance Tax Act 1984

representatives or executors must deal with his estate. If there is a significant value to the estate, then commonly a solicitor will be involved who will provide guidance. That is not necessarily the case, though, and lay people can deal with an estate. HMRC guidance[52] covers the basic requirements including valuing jointly-owned property and dealing with lifetime gifts. A further section[53] covers the transferable nil rate band for spouses.

The HMRC Inheritance Tax Manual[54] does provide a very good summary of what constitutes a spouse or civil partner. HMRC Manuals, however, are not written with the lay person in mind, and are unlikely to be the first port of call for the unrepresented, if in fact they locate them at all, which is doubtful.

4.1.3. Settlement Provisions

Introduction

At first, it might be considered that legislation relating to settlements (or trusts) might have no relevance for most couples – and especially so for low-income couples. Unfortunately, because of HMRC's stated opinions in relation to the ownership of various family businesses, this is far from the case. There are other areas, too, where this legislation will be of importance.

This being an area that may be unfamiliar to many readers, we set out the background in some detail in Appendix 7 while concentrating mainly on the consequences of the legislation in this section.

Background information on settlements or trusts

In the UK, broadly an individual is taxed on all income arising to them. In addition, certain types of transactions lead to profit or gains that are treated as income of the individual. This can be the case for income arising to settlements or trusts, in particular. In other words, the income of the settlement may be assessed on an individual settlor rather than on the trustees of the settlement. It is important in this context to realise that HMRC might consider a settlement or trust may have been created for the purposes of these provisions where there has merely been a gift from one individual to another, although outright gifts between spouses are exempted from these provisions.

Legislation

The legislation is set out in Chapter 5, Part 5 Income Tax (Trading and Other Income) Act 2005 and seeks to tax an individual on income that arises on an asset that they have previously given away. We will concentrate our narrative on family businesses as that is an area where issues might commonly arise for couples.

At first blush, it might be easy to think that the legislation applies only to spouses. Section 625 applies the charge to income tax on the individual who made the gift (the settlor) in relation to income arising where the settlor **or their spouse or civil partner** will or may receive benefit from the gift. In other words, this is widely drawn – there only needs to be a possibility of receiving a benefit for the income to be taxed on the settlor. There are various exceptions, but we will only examine the legislation as it affects couples.

For the purposes of this legislation a spouse or civil partner does not include:

- one from whom the settlor is separated under a court order or separation agreement; or

52 https://www.gov.uk/valuing-estate-of-someone-who-died

53 https://www.gov.uk/inheritance-tax/leaving-assets-spouse-civil-partner

54 http://www.hmrc.gov.uk/manuals/ihtmanual/IHTM11032.htm

- one from whom the settlor is separated where the separation is likely to become permanent;
- the widow/widower/surviving civil partner of the settlor (in other words a settlement can be set up by a husband where his wife can benefit after his death and will be excluded from these provisions);
- a person the settlor may marry/register a civil partnership with in the future.

The first two bullet points are similar to a negative version of the definition in section 1011 ITA 2007 that is used to describe living together (see section 4.1.1 above). Rather than introduce a further definition, it may have been more helpful to have some consistency in the terms used. The legislation clearly targets gifts to a settlement from which spouses and civil partners might benefit, but HMRC consider that the legislation covers other circumstances too.

HMRC opinions on businesses involving spouses/cohabitees

As we have seen above, HMRC argue that certain gifts actually constitute settlements, without there being a trust deed in existence. Indeed, the former Inland Revenue's Tax Bulletin 64 of April 2003[55] contained a long article on Businesses, Individuals and the Settlements legislation. Most tax professionals did not agree with the examples given. But the area remains contentious.

The original Tax Bulletin article contained the following comments showing where the Inland Revenue might have considered that income paid to another business owner might be taxed on someone else (the settlor):

- "Main earner drawing a low salary leading to enhanced profits from which dividends can be paid to shareholders who are friends or family members.
- Disproportionately large returns on capital investments.
- Differing classes of shares enabling dividends to be paid only to shareholders paying lower rates of tax.
- Dividends being waived so that higher dividends can be paid to shareholders paying lower rates of tax.
- Income being transferred from the person making most of the profits of a business to a friend or family member who pays tax at a lower rate.

There are a wide range of arrangements that can potentially be caught by the settlements legislation which do not involve a trust. Each case will depend on the facts but some of the most common situations which we see are:

- Shares subscribed at par that carry only restricted rights.
- Shares given away that carry only restricted rights.
- Shares subscribed at par in a company by someone else where the income of the company derives mainly from a single employee.
- A share in a partnership gifted or transferred below value.
- Dividend waivers.

55 http://webarchive.nationalarchives.gov.uk/20110620155444/http://hmrc.gov.uk/bulletins/tb64.pdf

- Situations where dividends are paid only on certain classes of shares.

- Dividends paid to the settlor's minor children."

Thus it can be seen that the Inland Revenue took the view that for businesses owned by couples, any profits should be allocated for tax purposes in the proportion that they were 'earned'.

As a result of unrest in relation to the above article, in February 2004 the Inland Revenue issued a Revenue Interpretation – RI 268[56] – that provided further narrative without changing their opinion. The Inland Revenue were keen to confirm that any case would have to be considered taking account of all the relevant circumstances. Many accountants and tax practitioners remain opposed to HMRC's (and previously the Inland Revenue's) position. Thus it is difficult to see how an unrepresented couple might fulfil their self assessment obligations.

HMRC have pursued a number of cases in this area, the best known being *Jones v Garnett [2007] All ER (D) 390 (Jul)* (otherwise known as *Arctic Systems*). Further details are contained in Section 5.

There are cases involving minor children, but we have not found any cases where a cohabitee rather than a spouse or civil partner has been involved (though they may be difficult to identify). This is despite HMRC stating the legislation applies equally to other relationships:

> "We have been asked to reconsider the application of the settlements legislation to family/company arrangements as it has been suggested these involve special factors. We consider this is a misunderstanding of the settlements legislation which was enacted specifically to prevent individuals avoiding tax by diverting income to a family member or friend."[57]

Implications for couples with jointly owned businesses

HMRC require an individual to self assess any settlement income and report it on the trust and estates pages of the tax return. Given that there is disagreement and uncertainty in the way this legislation is interpreted, it seems unlikely this often takes place, but HMRC's interpretation appears to be that couples, whether married or not, would all be treated the same. However, given the tax cases that have already been heard, it seems more likely that married couples might be more easily identified and targeted for HMRC attention in this area than unmarried couples.

As a final note, the then Government stated that they would legislate to reverse the Jones v Garnett decision.[58] Subsequent to that, in the Pre Budget Press Release of 2008,[59] they announced the matter would be kept under review. To date, no further legislative change has taken place.

Guidance

Guidance on this legislation is provided in the Trusts Manual at TSEM4200[60] onwards:

> "Where the settlor has retained an interest in property in a settlement, the income arising is treated as the

56 http://www.litrg.org.uk/NR/rdonlyres/80640D32-BFE1-4FAE-928E-43C17EF496CD/0/RI268.pdf

57 RI268

58 http://www.hmrc.gov.uk/ria/income-shifting.pdf

59 http://webarchive.nationalarchives.gov.uk/20100407010852/; http://www.hm-treasury.gov.uk/d/pbr08_completereport_1721.pdf, para 5.103

60 http://www.hmrc.gov.uk/manuals/tsemmanual/TSEM4200.htm

settlor's income for all tax purposes. A settlor has retained an interest if the property or income may be applied for the benefit of the settlor, a spouse or civil partner."

The guidance then continues:

> "The Settlements legislation most commonly applies to arrangements involving a settlor's spouse, civil partner or minor children. However, section 625(1) makes it clear the settlor is treated as having an interest in property if 'that property or any related property is, or will or may become, payable to or applicable for the benefit of the settlor or his spouse or civil partner in any circumstances whatsoever'. It is not necessary for the settlor's spouse, civil partner or children to be the people to whom the income is transferred. If the settlor or their spouse or civil partner may benefit regardless of who else benefits then the legislation can apply."[61]

These statements are not easy for the lay reader to follow. Although there is some basic information on GOV.UK, this is limited to explaining the roles of the various parties connected with the trust[62] and defining what a settlor interested trust is.[63] In the section dealing with the income tax of trusts,[64] there is a section on settlor interested trusts, but this is not clear at all.

Application of the settlements legislation to couples

Married couples and civil partnerships

We discussed briefly what constitutes a marriage in Section 4.1.1.1. The same considerations will apply in relation to this legislation.

Unlike the MCA provisions, there is no additional requirement of the couple having to live together. However, the definitions given to the terms 'spouse' and 'civil partner' appear to give the same outcome as the MCA requirement to 'live together'.

Married couples who live apart together, that is maintaining an emotional relationship but not living under the same roof, but who are not separated under a court order, separation agreement or in circumstances likely to be permanent will be treated as spouses/civil partners for the purposes of the legislation. The term 'separated in circumstances likely to be permanent' therefore appears to refer to emotional separation or emotional and physical separation together but not physical separation alone. This means that even if a spouse lives away from the settlor, for example for work purposes, they will be treated as a spouse.

Fairness, consistency and certainty

Having separate rules for married couples and other couples does not seem fair, although it is easy to see that the writers of the legislation might have found this distinction most easy to define, particularly as cohabitation was rarely discussed at the time that the legislation was first introduced in the 1930's. Given the prevalence of couples living together as if they were married in today's society, this is an area that might seem anachronistic – indeed see the section above on HMRC's opinions on businesses involving spouses/cohabitees.

The definition of married couple is very similar to that for the MCA and so provides some consistency.

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61 Both quotes taken from TSEM 4200

62 https://www.gov.uk/trusts-taxes/overview

63 https://www.gov.uk/trusts-taxes/types-of-trust

64 https://www.gov.uk/trusts-taxes/trusts-and-income-tax

It is difficult to see how an unrepresented taxpayer might stumble across this legislation, it being counter-intuitive. Thus there can be little certainty that couples are applying it in a similar manner to each other. Even simple cases are open to interpretation. In addition, given that the legislation ceases to apply to married couples once a separation takes place, there is, as with other provisions, the possibility of dispute in connection with the date of separation.

The application of the legislation appears uncertain. While the guidance clearly points to relationships other than married couples being potential targets, and indeed that might be read into the legislation, practically it would be difficult for a taxpayer or indeed their adviser to identify all such circumstances – and it would seem that HMRC might face even more difficulties.

Explanation and enforcement of the rules

HMRC's enforcement of the rules has only really been examined in the context of businesses – and that is considered in Section 5. While the situation where a settlor has retained an interest in a settlement has been well-documented[65] as far as IHT is concerned (where broadly rules apply to ensure that the property in such settlements remains within the settlor's estate for IHT), there is little helpful information on these income tax provisions. The scant information that we have found on GOV.UK, as noted above, means that it would be difficult for the taxpayer to know that the rules might apply at all, let alone how they might make a decision to include such income on their tax return.

4.1.4. Statutory Residence Test (SRT)

Introduction

To a large extent, liability to UK taxes depends on being UK resident. Until 6 April 2013, there was no set of definitive rules to determine residence but instead HMRC guidance was generally used. This previous guidance (non-statutory) was contained in HMRC6.[66] Cases could still be disputed depending on their individual facts.[67] It is interesting to note that an example[68] in HMRC6 (Sarah in the section on ordinary residence) used an unmarried couple. Because it was not mandatory to follow the guidance, taxpayers might have found themselves uncertain in how the guidance applied to their individual situation.

There is now an SRT and we examine below the implications this has for couples.

At the outset, it should be noted that the SRT operates on an individual basis – in other words each individual needs to consider their own residence by following the rules laid out in the legislation. Although each individual considers their residence situation separately, depending on their other circumstances, they may need to consider whether they have 'sufficient ties' to the UK – and their personal relationships may affect those ties. The SRT applies on a year-by-year basis – but each tax year cannot be totally considered in isolation as the results for previous years may affect the number of sufficient ties to the UK an individual is allowed to have, while remaining

65 See HMRC Inheritance Tax Manual at IHTM14301 onwards; http://www.hmrc.gov.uk/manuals/ihtmanual/IHTM14301.htm

66 http://webarchive.nationalarchives.gov.uk/20101111063954/http:/hmrc.gov.uk/cnr/hmrc6.pdf

67 In the case of *R (oao Davies and James; Gaines-Cooper) v HMRC [2010] EWCA Civ 83*, the taxpayer sought to rely on what he considered to be Inland Revenue (as it then was) practice as contained in booklet IR20, the precursor to HMRC6. The taxpayer argued that the guidance in the booklet, while being more generous than the ordinary law, ought to be able to be relied upon to determine residence and ordinary residence for tax purposes, particularly because the Inland Revenue's settled practice was to follow the guidance. It was held that the guidance was unclear in some aspects and could not therefore found a legitimate expectation in the mind of the taxpayer. Accordingly, the taxpayer's appeal failed. Following this case, the new statutory residence test was introduced to provide more certainty.

68 Page 20, HMRC 6

non-UK resident.

The SRT was introduced with effect from 6 April 2013. It was thought from the outset that the test was likely to bring more people within the scope of UK tax: it would also be harder to become non-UK resident. The legislation determines an individual's residence by reference to a number of steps. There are two overriding automatic tests to be considered:

1) the statutory non-residence position (that takes precedence); and

2) the statutory residence position.

If an individual cannot resolve their residence position by way of one of the automatic tests, then they have to consider the number of 'ties' they have with the UK.

Legislation

The SRT was introduced by section 218 and Schedule 45 of Finance Act 2013. We noted above that the overriding automatic tests take precedence.

Automatic non-UK residence

The statutory non-residence position is satisfied if any one of five conditions is satisfied. That is then conclusive: if the individual is non-resident in the UK, there is no need to consider the SRT further.

Automatic UK residence

If an individual does not satisfy the automatic non-residence test, the next stage is to consider whether they might be UK resident under the automatic residence test.

They will be UK resident if they satisfy one of several conditions.[69] One of these is that:

- they have a home in the UK and are present there on at least a total of 30 days (regardless of the time spent there on each day) in the tax year, AND

- in a period of at least 91 consecutive days (part of which falls in the tax year) they either have no home overseas OR they have one or more non-UK home(s) in which they are present for fewer than a total of 31 days in the tax year.

If the individual has more than one UK home,[70] each is considered separately for the 30-day and 91-day counts. The legislation recognises that the definition of 'home' will depend on the facts of each case. For example, a holiday house may not be a home – but other properties not owned by the individual might be homes – for example, if a property is rented.

For example, if Alan has two homes in the UK and spends 25 days at one home but 15 days at the second home in a tax year, then he has not breached the 30-day test mentioned above because he has spent less than 30 days in one home.

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69 The automatic residence tests are in paragraphs 5 to 10, Schedule 45, Finance Act 2013.

70 Paragraph 8(8), Schedule 45, Finance Act 2013

Further guidance is provided in HMRC leaflet RDR3:[71]

> "A home can be a building (or part of a building), a vehicle, vessel or structure of any kind which is used as a home by an individual. It will be somewhere which an individual uses with a sufficient degree of permanence or stability to count as a home."

And later in that same document:

> "A place can still be a home even if an individual does not stay there continuously. If, for example they move out temporarily but their spouse and children continue to live there, then it is still likely to be their home."

Of course, the information in the booklet is guidance only and, as we noted above, the taxpayer may not be able to rely on guidance where it is not clear and unambiguous.

For a married person, it thus seems that their spouse's home, assuming the spouse remained in the UK and they were not permanently separated, would be a home for these purposes. Similarly, a property to which one of the couple returned regularly might be a home. Thus, unless there was any formal separation agreement, it seems that the home of the spouse would influence an individual's residence position, even if they were physically separated.

For an unmarried person in similar circumstances, the position should be similar. This is most clear if they had been living together as a married couple prior to having to rely on the SRT. However, if they were not living in the same property prior to one party leaving the UK, the home of the partner remaining in the UK might not necessarily be considered to be a 'home' for the individual whose residence situation is at stake. Even if there was a child remaining in the UK with a partner, it is not clear that HMRC would be able to argue that the property was a 'home' for the individual whose residence was being determined.

The sufficient ties tests

If neither the automatic non-residence test nor the automatic residence test is satisfied, it is necessary to consider the number of ties that an individual has with the UK. Depending on the number of ties an individual has with the UK, they are able to spend a certain number of days in any tax year in the UK before they become UK resident. The more ties they have, the fewer days they may spend in the UK before they acquire residence in the UK for tax purposes.

Examining the relevant ties

Among the ties that can be considered, there are two that require consideration in some depth with regard to couples – family ties and accommodation ties. The other ties do not depend on the individual's relationship status to any extent.

Sufficient ties – family test

Relevant to the question of residency is whether the person has a 'family tie' for a year. The legislation states that an individual ('P') has a family tie if a 'relevant relationship' exists with another person and that person is resident in the UK:

> "(2) A relevant relationship exists… if at the time:
>
> (a) P and the other person are husband and wife or civil partners and, in either case, are not separated,

71 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/381705/rdr3_1_.pdf

(b) P and the other person are living together as husband and wife or, if they are of the same sex, as if they were civil partners."[72]

It goes on to say:

"(5) "Separated" means separated:

(a) under an order of a court of competent jurisdiction,

(b) by deed of separation, or

(c) in circumstances where the separation is likely to be permanent."

Thus, separation is defined as it is in section 1011 ITA 2007 (see section 4.1.1.1 above).

There should therefore be no difference between married and unmarried couples for the purposes of this family tie. Provided they are a couple, a family tie will exist if the other member of the couple remains resident in the UK. This is clear; only if the couple are separated, will that tie end.

Proving that separation has taken place, in the absence of a formal separation agreement, might be difficult when one party is not in the UK and has habitually spent some time working away from home. HMRC have stated[73] they will use the same tests as are used for tax credits purposes to determine whether a couple are living together as if they are married (see section 4.2.1 below). There are obvious potential difficulties for couples who are separated. For example, where one of the partners returns to the UK to visit their child, possibly staying with the 'partner' from whom they are actually separated, will there be arguments that they are not actually separated if there is no formal documentation?

Sufficient ties – accommodation test

This test is complex and we will do no more than broadly paraphrase it here. An individual has an accommodation tie if he has a place to live in the UK, it is available to him for a period of 91 days and he spends at least one night there. This place to live may be a holiday home and he need not actually own it.

If the accommodation in question is the home of a close relative (defined below), then he needs to spend at least 16 nights there in order to acquire an accommodation tie.

"(6) A "close relative" is:

(a) a parent or grandparent,

(b) a brother or sister,

(c) a child aged 18 or over, or

(d) a grandchild aged 18 or over,

72 Extracted from paragraph 32, Schedule 45, Finance Act 2013

73 RDR3 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/381705/rdr3_1_.pdf

in each case, including by half-blood or by marriage or civil partnership."[74]

It is noticeable that this does not include a home of a cohabitee (presumably because that is intended to be covered by the family tie, above), but nor does it include any family of the cohabitee. Thus unmarried couples possibly obtain an advantage if one partner does not wish to be resident in the UK for tax purposes. Whether the couple were cohabiting or living apart together – that is maintaining an emotional relationship but not living under the same roof – before the individual left the UK, returning to the UK and staying at the home of a member of the family of the cohabitee will not result in the accommodation tie being satisfied.

Example – accommodation tie applying to married couples as against unmarried

So let us consider two couples. Mr and Mrs A are married. Mr B and Miss C are not. They have similar circumstances. Both Mr A and Mr B have recently taken up some work outside the UK. Prior to that they both lived in the UK as part of their respective couples. In 2014/15, neither Mr A nor Mr B satisfies the automatic non-residence test. Nor do they satisfy the automatic residence test. Over Christmas 2014, both spend 21 days staying with the parents of their spouse/partner.

Each man therefore needs to consider whether he has 'sufficient ties' with the UK to make him UK resident. Both have a family tie, because their spouse/partner remained resident in the UK. Mr A is married, so has an accommodation tie arising from staying with the parents of his wife for more than 16 days. On the other hand, Mr B has no such accommodation tie since his partner's parents are not related by half-blood or marriage.

Individual leaves the UK to take up full-time work abroad

In this case, the individual who leaves the UK for full-time work abroad will become non-UK resident from the date of departure (assuming the relevant conditions are satisfied). By statute,[75] any accompanying spouse or individual with whom the departing person lived as if they were a married couple will similarly become non-resident at that time – regardless of what the SRT would otherwise deem their residence position to be.

Fairness, consistency and certainty

The SRT will produce broadly the same results for couples, whether married or not. The only exception to this equal treatment is where a married individual acquires an accommodation tie by virtue of visiting their spouse's relatives, whereas an unmarried couple would not produce the same result.

The definitions of couples used for the SRT are consistent with those used elsewhere in the income tax legislation, including the definition of separated.

The SRT produces a result that is certain for individuals provided they are able to determine their 'couple' status properly. HMRC also published an online residence indicator that was able to be used by taxpayers, but this has not been transferred to GOV.UK. None of the guidance in RDR3 or elsewhere properly covers whether two people are a couple or are separated, for example.

74 Paragraph 34, Schedule 45, Finance Act 2013

75 Paragraph 45, Schedule 45 Finance Act 2013

4.1.5. High Income Child Benefit Charge (HICBC)

Introduction

The purpose of the HICBC is apparently to create a proxy for the politically difficult means-testing of child benefit (CB). This charge can arise to either member of a couple – so identifying the couple is of great importance.

Where any person entitled to CB (or their spouse or unmarried partner – in other words, the other member of the 'couple') has an Adjusted Net Income (ANI)[76] exceeding £50,000 for a tax year, 1% of the CB is clawed back for every £100 of such excess. This means that the HICBC cancels out the benefit fully where the ANI reaches £60,000. Alternatively, the person entitled to the CB may elect not to receive it, in which case there is no charge. Nevertheless, the person entitled to CB should claim it so that entitlement to National Insurance credits (that count towards the state pension) might arise, for example.

As this report focuses mainly on low-income taxpayers and claimants of state benefits, it might seem a diversion to comment on the HICBC. We do so, however, as it can have consequences for those on low incomes – for example, the low-income (or no-income) partner of a higher earner – and create particular issues for them, such as the need to maintain their claim to CB and consequent National Insurance credits. There might also be impacts if the household is disrupted due to separation, for example.

A low-income partner of an individual liable to the HICBC might elect not to receive CB, so that the HICBC does not arise. On separation, however, the individual is required to notify the Child Benefit Office of the change in family circumstances and request that CB is paid. GOV.UK[77] advises that CB will commence payment on the Monday following receipt of the claim in accordance with Section 13A Social Security Administration Act 1992. A low-income parent may find that they have missed out on some CB because they did not realise that a separation was permanent: indeed they may be reluctant to make the claim immediately if they hope that a reconciliation is possible. Although it is possible that they could later be awarded CB, provided they make the claim within two years,[78] such an individual may have suffered financial hardship in the meantime. GOV.UK makes no mention of the ability to make such a claim for CB that has been unpaid in these circumstances.

Another issue for the low-income partner of an individual liable to the HICBC relates to how the 'family' finances are managed. The individual liable to the HICBC may not be prepared to 'share' their income so that CB is effectively lost to the low-income partner. At the start of any relationship, discussion of financial matters may not be a priority and it is easy to see how an individual may not be sure that they and their new partner have moved in together on a permanent basis. Accordingly, they may not believe that any change in circumstance requires to be provided to the Child Benefit Office.

If the person entitled to the CB is a partner of someone 'throughout the week', and that partner has an income exceeding £50,000, the charge falls on the partner with the higher income. Entitlement to CB, and the identification of a potentially chargeable partner, are both to be judged on a week-by-week basis, since CB accrues weekly, with any consequent apportionment over the tax year.

If a person has a child living with them and some other person who is not their partner is entitled to CB for that child, but not subject personally or via their partner to the charge, the person with whom the child lives will be subject to the charge. This is referred to later as the 'vicarious charge'.

76 ANI is defined in Section 58 of ITA 2007 as "total income" adjusted mainly by pension payments, losses and Gift Aid, but not PAs.

77 https://www.gov.uk/child-benefit-tax-charge/restart-child-benefit

78 Section 13A(7) Social Security Administration Act 1992

For example, a child, Charlotte, lives with her Aunt Amy and Uncle Stuart. Charlotte's father, Frank, pays for all her upkeep and so claims CB for her. Neither Frank nor his partner have sufficient income to be liable to the HICBC, so a charge might be imposed on Aunt Amy or Uncle Stuart, if at least one of them has a sufficiently high income since they are deemed to be receiving CB by virtue of Frank's contributions towards Charlotte's upkeep.[79]

Legislation

The HICBC was introduced by Section 8 and Schedule 1 of FA 2012 and came into effect in January 2013. A person is a 'partner' of another person for HICBC purposes if any of the conditions A to D are met:

> "681G(2) Condition A is that the persons are a man and a woman who are married to each other and are neither –
>
> (a) separated under a court order, nor
>
> (b) separated in circumstances in which the separation is likely to be permanent.
>
> 681G(3) Condition B is that the persons are a man and a woman who are not married to each other but are living together as husband and wife.
>
> 681G(4) Condition C is that the persons are two men, or two women, who are civil partners of each other and are neither—
>
> (a) separated under a court order, nor
>
> (b) separated in circumstances in which the separation is likely to be permanent.
>
> 681G(5) Condition D is that the persons are two men, or two women, who are not civil partners of each other but are living together as if they were civil partners."[80]

Application of the legislation to couples

The definition of 'partner' in the legislation for HICBC purposes mirrors the tax credits legislation which is discussed fully later (see section 4.2.1). Therefore no further discussion is required here.

Fairness, consistency and certainty

In terms of the overall rules, there is a clear legislative intention to ensure that any type of couple, one or more of whom has a high income, is caught by the HICBC.

The marginal rate of tax in relation to a one-child claim is 52.6%[81] and this increases by a little over 7%[82] for each subsequent child. Whatever the couple's status, the incentive to lessen the impact will be strong, for example by paying gift aid or pension contributions (the latter perhaps now even more attractive with increased flexibility, from April 2015, to draw benefits).

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79 Section 681D Income Tax (Earnings and Pensions) Act 2003

80 Section 681G Income Tax (Earnings and Pensions) Act 2003

81 Weekly child benefit is £20.50. Annual receipt is £1,066. Withdrawing 1% per £100 of income creates a tax charge of 10.6%. That is on top of income tax of 40% and NI of 2%.

82 Each subsequent child receives £13.65 per week or £709.80 annually. Withdrawing a further 1% leads to a tax rate just over 7%.

Bringing in unmarried (different- and same-sex) couples is intended to be an equalising provision, broadly matching the qualifying conditions for CB itself. Without it, such couples would have an unfair advantage, but the marginal tax rate is so high that unmarried couples might seek escape routes, legally or otherwise.

Where one or both of a couple straddle the £50-60k income band, to comply with the law, they need to know each other's income. This is something within an income tax context that a married couple have not had to do since the introduction of Independent Taxation in 1990, and an unmarried couple have never had to do.[83] The GOV.UK website says:

> "**If you can't get information from your partner or ex-partner**
>
> You can ask HM Revenue and Customs (HMRC) whether your partner gets Child Benefit or has a higher adjusted net income than you using an online form. HMRC can only reply 'yes or no' (they won't provide any financial information).
>
> You can only do this if your income is more than £50,000 and you and your partner either:
>
> - live together
> - separated within the tax year you want the information for"[84]

The above begs the question as to what a person does if their income is not more than £50,000 and they do not know their partner's income details. No further guidance appears to be given on this point. But even if a person can use the service, the answer will still partly breach confidentiality, and could give sensitive information to someone intending to separate from a partner as it will at least give them an indication of the other's circumstances.

For couples living together as if they are married constantly in the same house, the legislation imposes a clear charge. If a couple, married or not, split and go their separate ways, the incidence of any charge will cease at the time they can show the separation became permanent. It will normally not be difficult to demonstrate that it became permanent at the time of physical separation.

In the circumstance where couples separate emotionally but not physically (that is, they continue to live in the same property) the HICBC will continue to run until the couple can show that the separation is likely to be permanent. For such a married couple, a Deed of Separation or a divorce would be conclusive. But the latter can take time and expense, and it may be difficult to persuade meanwhile on permanency. If the child is theirs, continuing shared support within the household might increase the difficulty. For an unmarried couple in similar circumstances, divorce is not relevant, but Deeds of Separation can be appropriate for settling financial matters. They should also be persuasive about the permanence of the separation.

The wording of the legislation is slightly different from that used elsewhere for both income tax and state benefits referring as it does to living together as man and wife 'throughout the week' for the HICBC to bite. While this may be a direct result of the fact that child benefit is payable weekly and therefore a time period is needed to cover separation and formation of couples, it is possible that couples could argue that they were simply not living together as man and wife throughout the week where, for example, one of them worked away from home during the week returning to the 'family home' only at weekends. Guidance is needed on this point.

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83 Other than in connection with children's tax credit.

84 See: https://www.gov.uk/child-benefit-tax-charge/pay-the-charge and the HMRC online form: https://online.hmrc.gov.uk/shortforms/form/HICBCDisc?dept-name=&sub-dept-name=&location=43&origin=http://www.hmrc.gov.uk

A similar argument might be mounted due to imprisonment or from one partner moving into a nursing home. HMRC have confirmed that such apartness would not count as 'separation' for disqualifying a married couple from MCA, but it is not clear if either of these circumstances would relieve couples from the HICBC. And would it be easier for an unmarried couple to run that argument? Schedule 1 of FA 2012 gives no guidance.

Two people who have become emotionally attached and who at that time have separate residences may well be persuaded by the HICBC to remain living in separate properties rather than become live-in partners, as they may then be able to claim not to be caught by HICBC. Or they may move in together but be tempted to maintain their existing addresses for correspondence, to make it harder for HMRC to detect the true situation – in other words, commit fraud. It seems unlikely that a cohabiting couple would separate simply because of the imposition of the HICBC unless they already had a second residence. They might however be tempted to simulate a split by declaring one partner to have moved to the second address.

HMRC took the reasonable decision to alert people individually in 2013 to the potential for being caught by the HICBC. But the impossibility, or the disproportionate cost, of linking CB claimants with taxpayer addresses meant that, in order to cover spouses/partners, the alert could only be done by a general warning issued from the tax database to everyone at or above the £50,000 income level. It therefore went both to chargeable and to wholly unaffected individuals, including some for whom it would have been highly insensitive (eg the unwilling childless). If future alerts are proposed, they need to be issued in a way which does not suggest bureaucratic callousness.

It is too early to say how closely HMRC will enforce the rules around 'partners' and whether they will carry out compliance investigations on the same scale as they have with tax credits by carrying out credit reference checks looking for suspected partners.

Conclusions

The fact that both married and unmarried couples are treated in the same way means that the charge affects all couples equally. To limit the incidence of HICBC either to married or civil partnership couples only, or to unmarried couples only, would only create unfairness. Only family or friendship partnerships escape the HICBC outright, and it is doubtful that anyone would wish to change that.

Explanation and enforcement of the HICBC rules

Prior to May 2014, in advising on the definition of 'partner' HMRC included this phrase on their website:

> "(someone) you are living with – or have lived with during a tax year – and are not permanently separated from."

It should be noted that the phrase 'or have lived with during a tax year' is not in the legislation but presumably referred to one of two things:

1) The individual needs to consider whether they have lived with a partner at any time during the relevant year rather than considering their present circumstances; or

2) As the tax charge accrues on a week-by-week basis, the individual should consider their relationship on that basis.

However, from May 2014 the material was moved from the HMRC website to GOV.UK and much of the detail has been removed. We can find no explanation of the term 'partner' on the GOV.UK or HMRC website in respect of

the charge. There is also no guidance in the notes[85] or the form[86] on which CB is claimed. The online form[87] does contain the following information:

> "If you are married or are in a civil partnership, but no longer live with your husband, wife or civil partner, you should say that you are separated.
>
> If you are separated from your husband, wife or civil partner only because you work away from them, you should say that you are married or in a civil partnership.
>
> Civil partnerships in the UK, granted under the Civil Partnership Act 2004, give same-sex couples most of the rights and responsibilities of marriage."

That information still does not provide clear guidance as to when separation might occur or a couple might be formed.

85 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/359768/ch2-notes.pdf

86 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/359765/ch2-flat.pdf

87 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344478/ch2-online.pdf

4.2. Benefit provisions

4.2.1. Tax credits – Working tax credit and child tax credit

Introduction

Although the term 'tax credits' implies that there is a relationship to income tax, these are, in fact, state benefits that are administered by HMRC. The main legislation is contained in the Tax Credits Act 2002. To some extent, the name 'tax credits' reflects that many of the rules regarding quantification of income for tax credits follow the income tax legislation, but with some modifications and disregards.

Despite the fact that tax credits replaced several DWP benefits and are considered to be benefits themselves, the Government introduced a new definition of couples for tax credits purposes that was based in part on the benefits system and in part on the tax system.

Tax credits are due to be replaced eventually by UC. The definition of a couple for UC is covered in Section 4.2.2.

Legislation

Section 3(3) Tax Credit Act 2002 states that a claim for a tax credits may be made:

> "(a) jointly by the members of a couple both of whom are aged at least sixteen and are in the United Kingdom, or
>
> (b) by a person who is aged at least sixteen and is in the United Kingdom but is not entitled to make a claim under paragraph (a) (jointly with another)"

The Act then goes on, in Section 3(5), to explain what a 'couple' is:

> "(a) a man and woman who are married to each other and are neither:
>
> i. separated under a court order, nor
>
> ii. separated in circumstances in which the separation is likely to be permanent,
>
> (b) a man and woman who are not married to each other but are living together as husband and wife,
>
> (c) two people of the same sex who are civil partners of each other and are neither –
>
> i. separated under a court order, nor
>
> ii. separated in circumstances in which the separation is likely to be permanent, or
>
> (d) two people of the same sex who are not civil partners of each other but are living together as if they were civil partners."

It is crucial to realise that this definition, in contrast with definitions for other state benefits and UC, in particular, does NOT refer to households (see section 4.2.2 for commentary on households).

Guidance

HMRC provide extensive guidance both in their technical manuals and the claimant compliance manual on what constitutes a couple. We consider this in Section 5 below. The guidance covers both married couples and unmarried couples.

Married couples and civil partners

HMRC will treat two people as a couple from the date of marriage or registration of their civil partnership, regardless of whether they physically live together or are separated physically for any reason.[88] They also acknowledge that married and civil partnership couples may be separated and living in the same property.[89]

Living together as a married couple (or as civil partners)

There is no definition in the legislation of what living together as a married couple means. HMRC acknowledge in their manual that things have changed in 'modern day' relationships.[90] In its section on short term relationships,[91] it also acknowledges that a relationship of less than three months is unlikely to satisfy the requirement to be living together as a married couple.

Application of the legislation and guidance to potential couples

Married couples and civil partners

Married couples and civil partners who are not:

- separated under a court order,
- separated by deed of separation, or
- separated in circumstances likely to be permanent

will be treated as a couple for tax credits purposes. This means that their joint income and circumstances will be taken into account when calculating their benefit.

It also means that married couples who live apart together such that they are a couple but maintain separate residences, but who are not separated in one of the above three ways will be treated as a couple. The term 'separated in circumstances likely to be permanent' therefore appears to refer to emotional separation or emotional and physical separation together, but not to physical separation alone.

The situation is slightly more complicated for those who are emotionally separated, but living in the same property. If such a couple are separated under a court order, separated by deed of separation or separated in circumstances likely to be permanent then they will not be treated as a couple even if they are still married. However, if they physically live in the same property while being separated emotionally or are separated temporarily so that it falls short of 'circumstances likely to be permanent' then it is likely they will be treated as a couple for tax credits and assessed jointly unless they can provide evidence to the contrary. The Upper Tribunal case of *DG v Her Majesty's*

88 http://www.hmrc.gov.uk/manuals/ccmmanual/ccm15035.htm

89 http://www.hmrc.gov.uk/manuals/ccmmanual/CCM15395.htm

90 http://www.hmrc.gov.uk/manuals/ccmmanual/ccm15045.htm

91 http://www.hmrc.gov.uk/manuals/ccmmanual/ccm15220.htm

Revenue and Customs (TC) [2013] UKUT 0631 (AAC) considered whether a married couple might live in the same household and be considered to be separated for these purposes. It found that it was possible and the findings here may be of use to other couples.

Another relevant case is *Holmes v Mitchell (HMIT) (1991) 63 TC 718*, which dealt with a claim for married man's allowance, where it was held that although Mr and Mrs Holmes continued to occupy the same property for several years, nevertheless they were living in separate households.

What is living together as a married couple for these purposes?

Couples who are physically and emotionally living together as a married couple will be treated as a couple for tax credits purposes and assessed jointly.

There is no requirement in tax credits that a couple be part of the same household. Therefore, under the strict wording of the legislation, a couple who are living apart together (such that they are emotionally living together as husband and wife, regardless of the fact that they maintain separate residences) could be treated as a couple for tax credits and therefore obliged to make a joint claim rather than two single claims. HMRC guidance[92] directs staff to consider six tests in determining whether two people are living together as husband and wife or civil partners. These tests are based on DWP Case law:

- Whether the couple are living in the same household
- The stability of relationship
- The level of financial support between the couple
- The presence of dependent children
- Public acknowledgement of the relationship
- Sexual relationship (this is not used any more unless information is volunteered by the claimant).

In practice, we think that it is unlikely that HMRC would link two partners who were living apart together as a couple. HMRC may not be aware of any potential links between the two individuals, as generally such couples will have separate finances as well as separate houses and addresses. HMRC's former website examples[93] suggested and their current guidance manuals[94] still suggest that HMRC place great weight on whether an unmarried couple are part of the same household and living in the same property when determining if they are living together as a married couple. So, unlike married couples, where the presumption is that they are a couple first, the opposite is true for those who might be living together as if they are a married couple – that is, they are to be treated as single unless it can be shown they are living together as a married couple.

It becomes more difficult to apply the legislation to those who are emotionally separated but living in the same property and who are neither married nor in a civil partnership: they will be treated as a couple if HMRC determine that they are living together as a married couple after applying the criteria in their guidance. Again, this is different from married couples where the presumption is they are a couple unless they can show they are 'separated in circumstances likely to be permanent'. HMRC guidance confirms that two people may live in the same household

92 http://www.hmrc.gov.uk/manuals/tctmanual/TCTM09340.htm

93 These examples are not available on the National Archives nor on GOV.UK.

94 http://www.hmrc.gov.uk/manuals/tctmanual/TCTM09440.htm

but that does not automatically mean they are living together as a married couple although HMRC guidance and procedures may act to treat them as a couple. However, the law is clear – those who are emotionally separated but still living in the same property, and who have the same degree of separation as there would be if one them had left the home, should not be treated as a couple for tax credits purposes.

Finally, those who are permanently separated both physically and emotionally will be treated as single people. Temporary separation is less straightforward for those living together as a married couple compared to *bona fide* married couples. For married couples, the legislation is clear that they are a couple if temporarily separated, whereas for those who are living together as a married couple, it appears that HMRC's main test is whether the living together as a married couple criteria apply, rather than whether the separation is permanent or temporary *per se*.

Inconsistency with DWP benefits

Tax credits legislation does not contain any reference to living in the same household whereas DWP legislation includes a same household requirement for married couples and civil partners. This means that a married couple or civil partners who remain physically separate but emotionally together could be treated as a couple for tax credits (which has no same household requirement) but as two single people for DWP benefits.

Similar issues arise for those who are living together as husband and wife or civil partners. DWP guidance is very clear that in order to be treated as living together as husband and wife or civil partners, the couple must be members of the same household. If they are not, then they will examine the relationship no further. If they are found to be members of the same household, only then will DWP examine the nature of their relationship. DWP guidance confirms that even if two people are found to be members of the same household, it does not always following that they will be living together as husband and wife or civil partners for benefit purposes. Again, the slight difference in approach means people could have a different determination than for tax credits.

Fairness, consistency and certainty

Although HMRC guidance does not state, as DWP guidance[95] does, that the rules are designed to be fair as between married couples and civil partners and their unmarried counterparts, the wording of the legislation suggests that may well have been the intention.

However, the wording used in the legislation and the guidance HMRC use has created some uncertainty. This is most evident when considering those who are emotionally separated but still living in the same property. The fact that married couples and civil partners are treated as a couple from the date of marriage or registration of their civil partnership means that where they physically live is not relevant as long as they are not separated permanently or under a court order. Permanent separation refers to emotional as well as physical separation in this instance. However, those who are not married in similar relationships living apart are not presumed to be a couple unless the living together as a married couple criteria applies: in many cases probably it will not because there will be no financial factors or household ties and therefore they are likely to be treated as single if they are not living in the same property. If there are financial ties, though, it is difficult to see how HMRC might identify those and so be in a position to assert that a couple exists.

From a consistency perspective, claimants may well fall foul of the slightly different definition between tax credits and DWP benefits, as the latter requires that both married couples, civil partners and those living together as if they are a married couple are members of the same household. DWP guidance[96] states that being members of the same household does not necessarily mean living in the same property which allows for living apart due to work

95 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296090/dmgch11.pdf, paragraph 11003

96 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/337399/dmgch11.pdf; 11051 and so on

or caring responsibilities, but generally it will indeed mean that the couple share the same home. This difference in definition is likely to be more of a problem for married couples who live apart – that is, they each maintain their own residence – as noted above.

Both married and unmarried couples are likely to encounter issues relating to certainty. For married couples and civil partners who are separated, whether or not they are separated in 'circumstances likely to be permanent' is difficult to ascertain and HMRC may well come to a different conclusion than the couple themselves. However most uncertainty relates to those who are living together as a married couple in any form, particularly when relationships are new. The point at which a relationship becomes sufficiently cemented such that the couple is living together as a married couple is difficult to ascertain, and again HMRC may well come to a different view to the couple themselves.

Explanation and enforcement of the rules

Up until May 2014, the HMRC website[97] did attempt to give further explanation as to what constitutes a couple for tax credit purposes. It included a series of examples that showed different circumstances and whether those people should claim as a couple or as two single people. These examples were HMRC's interpretation of the rules and, subject to the issues of evidence discussed in section XXX (page14/15), were generally helpful. It is therefore disappointing that when material was moved from the HMRC website to GOV.UK, this detail was lost.

We can find little information on GOV.UK about what the term 'couple' means for tax credits, although it is used in the tax credits section of the site.[98] One part of the GOV.UK tax credits material[99] says claimants should notify if a "Relationship starts or ends, eg you live with a new partner, get a permanent separation or divorce." Not only is this not accurate (by suggesting that living with someone is the deciding factor and by suggesting that there is some way to 'get' a permanent separation),[100] but it is not consistent with some information in various forms and leaflets that are held on the HMRC website.[101] A deed of separation or a divorce will involve a couple in incurring significant costs they may be unable to afford. In the same vein, moving out of a shared home into another may prove beyond the means of some couples and hence they remain in the same property. Further, when some couples separate, even though one partner leaves the previous home, they may not immediately find any permanent accommodation elsewhere and resort to living with friends, sleeping on sofas or in their cars, for example. Thus the 'absent' partner may not change their address for some time after they leave their previous home.

On the issue of enforcement, tax credits compliance interventions into undisclosed partners are continuing to rise. From late 2014, HMRC have been using a private company, Concentrix, to carry out compliance interventions allowing them to carry out greater numbers. HMRC also can obtain credit information from Experian, the credit reference agency.[102]

In our experience, most investigations are of single claims where HMRC believe there may be an undisclosed partner. It is much rarer to see HMRC investigating a couple claim to find out whether they really are a couple. This

97 http://www.hmrc.gov.uk/manuals/tctmanual/TCTM06100.htm; http://www.hmrc.gov.uk/manuals/tctmanual/TCTM09320.htm; http://www.hmrc.gov.uk/manuals/tctmanual/TCTM09330.htm; http://www.hmrc.gov.uk/manuals/tctmanual/tctm09350.htm; http://www.hmrc.gov.uk/manuals/tctmanual/tctm09360.htm

98 https://www.gov.uk/claim-tax-credits/joint-claims

99 https://www.gov.uk/changes-affect-tax-credits

100 Although a Deed of Separation can be drawn up, this involves a cost to the couple, which might be beyond the means of many low-income tax credits claimants.

101 For example http://www.hmrc.gov.uk/leaflets/wtc2.pdf or http://www.hmrc.gov.uk/leaflets/wtc1.pdf where couples are described.

102 See for example HMRC's Debt Management Manual, DMBM666570: http://www.hmrc.gov.uk/manuals/dmbmanual/DMBM666570.htm

is because there is much more financial incentive to claim as a single person due to the fact that only one income is then taken into account. These investigations rely heavily on the credit reference data to show that two people are either living together as a married couple, or are a married couple who are not 'separated in circumstances likely to be permanent'. We discuss this further in Section XX (page 14/15) which looks at the role of evidence in establishing couple status.

4.2.2. State Benefits

Introduction

Whether or not two people are part of a couple is an extremely important issue for many state benefits. This section looks at the definitions used for state benefits and the consequences that flow from those definitions for potential couples.

DWP guidance[103] states that the general principle in Social Security legislation is that couples should be treated in a similar way. So that a couple who are living together as a married couple or civil partners should be treated in the same way as if they were married or in a civil partnership. It goes on to say that:

> "the principle behind this is that an unmarried couple or couple who are not in a civil partnership should not be treated more or less favourably than a married couple or couple in a civil partnership."

While the tax provisions we have looked at do not generally apply to unmarried couples or those who are not in a civil partnership, by contrast living together has been part of Social Security legislation since 1948. Originally the couple definition included those 'cohabiting with a man as his wife' which was then replaced in 1977 with the concept of living together as husband and wife. Throughout this report, we refer to this more generally as living together as a married couple, given that in parts of the UK same sex marriages are now possible.

Legislation

Most means-tested DWP benefits, including UC, use the same definition of a couple.[104] It is important to appreciate that this definition is not the same as that used to define a couple for tax credits purposes, as mentioned in Section 4.2.1 above. For these means-tested benefits a couple means:

> "(a) a man and woman who are married to each other and are members of the same household;
>
> (b) a man and woman who are not married to each other but are living together as husband and wife;
>
> (c) two people of the same sex who are civil partners of each other and are members of the same household;
>
> (d) two people of the same sex who are not civil partners of each other but are living together as civil partners."

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103 Paragraph 11003 DMG Chapter 11 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296090/dmgch11.pdf

104 1 SS (C&B) Act 1992, s 137; IS (Gen) Regs, reg 2(1); SS (C&P) Regs, reg 2; SFCWP (Gen) Regs, reg 1(2); SFMFE (Gen) Regs, reg 3(1); SS (IFW) (Gen) Regs, reg 2(1); JSA Regs, reg 1(3); SS (CMB) Regs, reg 1(2); SS CS (D&A) Regs, reg 1(3); SFWFP Regs, reg 1(2); SS (BCO) Regs, reg 6(1A); SPC Regs, reg 1(2); ESA Regs, reg 2(1)
Welfare Reform Act 2012, s39

There are some benefits that are restricted to the first two groups (married couples and civil partners), generally being contributory benefits, and we discuss these further below.

Guidance

Given the importance of determining whether two people are part of a couple or not for benefits purposes, it is not surprising that DWP have some very detailed guidance[105] on the subject as part of their Decision Makers Guide (DMG). Chapter 10 of that Guide covers evidence of marriage in some detail and Chapter 11 covers living together as husband and wife and civil partners.

Definition of a 'household'

Both married couples and those living together as a married couple are only classed as a couple if they are 'members of the same household'. Unhelpfully the term household is not defined in legislation for most DWP benefits but DWP guidance,[106] based on established case law, states that it should be given its normal everyday meaning of:

> "a domestic establishment containing the essentials of home life. Household and home are not the same. Household may refer to people held together by a particular kind of tie, even if temporarily separated."

Under the heading 'Two people living in one dwelling', the guidance continues:

> "To be members of the same household means that:
>
> 1) They live in the same house, flat, apartment, caravan or other dwelling place and neither normally lives in another household AND
>
> 2) They both live there regularly apart from absences necessary for employment or to visit relatives."[107]

The guidance does acknowledge that it is possible to live in one dwelling but not necessarily be living together in the same household, and that includes "two people are married to each other or who are civil partners of each other who separate but refuse to leave the 'home'."[108]

The exception to the above is pension credit, where the legislation[109] includes provisions that treat people as being or not being members of the same household.[110] This broadly echoes the DWP guidance for other benefits although it has more concrete rules such as two people are not treated as being part of the same household if they are living away, do not intend to resume living with the claimant and the absence is likely to exceed 52 weeks. UC has some similar legislation that covers temporary absences.

105 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296090/dmgch11.pdf https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296089/dmgch10.pdf

106 Paragraph 11051 Chapter 11 DMG

107 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296090/dmgch11.pdf, paragraph 11053

108 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296090/dmgch11.pdf, paragraph 11054

109 Section 17, State Pension Credit Act 2002

110 Statutory Instrument 2002/1792, paragraph 5

Application of the legislation and guidance to couples

Married couples and civil partners

The situation for married couples and civil partners who live together both physically and emotionally is straightforward and they will be treated as a couple for most means-tested benefits.

Married couples and civil partners who live apart together so that there is an emotional relationship between them but a physical separation are not as straightforward. Where the physical separation is temporary (for example due to work, holidays, education, caring responsibilities) then it is probable they will be treated as a couple. However, where the physical separation is more permanent (for example a couple who are on their second marriage and have teenage children who are settled and therefore they continue to live in two separate houses), the situation is not straightforward and rests on whether DWP would decide they were part of one household. It is likely in this situation, based on the guidance, that they would not be considered as a couple because although there is an emotional relationship they are maintaining two separate households.

We must then consider married couples and civil partners who are emotionally separated. Under the legislation, those who have separated physically as well as emotionally on a permanent basis would not be treated as part of a couple. As noted in Section 4.2.1 providing evidence of this may not be straightforward, which means DWP may decide otherwise – that is, that they are still a couple.

Those who are living together in the same property but who separated emotionally and continue to live in the same property would not be considered a couple providing they could demonstrate they are no longer members of the same household. Again, evidencing this and ensuring DWP accept such evidence is a separate issue.

Finally, those who are temporarily emotionally separated, whether they continue physically living together or not, are likely to be treated as part of a couple as it will be harder to demonstrate they are no longer members of the same household if the separation is only temporary. However, if they can show that they are not part of the same household, then they will not be treated as part of a couple.

Living together as a married couple or civil partners

Under the legislation, the position for those living together as a married couple or civil partners is exactly the same as outlined above for married couples. We discuss further below whether in reality the DWP treat them the same way.

The DWP guidance identifies a number of factors, drawn from case law, that may commonly be associated with a household. It notes that these factors have been used in cases dealing with married couples who are estranged but still living in the same property, but also in deciding whether an unmarried couple or a same sex couple not in a civil partnership are living in a shared household. The factors to be taken into account 'when making a finding as to whether a household exists' are:

1) "The circumstances in which the claimant and their partner came to be living in the same house

2) The arrangements for payment of the accommodation

3) The arrangements for the storage and cooking of food

4) The eating arrangements (whether separate or not)

5) The domestic arrangements such as cooking, cleaning, gardening and minor household maintenance

6) The financial arrangements

7) Evidence of family life"[111]

DWP make it clear that it is possible to have a shared household but not be a couple provided the two people are not living together as a married couple. Equally, the guidance also states that even if both people own or rent other accommodation, they can still be thought of as members of the same household – particularly if the other accommodation is seldom used. However, a person cannot be a member of more than one household at the same time.

Definition of living together as a married couple or civil partners

Living together as a married couple or as civil partners is not defined in legislation. DWP rely on a set of characteristics that were set out in the case of *Fitzpatrick v Sterling Housing Association [1999] UKHL 42*. When considering whether two people are living together as a married couple, DWP will therefore look at:

- Financial support
- Stability of the relationship
- Sexual relationship
- Children
- Public acknowledgement
- Future plans

Exceptions

Most means-tested DWP benefits follow the rules outlined above, however there are some exceptions which are discussed below.

State Pension

Although the state pension was introduced in 1908 and a widow's pension from 1925, it is only more recently, with the increasing incidence of disjointed families, that the difference in state pension provision between married couples on the one hand and their cohabiting counterparts on the other hand have become more noticeable.

From 1948, married women were able to opt out of paying full NIC and rely on their husband's NIC record to pay them a state pension, but this was only paid to them when their husband reached state pension age and then only at 60% of the basic rate.

The 1975 Social Security Act stopped these elections from 1977 and so from that date married women were liable to pay the same NIC as other workers, but those women who had already made the election could continue with it.

Married/widowed/divorced women may also claim their state pension (or increase it) using contributions made by

111 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296090/dmgch11.pdf, paragraph 11055

their husband (or ex-husband while they were married or before they were married).[112]

The Pensions Act 2014 makes significant changes to this regime as from April 2016. Broadly, from that date, women will be unable to claim a state pension based on their husband's contributions except in certain transitional circumstances.

This new regime thus removes the distinction between married and unmarried couples in the future, although there will be a considerable time when transitional rules apply enabling a survivor to make a claim in relation to their late spouse's entitlement to state pension as long as the marriage took place before 6 April 2016.[113]

Payments made to the bereaved

Three benefits – widowed parent's allowance, bereavement payment and bereavement allowance – are due to be withdrawn as a result of the Pensions Act 2014 and are to be replaced with Bereavement Support Payment. Full details are yet to be made in regulations, but we do know that such a payment will be made only to a surviving spouse or civil partner and will be based on the contributions record of the deceased, unless death was as a result of industrial injury. Both current and future entitlement will therefore depend on a marriage or civil partnership being in existence at death in order for a benefit to be paid. Whether a separation has taken place is irrelevant.

Where children lose a parent, it is difficult to see why those whose parents were unmarried should find themselves in a different position to those children whose parents were married.

Widowed parent's allowance (WPA)

Entitlement is in part based on being widowed below state pension age and receiving CB for a child whose parent has died – in other words an individual caring for their step-child might be entitled to this. However, it is only available to couples who were married or in a civil partnership and not to cohabiting couples in the same circumstances. It is also possible to claim where the married couple were separated at the time of the death, but not if they were divorced. In contrast to the rules for state pension, WPA cannot be claimed where the widow/er remarries or starts living with a new partner as if they were a married couple or civil partners.

Bereavement payment

A £2,000 lump sum payment is available if a spouse or civil partner dies when not in receipt of the state pension and the survivor is under state pension age. Eligibility for the payment is based on the deceased's National Insurance record, but if the death was as a result of work, the deceased's National Insurance record is irrelevant.

The payment cannot be received if the parties were divorced or if their civil partnership were dissolved, but eligibility continues while a couple are separated as long as the surviving spouse was not living with someone else as spouse or civil partner at the time of death.

Bereavement allowance (used to be known as widow's pension)

This is payable for up to 52 weeks if a person's spouse or civil partner dies while the survivor is aged 45 up to state retirement age. The amount receivable depends on the deceased's National Insurance record. But if there is entitlement to WPA, then that is paid in preference.

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112 But if the woman remarries or enters a new civil partnership before she reaches state pension age, this ability to claim on contributions made by her former or deceased husband is no longer available.

113 But if the woman remarries or enters a new civil partnership before she reaches state pension age, this ability to claim on contributions made by her former or deceased husband is no longer available.

The payment cannot be received if the parties were divorced or their civil partnership was dissolved, but eligibility continues while the couple are separated as long as the surviving spouse was not living with someone else as spouse or civil partner at the time of death.

Maternity allowance

Maternity allowance is paid to a woman subject to certain qualifying conditions, based on her own NIC record if she has paid insufficient contributions to be entitled to statutory maternity pay.

Normally eligibility to maternity allowance has no link to marriage. An EU Directive[114] has forced the UK to offer maternity allowance to women who undertake unpaid work in their husband or civil partner's business, even if they are separated – but not where she may work for an unmarried partner. This commenced from 1 April 2014 for babies due on or after 27 July 2014. The rate of maternity allowance and the length of time it is paid in these circumstances are both less favourable than if the woman claimed on her own NIC record, but it still represents a difference between married and unmarried mothers.

Fairness, consistency and certainty

The rules are most certainly not fair when considering those benefits listed under the 'exceptions' heading above. Those who are living together as if they were married or civil partners do not qualify for those benefits, yet married couples and civil partners do and even those married couples who are separated (providing it has not resulted in divorce) qualify. This unfairness is compounded by the fact that the benefits can be lost when someone starts to live together as spouse or civil partner with someone else, yet that status is not recognised for the giving of the benefit in the first place –seemingly without any real justification.

DWP state in their guidance for means-tested benefits that the rules are fair as between married couples and unmarried couples. However, in reality that is unlikely to be the case due to the greater difficulty of evidencing couple status if not married – particularly when looking at couples who are together emotionally but maintain separate residences, and those who are temporarily separated (whether physically living apart or not).

This is because marriages and civil partnerships can be evidenced fairly easily and require no further investigations or considerations on the part of the DWP decision maker. So in cases of living apart together, the DWP would be focusing on whether or not the married couple are members of the same household.

However, for those who are living together as a married couple, DWP first need to consider a set of criteria and if two people are living apart together, it is likely that DWP would either not look any further into the situation. Or they might perhaps apply the criteria and conclude that they were not living together as a married couple at all, so it would not then be necessary to consider whether they were members of the same household. We therefore think it is more likely that some potential couples living together as if they were married would be treated as single people compared to married people in a similar situation where the determination is likely that they are part of a couple.

With regards to the issue of consistency, although there is some consistency between most means-tested benefits, including UC, the benefit definition is different to that used for tax credits, CB and the tax provisions we have already discussed. The most notable difference is that the DWP benefits have the same household requirement that is not present in tax credits. Nor does the DWP legislation define permanent separation in the same way as tax credits, CB and tax provisions. When compared to the tax provisions, the most notable difference is that DWP benefits do extend to those living together as a married couple, whereas most of the tax provisions do not.

114 Article 8 of European Directive 2010/41/EU

From a claimant's perspective, certainty is extremely important. However, the complexity of the rules and the differing definitions mean that people will find it difficult to know for certain how their position will be viewed by DWP.

Explanation and enforcement of the rules

For those who are living together as a married couple or civil partners, is it particularly difficult as in some cases, especially when relationships are in the early stages or the latter stages when separation, to know whether DWP would treat two people as part of a couple.

We searched GOV.UK and were unable to find any public-facing guidance[115] on what constitutes a couple for DWP benefit purposes, therefore many people will face uncertainty in this area and possibly serious consequences in the form of penalties, overpayments and even prosecution. The relevant pages for each benefit mention 'couples' but we could not find any guidance on what that actually means.

DWP do enforce the rules and carry out investigations into claims where they suspect people may be living with someone but claiming as a single person. Such investigations are more common than investigations into whether two people already claiming as a couple should be claiming as two single people.

115 The technical decision makers guides are, as previously noted, held on GOV.UK, but these are not written for general public consumption, nor are they immediately accessible from the general guidance pages of that website.

5. Example couple scenarios and the impacts of different couples definitions and guidance

Introduction

At various points in this report we comment on guidance provided to couples to enable them to establish their entitlement to tax reliefs or state benefits. The consequences of making an incorrect decision as to their couple status can have serious financial impacts on the individuals concerned, so in this section we examine the legislation, guidance and case law by means of seven representative couples.

Introduction to the couples

Couple A

Amy and Adam got married in April 2010. They have a child, Andrew, born in 2011. Adam earns around £75,000 per year and Amy is a housewife. They each own one property and Adam is about to sell his property (that was his home before their marriage but which they have continued to visit for holidays).

Couple B

Brian and Barry regard themselves as a couple for social functions, holidays and so on. They have no dependent children, but each own a property. Because Brian often works in Aberdeen, he has a flat there, whereas Barry's home, where they spend most of their 'joint' time, is in Leicester.

Couple C

Connie and Colin have lived together since around 2009. They have three children of their own. Both work part-time and share childcare along with Connie's mum. A few months ago, Connie was diagnosed with depression and moved back to stay with her mum so she could get more rest. The three children remain living with Colin.

Couple D

Debbie and Daniel have been married for three years. They have a son, David. Following a recent incident, Debbie has moved out of the family home, taking David with her. She thinks the marriage is over, but Daniel thinks that a reconciliation is possible.

Couple E

Eddie and Eric are civil partners. Eddie's health has deteriorated and he has had to move into residential care now that his eyesight has deteriorated to the extent that he is considered to be blind. They are both aged 82.

Couple F

Flo and Frank have been married for several years. They run a catering business that provides food for parties, weddings, funerals and so on. Flo is responsible for most of the cooking, food preparation and food ordering, while Frank often helps her deliver the goods and lay them out. The business is operated by a limited company, F is for Food Ltd, in which Flo owns one 'A' share and Frank owns one 'B' share. They take all decisions together, but Flo's 'A' share actually carries all the voting rights, with Frank's 'B' share carrying income rights only. Equal dividends have been declared on the shares each year to date.

Couple G

Gunther and Greta are not married. They each rent a property. Their children normally live with Greta, but they sometimes spend time at Gunther's property. When Greta is working, Gunther sometimes stays at Greta's house to help out with childcare but Gunther keeps his own property because he has another child (not Greta's) who sometimes stays with him.

Application of legislation to the couples

Couple A

This couple is in a fairly straightforward situation. They are married, but not separated. Their tax situation is clear. The only state benefit they are likely to be able to claim is CB. Unfortunately if that is paid, Adam will have the HICBC applied to his earnings so that overall the family will obtain no financial gain. As Amy is not working, it would be beneficial for her to claim CB as that would enable her to receive National Insurance credit towards her state pension. She can decide not to have it paid, though, so that Adam does not suffer the HICBC.

The position regarding the sale of Adam's property might give rise to a chargeable gain. But, if Adam considers that this may be an issue, the guidance he finds may not be most helpful. The leaflet of notes accompanying the main self assessment return,[116] contains the following guidance regarding sale of a home when describing what does not require to be disclosed:

> "disposals of your own home where
>
> — it has been your only home during your ownership and was not used for any other purposes, for example, in your business
>
> — the house has been used as your home throughout your ownership (but you can ignore the last three years[117] of ownership)
>
> — the garden and grounds disposed of at the same time do not exceed half a hectare."

This guidance completely omits to mention that a married couple may only have one home between them for this purpose.

On the other hand, if Adam were to look at GOV.UK,[118] there it is made clear that a married couple may only have one such home between them as long as Adam reads through sufficient sections.

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116 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/354204/sa150.pdf; page TRG6

117 This time limit now reduced to 18 months.

118 https://www.gov.uk/tax-sell-home/absence-from-home

Couple B

Barry now does a low-paid job, having been made redundant. He is considering whether he might make a claim for tax credits. The first thing he needs to decide is whether he can make a claim as a single person or whether he would have to make a joint claim with Brian.

HMRC guidance[119] follows the approach that DWP uses for establishing whether couples exist for other state benefits. In particular, the following criteria are used:

- Whether the couple are living in the same household
- The stability of relationship
- The level of financial support between the couple
- The presence of dependent children
- Public acknowledgement of the relationship
- Sexual relationship (this is not used any more unless information is volunteered by the claimant).

While the last four indicators would provide some evidence, it is the first indicator – the mention of the 'household' – that causes particular difficulty. We noted above that DWP legislation actually requires that, for two people to be considered as living together as a married couple or civil partners, they must be in the same household. Tax credits legislation does not have this same household requirement for either married or unmarried couples and therefore by including it on this list, it is merely an indicator towards whether or not the couple are living together as if they were married, rather than (as in most DWP benefits) a separate consideration. This can cause differences in practice and it is entirely possible that two people could be considered a couple for DWP benefits but not for tax credits and vice versa.

From a look at the guidance, Barry does not think they live in the same household (even though that is irrelevant), because Brian lives and works in Aberdeen throughout the week. He considers that the relationship is stable and indeed his family and their friends in Leicester acknowledge the relationship. On the other hand, Brian's family, colleagues and friends do not know about Barry. Until recently Barry was in a well-paid job and their finances were entirely separate. It is possible that with this change in circumstances Brian will 'share' more of his resources, but this is not clear as yet.

Accordingly, Barry decides to make a claim as a single person. Whether that is the correct decision or not, if Brian decides to make regular contributions to Barry's costs, would Barry's decision change? And would he know he had to disclose the change?

He looks at the relevant page on GOV.UK.[120] This gives no indication he might have to report such a change. He does, though, take a screenshot of the relevant page so that he can refer to it later. See Appendix 8. If he had looked at the page relating to joint claims, though, it does mention joint financial commitments. Whether that would have prompted him to consider the matter further is debatable.

119 http://www.hmrc.gov.uk/manuals/ccmmanual/CCM15040.htm

120 https://www.gov.uk/changes-affect-tax-credits

Couple C

Connie and Colin have a similar issue regarding their claim to tax credits. Before Connie moved to stay with her mother, they had a joint claim. Can they each claim as a single person now? This may depend on how long Connie is absent from the family home and any financial support between the couple. The distinction made on GOV.UK[121] is whether there has been a permanent separation – and perhaps that is something that will only become clear after a period of time.

If HMRC decide to investigate any claim made as a single person, it is to be hoped that the decision in *SS v HM Revenue and Customs (TC) [2014] UKUT 0383 (AAC)*, Case No. CTC/1055/2014[122] would lead HMRC to prepare their case better.

This case involved a single claim which HMRC asserted should have been a joint claim, but HMRC failed to supply evidence of the facts they asserted and the claimant was not given adequate indication of what evidence she could provide which would be appropriate in her case. The Tribunal was therefore not entitled to draw adverse inference about a failure to provide evidence where the claimant was not given adequate explanation of what would be appropriate evidence. The decision was also critical of the quality of HMRC's submission.

Couple D

This married couple have different views on the marriage status. Debbie believes they are permanently separated whereas Daniel does not: he thinks the separation may be only temporary. Regardless whether the separation is temporary or permanent, any claim to TAMC would still be allowed. Similarly, assets transferred between them could still continue with no IHT implications. However, if Daniel decided to transfer some of his share portfolio to Debbie, the question as to whether their separation was temporary or permanent would be relevant. He could only transfer shares without CGT charge in the period up to the end of the tax year when they became permanently separated.

If Debbie and Daniel jointly own their family home, then the date of separation will start the clock for calculating the last 18 months of ownership and thus the ability to sell the property without Debbie becoming potentially liable to CGT (subject to the provisions mentioned in section 4.1.2.1 above for divorcing couples).

Debbie and Daniel may well have been making claims for tax credits. If so, Daniel would be inclined to continue with their joint claim (as he considers the separation to be temporary) while Debbie might try to make a new claim as a single person since she considers the separation to be permanent.

If Debbie later did make an attempt at a reconciliation, this could further complicate matters.

Couple E

Eddie and Eric are still civil partners – and they do not regard themselves as separated, although they are living physically apart. Eric has claimed the MCA up to now and wonders whether he may still do this.

GOV.UK has some information about living together for the purposes of the MCA, which helpfully includes the following:

> "You can still claim Married Couple's Allowance if you're unable to live with your spouse or civil partner because of:

121 https://www.gov.uk/claim-tax-credits/joint-claims

122 See http://www.osscsc.gov.uk/Aspx/view.aspx?id=4288

- illness or old age, eg where your spouse or partner is in residential care
- working away from home
- an armed forces posting
- being in prison
- training or education"[123]

However, the main part of the website does not explain what constitutes separation so as to end access to MCA. Of course, given Eric's age, he may not have access to the internet since many older people are digitally excluded. Once he accesses the guidance, Eddie is confident he can continue to claim the MCA in his circumstances.

It would seem that Eddie would now be eligible to claim the BPA. If he does so, he would be able to transfer any unused sum to Eric and so reduce their overall tax bill.

As an aside, but potentially relevant to this example, we note that the GOV.UK guidance on the BPA fails to mention that if a person registered as blind in a particular tax year but obtained the evidence of blindness on the basis of which the registration was made during the previous tax year, they can in fact claim the allowance for the preceding tax year. [124]

Couple F

Flo and Frank have completed their tax returns each year showing all dividends they have received from their company. But is that sufficient?

The notes to the self assessment tax return[125] give no indication that anything further needs to be investigated. There is a Helpsheet 270 to the tax return, though. This is available online, but it is unlikely to be accessed unless someone had already accessed the additional pages of the tax return that relate to trusts. Helpsheet 270 gives examples of transactions that might be caught by the legislation – all involve spouses and not cohabiting couples. That is unhelpful since the guidance in the manuals makes it clear that there is no restriction on the application of the legislation to transfers between married couples.

There are two tax cases that may be relevant, though:

Jones v Garnett [2007] All ER (D) 390 (Jul) (otherwise known as *Arctic Systems*) – as discussed in section 4.1.3 above.

This involved a limited company with two ordinary shares in issue – one each owned by Mr and Mrs Jones. It was agreed that most of the company's 'income' was due to the efforts of Mr Jones, while his wife undertook administrative duties. Each were paid small salaries with the balance of the company's income being distributed by way of dividends. This case escaped the settlement provisions because although it was held that there may have been bounty in allowing Mrs Jones to own one of the shares, the gift was held to be more than 'wholly or

123 See https://www.gov.uk/married-couples-allowance/eligibility

124 Section 38(4) Income Tax Act 2007

125 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/354204/sa150.pdf; page TRG

substantially' a gift of income from Mr Jones to Mrs Jones – due to the rights and obligations of being an ordinary shareholder – meaning that this legislation did not apply.

In another case, *Patmore v HMRC [2010] UKFTT 334 (TC)*, HMRC partially succeeded in their argument that the settlements legislation should apply and that some of the income paid to the wife should actually be assessed on the husband. This case was differentiated from the *Arctic Systems* case above because the wife was issued with a separate class of share on which 'enhanced' dividends were paid. The enhanced level of dividends (over and above the 'fair' proportion) was held to be subject to the settlement provisions and thus were assessed to tax on the husband, even though they had been paid to the wife.

Although it seems likely that Flo and Frank might fall foul of the settlements legislation as it applies to their business, they are unlikely to realise they may have an issue to consider.

Couple G

Gunther's working hours are suddenly cut because of a problem with a customer of the factory where he works. He decides he needs to claim state benefits.

If he makes a claim to tax credits, then he has to decide whether to claim as a single person or to make a joint claim with Greta. DWP guidance, as we have seen, considers whether the two people are living in the same household. On the basis that he and Greta do not share a household, he submits a claim as a single person. This may not be correct, though, since the tax credits legislation does not mention households. The correct question is whether Gunther and Greta are living together as husband and wife (regardless of whether they are in the same household).

On the other hand, if Gunther was to make a claim for UC, he then needs to decide if he and Greta live in the same household. If they do, then he needs to make a joint claim.

The facts of this case are such that he may be treated differently for tax credits and UC. In any case, he will have to maintain evidence to support the decision he takes.

It is these types of cases which might also give rise to anomalous situations on the transfer from tax credits to UC. We make a specific recommendation in this connection in section 6.

6. Conclusion and recommendations

This report has demonstrated the complexities of navigating the tax and benefits systems for all couples. While some will find it easier to identify their couple status (usually those married or in a civil partnership), the implications of their relationship on their resulting financial situation for tax and benefits purposes might still be far from obvious.

Guidance-based recommendations

We have shown that there is a lack of guidance and we are willing to work further with HMRC and DWP, together with the Government Digital Service in terms of GOV.UK guidance, to rectify this. Particular points to address are:

- To review where information on couple status for tax credits might have previously existed on the HMRC website, but has been lost in the initial transition to GOV.UK, and how couples might now be guided in future.
- Whether it might be possible to create some form of online tool for couples such that they are able to determine (and to review at appropriate junctures) their status for various tax, tax credits and benefits purposes. Such a tool could conclude with offering guidance about what the couple then need to do (for example, notify HMRC or DWP of a change in circumstances).
- To ensure that information is available to couples advising them of what type of evidence Government Departments might need from them in the event of a query as to their couple status. Improved guidance should lead to fewer fraudulent claims.
- To ensure that clear guidance is put in place for married couples and civil partners on the introduction of the new transferable allowance. At present, we are concerned that claims for this allowance are planned to be 'digital by default' and that many of those potentially eligible – especially pensioners who are not entitled to the MCA – might be excluded from claiming the relief as a result.[126]

Until adequate information is provided by Government departments about what constitutes a couple and the various evidence needed, we stress that claimants should not be punished (whether by penalties or overpayments of benefit) for getting their status wrong due to innocent error. In raising penalties or considering whether to recover overpayments, we urge HMRC to be particularly mindful of errors which have occurred in declaring couple status since tax credits information was moved to GOV.UK earlier this year.

More general recommendations as to the treatment of couples

The seeds of further, stronger, conclusions than those outlined below have been sown in the writing of this report; but to recommend a single definition of a couple for all tax and benefits purposes, for example, would require much more detailed analysis of the pros and cons of having a single definition and where the winners and losers might lie (depending on the definition chosen). We have included at Appendix 9 to this report some thoughts on

126 See our report on digital exclusion, highlighting the prevalence of such exclusion amongst older people, amongst others: http://www.litrg.org.uk/reports/2012/dig-excl

the possibility of such a single definition that were prompted in the course of preparing this report, but which we stop short of recommending for the reasons noted.

There are two major changes to benefits currently in train – the introduction of UC, and the removal of existing bereavement benefits in favour of a single bereavement support payment. This is therefore an ideal time to consider the status of couples for those benefits in particular, and iron out potential errors in process or inconsistencies in proposed entitlement.

The tax landscape is also partly changing, with the introduction of the TAMC (yet maintaining the existing MCA for those eligible).

There seem therefore to be some obvious recommendations for possible courses of action which might make some improvement to the status quo:

1) HMRC and DWP will need to ensure that there are transitional arrangements in place for moving tax credits claimants to UC in the course of the coming few years. We noted above that both Departments seemed to have made the assumption that a couple/joint claimants for tax credits purposes would automatically be a couple/joint claimants for UC. As we have shown, the difference in the DWP definition of a couple (including a 'household' requirement) as against the tax credits definition, means this is not the case. The two departments must therefore work together to identify those possibly affected, and ensure their processes cope. They must also provide guidance to those affected in order that they understand their situation.

2) We suggest it would be possible to have some formal 'registration' process with HMRC and DWP to make an official declaration that a couple has been formed (or has separated), to provide some certainty for couples who have made a clear decision to enter into (or separate from) a committed relationship with each other. Clearly this could be subject to abuse, particularly from the viewpoint of falsely declaring a separation in order to claim benefits or tax credits on a single claimant rather than joint basis, but this should not be insurmountable with some checks or controls in place.

3) The process in the above recommendation might also be extended to allow one partner to declare where the other has left, but who might have refused to, or delayed, changing their address details for correspondence purposes and so forth. At present, the partner that has been 'left behind' has little or no control over the actions of their former cohabitee in that respect, such that data available to HMRC and DWP (credit reference data, for example) is likely to continue to 'evidence' that the other still lives in the property, even though they do not.

4) There is a blatant unfairness in the non-availability of bereavement support for unmarried or non-civil partner couples on the death of their partner. The restriction of the existing and proposed replacement benefit to married couples and civil partners seems to be formed on no immediately identifiable logic – particularly when we consider couples with dependent children (the children having no control over the decision of those who care for them to marry or not). This could be easily rectified by extending the benefit to those who lose a de facto spouse.

5) We recommend that the Government consider whether the MCA given its limited application and cost, could be extended to all couples (that is, committed couples, whether or not they are married or in a civil partnership) in the relevant age group without serious fiscal or practical difficulties.

6) Similarly, we recommend the Government consider whether the transferability of the MCA and that of the BPA could be made available to all couples.

7) One area where it would be very useful to have a more consistent treatment would be in connection with

separation – even if only to align the tax rules for married couples or civil partners who separate. This might take the simplest of the differing definitions of separation as its starting point, which seems to be that of the TAMC. This broadly identifies separation by reference to a formal separation agreement (but the degree of formality might be restricted so as to save costs – for example, using the process we propose at recommendations 1 and 2 above). So while some might delay obtaining the formal agreement, it could provide clarity for a great many separating couples whose date of separation is otherwise somewhat subjective.

The effect of this simplification might be broadly revenue neutral. It would increase (slightly) the number of couples able to claim the MCA (or to transfer the BPA); on the other hand the settlements legislation would only increase the number of couples caught by the charge; the SRT would also operate to make a tie with the UK more likely; CGT might be saved by some couples who did not yet have a formal separation agreement – but the number of such couples is likely to be small and, if the sums at stake are significant, they are likely to receive advice so that in the present situation little tax is actually collected.

To be clear, the 'registration' process for a couple to declare their status in recommendations 1 and 2 above is based on a couple declaring their status for the purposes of the law as it currently stands, rather than for, say, an unmarried couple to be treated as if they were married. During the course of preparing this report, we also gave some thought as to a possible more formal declaration – that for tax and benefits purposes a couple might declare that they wished to be treated as married. We again stop short of making a recommendation that such a system be introduced, but include at Appendix 10 our preliminary thoughts on the subject. It might be particularly useful in cases where a couple wish to marry but are prohibited from so doing – for instance if one partner is forced to wait for a divorce from a former spouse.

Finally, we would enter a plea to government to acknowledge that the situation for couples is already confusing and disjointed. It is disappointing that recent changes in legislation – for example, the proposed bereavement support changes, the introduction of the HICBC, the SRT – have not sought to iron out even in some small way the differences in couples definitions; in fact in the case of the HICBC and SRT have added complexity by introducing subtle new definitions and considerations for couples. On future changes in legislation, we therefore recommend that the government consider the interactions for couples carefully and avoid introducing further complexity.

Appendix 1: About LITRG

The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

Appendix 2: Acknowledgments

This report was compiled by Gillian Wrigley, Victoria Todd and Kelly Sizer during summer and Autumn 2014.

Contributions to the report were gratefully received from Martin Hodgson, Leonard Beighton, Paddy Millard and Graham Sherburn.

We would like to thank those who painstakingly proof-read the report, not to mention Sophia Bell and Michael Woolley of the CIOT for their help in preparing it for publication and launch. Any remaining errors are the sole responsibility of the authors.

Appendix 3: Statistics

Introduction

In order to be able to draw some conclusions from our report, it was necessary to source data to provide us with the required information. Unfortunately, the data we sought to use was not available from a single source and we have had to make assumptions and extrapolate from existing data in order to produce our figures.

While we accept this is not an ideal situation, it does provide data that may be used for illustrative purposes.

Executive Summary of data used in report

Description of couple	Number of couples in the UK
Married couple/civil partner couple	12.5M
Married couple/ civil partner living apart together	390,000
Cohabiting couples not married or in a civil partnership	2.6M
Couples not married nor in a civil partnership but living apart together	500,000
Former couples still living together physically, but emotionally separated	1.8M

Note that the incidence of civil partnerships is still fairly low and same sex relationships have not been differentiated in any way from opposite sex relationships.

Sources of data

The main sources for our data were as follows:

The Office for National Statistics

Data from the 2011 census

The University of Bradford

Shelter

We comment on each source in turn below.

The Office for National Statistics (ONS)

This data,[127] published on 28 January 2015, is drawn from the Labour Force Survey in April to June 2014, described as a large household survey of people in the UK. Completion of the survey is not mandatory and the results are therefore not quite as reliable as those from the census, for example. Nevertheless these statistics are believed to be reasonably accurate.

127 http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-383612

The ONS data shows the following in Table 7:

Household type	Numbers
Married or civil partner couples	12.5M*
Cohabiting couples	2.6M*
Lone parent families	2.8M
One person households	7.6M
Multifamily households	0.3M
Other households	0.9M
Total UK households	26.7M

*By extrapolation from Table 7, where the total figure for couple households is shown as 15.1M while the total number of married couple families is shown as 12.5M in Table 1.

Multifamily households include, for example, parents living with their son and his partner as well as unrelated families.

Other households includes individuals living in the same property who are neither part of the same family nor are couples. This will include any individuals who may have been couples in the past but still occupy the same property.

This data provides us with basic information on married/civil partner couples and cohabiting couples (including same sex couples) who live together in one household. What it does not provide are estimates of the numbers of those living apart together or those who still live physically together but who have separated emotionally: for those figures we require to examine other surveys and extrapolate data.

Data from the 2011 *census*[128]

Recently produced statistics from the 2011 census, admittedly only covering England and Wales, show that while 20.5M people live together as married couples or civil partners (ie 10.25M such couples), a further 640,000 such people live apart, while not being emotionally separated. While it may be dangerous to assume the figures for Northern Ireland and Scotland might be similar, this is the assumption made. As the populations of Northern Ireland and Scotland together are much smaller than that of England and Wales, any difference should be relatively minor.

Accordingly, if the ONS figures show that 12.5M married couples/civil partnerships cohabit in the UK, (of whom 10.25M live in England and Wales), then we could extrapolate that in the UK approx. 390,000 such couples might live apart together (of whom 320,000 live in England and Wales).

University of Bradford

The University of Bradford (National Centre for Social Research) has a unit looking at people who live apart together. In one of their papers,[129] based on the 2006 British Social Attitudes Survey (carried out by the National Centre for Social Research: the survey sample for the 'family' type questions relevant to this report was 3,197 people) they quote that 10% of adults in the UK live apart from a partner. The survey size here is considerably smaller than that in the ONS study, but this figure of 10% appears in other publications too. Accordingly it is given

128 http://www.nomisweb.co.uk/census/2011/DC1108EW/view/2092957703?rows=c_larpuk11&cols=c_age

129 Simon Duncan & Miranda Phillips (2011) People who live apart together (LATs): new family form or just a stage?, International Review of Sociology: Revue Internationale de Sociologie, 21:3, 513-532, DOI: 10.1080/03906701.20122.625660

some credibility.

Although not stated explicitly, it seems clear from comments in the research that this figure does not include married couples or civil partners who choose to live apart. For the purposes of further comment here, we assume that this is indeed the case – that is, that they refer to couples living apart who are neither married nor in a civil partnership.

What is not so clear is the precise status of those 'living apart' relationships. Some will be akin to boyfriend/girlfriend relationships rather than 'couples'. It is suggested that by excluding teenagers, students and young people living in the parental home, approximately half of these couples might be excluded. Just by excluding those couples who had been together for less than six months, the number of living apart together couples was reduced by 25% (although it is not clear what proportion of these 'short term' relationships might be included in the teenagers, students and living in parental home category).

Our decision was to split living apart together couples into two groups, as in the research project by the University of Bradford – partners living apart (those that are more 'couple' like, approx 57%) and those dating but living apart (those that are more steady boyfriend/girlfriend like, approx 43%). The University of Bradford then looked at the reasons why such couples do not live together. For partners living apart, approximately 25% do not live together because they have little choice (partner has job elsewhere or is studying elsewhere or they cannot afford to live together) while a further 8% do not live together for reasons such as caring responsibilities, children or simply a wish to wait until they are married. The other reasons identified were more to do with the personal choice of one or both members of the couple.

Thus 33% of the partners living apart together in this study are in close intimate relationships akin to marriage/civil partnership but do not hold the relevant legal status to be treated as such.

In order to approximate the number of unmarried couples who are living apart together we have had to consider the total UK population.

Per the initial findings of the 2011 census,[130] the total UK population is approximately 63M, falling into the following age bands:

Age	% of population	Approx. number (based on total population of 63M)
0-14	18	11.34M
15-64	66	41.58M
65 and over	16	10.08M

Considering only the adult population (age 16 and over) means that we need to exclude all those under 15, but also exclude some in the range 15-64. As a 'rough and ready' figure we have assumed that the 50 years of ages represented by 41.58M of population arise approximately equally over the age ranges: we do know this is not quite the case because the UK has an ageing population, but for these purposes we are going to assume that approximately 1M people would fall to be age 15. On that basis approximately 50M people fall into the adult category.

If we assume that 10% of these adults are couples living apart together, then that equates to 5M people or 2.5M couples. From the University of Bradford research, we can assume that 57% of those are partners living apart – 1.425M couples. Of those, we have seen that 33% are not living together through having little choice or other

130 http://www.ons.gov.uk/ons/dcp171778_292378.pdf

caring responsibilities, for example. If we take this group as representing couples living apart together who would live together under different circumstances, there are just under 500,000 couples in this category.

Shelter

A Yougov survey for Shelter[1] has shown that many people live together due to housing costs, where they might otherwise have continued to live apart. But it also estimates that 3.6M people, or 1.8M couples, have been forced to continue living together after their emotional relationship has broken down because of housing costs. We have no breakdown of this figure between married and civil partner couples as compared with those not in a legal relationship.

1 http://england.shelter.org.uk/news/february_2013/two_million_couples_living_together_too_soon

Appendix 4: Abbreviations and glossary of terms

ANI – Adjusted Net Income

BPA – Blind person's allowance

BSP – Bereavement support payment

CB – Child benefit

CGT – Capital Gains Tax

DWP – Department of Work and Pensions

HICBC – High Income Child Benefit Charge

HMRC – HM Revenue & Customs

IHT – Inheritance tax

MCA – Married couple's allowance

NIC – National Insurance contribution

PA – Personal allowance

PRR – private residence relief (home)

TAMC – transferable allowance between married couples

UC – Universal credit

WEIR – wife's earned income relief

WPA – Widowed parent's allowance

Appendix 5: Council tax support – brief review of one Local Authority's calculator

In early November 2014, we looked at the Borough Council of King's Lynn and West Norfolk information on Council Tax Support.

The landing page we found on the Council's website[131] mentions restriction on entitlement in terms of savings and so forth, but makes no mention at all of whether a claim for support should be made as a single person or couple.

We then looked at their online calculator tool,[132] and helpfully the starting point of that tool guides the user to consider whether they are single or in a couple, with a link to the following further guidance:[133]

> "**Single or Couple?**
>
> If you live with a partner you should enter that you are part of a couple. It does not matter whether you are married or living together or an opposite-sex or same-sex couple.
>
> The meaning of 'couple' in the benefits and tax credits system is the same as in everyday speech. People who are living together in a relationship count as a couple for assessing their benefits and tax credits. If your situation is more complicated you should seek advice.
>
> The rules for benefits and tax credits apply to people who are living together as a couple in a relationship and not to people who are flat sharers or carers.
>
> Before December 2005 the law treated same-sex couples and opposite-sex couples differently. Same-sex couples were treated as individuals and opposite-sex couples were treated as one claim. However, these rules now apply equally to same sex and opposite sex couples. Whether or not you are registered civil partners, if you live with a partner you should enter that you are part of a couple. For more information see the Citizen's Advice guide for same sex couples.
>
> **How to claim as a couple**
>
> If you are in a couple you need to put in one claim form, giving details for yourself and for your partner. As a member of a couple, the income, savings and hours of work of both of the couple are taken into account.
>
> In couples the calculator assumes that the first person referred to ("you" or "client") claims benefits. If you are both eligible to claim an out-of-work benefit you should consider carefully which one of you should make the claim. For more information see couples and out-of-work benefits.

131 See http://www.west-norfolk.gov.uk/default.aspx?page=21496

132 See http://www.west-norfolkcalccts.entitledto.co.uk/

133 See http://www.west-norfolkcalccts.entitledto.co.uk/help/viewhelp.aspx?ePage=EntitlementCalculator&helpfile=couple

If you are in a polygamous marriage you should seek further advice on your benefit entitlement."

The above is helpful to some degree, for example confirming that the term 'couple' does not include flat-sharers or carers, we do note some problems with it below.

The note that "The meaning of 'couple' in the benefits and tax credits system is the same as in everyday speech" is not exactly true. As we demonstrated in section 3 of this report, the dictionary definition of a couple is broad and, as seen in section 4, the benefits and tax credits systems qualify the term much further – albeit (unhelpfully) in different ways.

In the cases of 'more complicated' situations and polygamous marriages, the tool suggests that the user should 'seek advice', but does not give any detail on where to seek advice from.

Appendix 6: Polygamous relationships

We pay scant attention to these relationships in the main body of the report due to their perceived infrequency in the UK. The last estimate of numbers was provided in 2008,[134] at under 1,000 legally recognised such marriages in the UK. Since then, there appears to be a greater awareness of such marriages, but it can be expected that their incidence remains very low.

Polygamous (that is, those where there are more than two spouses) relationships cause further issues. While such relationships may not be legally constituted in the UK, they may be elsewhere in the world and that can lead to conflict with the UK tax and benefits systems.

For example, a man may marry in the UK, but then marry a second time overseas where the second marriage is legal. If a second or subsequent spouse is able to come to the UK, then the UK government has set out how state benefits might be paid. As recently as May 2014, a statement[135] was made confirming that under UC such polygamous units might be paid more than they are under tax credits.

A married couple might be entitled to the MCA, but only one such allowance in a year might be paid to a polygamous relationship, assuming the other conditions were fulfilled.

One area where polygamous relationships might benefit is in relation to the ability to transfer assets between them free of IHT, whether separated or not, since the legislation[136] refers only to transfer of 'property which becomes comprised in the estate of the transferor's spouse [or civil partner]'. No further explanation of the term takes place, so that polygamous relationships might also benefit. Although it appears there have been no cases in this area considering IHT issues, there has been a case considering polygamous marriages for succession purposes, although IHT was not in point in this particular case. See Official Solicitor to the *Senior Courts v Yemoh & Others [2010] EWHC 3727 (Ch)*. This intestacy case established all spouses were recognised, but only received one spouse's share among them.

134 www.parliament.uk/briefing-papers/SN05051.pdf, page 12

135 www.parliament.uk/briefing-papers/sn05051.pdf

136 S18 IHTA 1984

Appendix 7: Additional technical commentary relating to section 4.1.1.1

Additional commentary in relation to the Married Couples Allowance (MCA)

In order to properly appreciate the current situation, it is useful to recognise the history of this allowance. This may be briefly summarised as follows:

1799 – married man taxed on all income of self and wife

1918 – the 'wife' allowance was introduced

1920 – the wife allowance was renamed the married man's allowance and increased significantly in value

1920 – wife's earned income relief (WEIR) introduced – set at a level that was the difference between two single PAs and the married man's allowance

1942 – the WEIR was increased to the level of the single PA

1990 – introduction of Independent Taxation; married man's allowance was replaced by the MCA

1994 – MCA restricted to basic rate (20%)

1995 – MCA restricted to 15%

1999 – MCA restricted to 10%

2000 – MCA abolished except where one spouse already aged 65 or over

2005 – MCA extended to civil partnerships

Following the changes to the WEIR introduced in 1942, couples with two earners were considerably better off than those where there was a single earner. When Independent Taxation was introduced, marriage continued to be recognised by the MCA, but this allowance was expensive, providing more benefit to high earners and it was gradually restricted until now it is of use only to married couples or civil partners where at least one of the couple is aged 79 or over.

Separation, death and becoming married

Full MCA is normally available in the year of separation (as defined above) or death. On the other hand, on becoming married, the allowance is restricted by 1/12th for each month in the year when the couple are not married. This seems an unnecessary complication.

Is the claimant a national of a country in the EEA?

Generally speaking, individuals are treated separately for considering their residence status (see section 4.1.4). But, as noted above, married couples and civil partners are treated as living together unless they are separated by a court order or a deed of separation or in circumstances such that the separation is likely to be permanent. This is the case even where the individuals are resident in different countries. Thus a husband may be working overseas, anywhere in the world, but still be entitled to the MCA if he is a national of an EEA country. Any allowance might then be transferred to his spouse. Given the age profile of claimants to the MCA, this particular effect of the legislation is likely to diminish rapidly in importance.

Other types of couple

Individuals who are living together as a married couple or civil partners (who have not married or entered into a civil partnership) cannot claim the MCA, unless they fall within the exception for some Scottish couples noted above at Section 3.

Comments on settlements

What is a settlement or trust?

A trust may be considered to be 'an extra pair of hands' to hold assets. If those assets generate income, or gains are realised in connection with them, then those 'profits' belong to the trust.

When we consider the taxation of settlements, or trusts, there are normally three other parties to be considered.

The first party to be considered is the trustees. They are responsible for administering the trust – and in most cases they are responsible for paying any tax due on the trust's property, albeit that the liability will be paid out of the trust's assets.

The second party is the settlor (there can be more than one settlor, but usually trusts have a single settlor). They are the person who donates the assets to the trust and also lays down any conditions for using those assets – normally in a written trust deed, but a trust may be established orally.

Finally the last party is the beneficiary (or beneficiaries). They are the person (or class of persons) who can benefit from the trust.

In the simple case, a person can put assets into a trust and the trust then has its own tax regime to deal with. While trusts are usually put in place for safeguarding purposes, for example where someone is unable to manage their own affairs, a degree of suspicion has arisen surrounding their use for tax avoidance purposes. For this reason, special income tax provisions were introduced in around the 1930s to prevent avoidance of tax by the device of placing some personal assets into a settlement.

For example, a husband might have placed assets in a trust for his wife – and his wife might have been able to obtain financial support from that trust while the couple overall might bear a lower rate of taxation than if the assets had been owned by the wife personally. Legislation was therefore introduced to counter this type of arrangement.[137] These provisions assess any income tax due in relation to the trust's assets on the settlor of the trust rather than on anyone else in specified circumstances, such as where assets are placed into a trust and the settlor can in any way benefit from the trust (either directly or indirectly, such as via what we might term a

137 Now in Chapter 5, Part 5 Income (Tax Trading and Other Income) Act 2005, having previously been in section 660A et seq Income and Corporation Taxes Act 1988.

'household' benefit of providing his wife or other family with additional income).

The relevance to couples is that in some cases the legislation specifically either targets gifts between spouses and civil partners, or indeed provides a 'let out' clause from such target.

Legislation

There are four areas where being part of a couple may be relevant for this legislation:

- a spouse or civil partner may benefit from the settlement;
- an outright gift is made to a spouse or civil partner that is not wholly or substantially a gift of income;
- the settlor might benefit from the settlement; or
- a minor child might benefit from the settlement.

We will consider these four areas in turn in relation to traditional settlements and then turn to the area of family businesses

A spouse or civil partner may benefit from the settlement

The legislation is set out in Chapter 5, Part 5 ITTOIA 2005.

Section 625 applies the charge to income tax on the settlor in relation to income arising to the settlement where the settlor **or their spouse or civil partner** will or may receive benefit from the settlement. In other words this is widely drawn – there only needs to be a possibility of receiving a benefit for the income to be taxed on the settlor. There are various exceptions, but we will examine the legislation only as it affects couples.

For the purposes of this legislation, a spouse or civil partner does not include:

- one from whom the settlor is separated under a court order or separation agreement; or
- one from whom the settlor is separated where the separation is likely to become permanent;
- the widow/widower/surviving civil partner of the settlor (in other words a settlement can be set up by one spouse where the survivor can benefit after his death – and this is excluded from these provisions);
- a person the settlor may marry/register a civil partnership with in the future.

The legislation clearly targets gifts to a settlement from which spouses and civil partners might benefit. The exclusions above mean that the definition of a couple is consistent with that used for the MCA.

An outright gift is made to a spouse or civil partner

Bearing in mind that this legislation affects not only gifts to 'formal' settlements, but also those to informal settlements, it can be seen that any gifts between spouses might potentially fall within the terms of the legislation and so result in income tax complications for the donor. Section 626 does provide an exception for outright gifts (that is, gifts that are not into a formal settlement) between spouses and civil partners, except where the gift is wholly or substantially a gift of income. It is clear that a gift into trust is treated differently because the donor will have had the opportunity to lay down some rule about how the income and capital may be used in the trust deed.

Thus if, for example, a wife gives a large sum of cash to her husband, there is no further tax implication for her (under these provisions). Any income will be her husband's for tax purposes; he can use the money how he sees fit. There are also no IHT issues for such a gift between spouses and civil partners if both are domiciled in the UK. But if, instead, she made the gift into a trust from which her husband might benefit, any income would be taxed on her.

It might be wondered what gift might be 'wholly or substantially' a right to income. Such a gift might be the gift of one spouse's right to receive income that was rightfully his, without a gift of the underlying asset to their spouse.

The position is quite different for gifts between cohabitees and we consider the possible implications below.

The settlor might benefit from the settlement

In contrast to the situation above where gifts are between spouses, this head of charge might be more difficult to identify.

Continuing the example at section 4.1.4, assume Miss A now gifts cash to Mr B. They are not married but live together as husband and wife. Under these provisions there seems to be potential for this to be deemed a settlement and for income to be assessed on Miss A *if she can benefit from this gift*. In many such cases an outright gift does not produce income; indeed if it is a cash gift it is often spent. From a compliance point of view it is not clear how HMRC might discover such a gift unless it were extremely large (and so raised questions as to the origin of the capital). Such a gift might also be treated as a potentially exempt transfer (PET) for IHT purposes.

In most cases where a formal trust deed is created, with proper advice, the trustees would be prevented from providing any benefit to the settlor (the settlor would be 'excluded' from benefit) so that these provisions were not invoked, but where, instead, an oral settlement was suggested by HMRC it is difficult to see how it might be proved that the settlor was excluded from all benefit.

A minor child might benefit from the settlement

There are similar provisions in ITTOIA 2005 covering cases where gifts are made to minor unmarried children of the settlor. This includes step-children – but a stepchild is defined as the child of one of the married couple. Thus a gift to the child of a cohabitee would not be within these provisions.

This is therefore an area where cohabiting couples have potential advantages, for example:

- One party could make a settlement (or an outright gift) for a child of the other party – and the income would be the income of that child. Bearing in mind that no spouse exemption for IHT is available, this may assist slightly with tax planning, but it is unlikely to cause widespread avoidance, especially since all new settlements are subject to the relevant property regime and so are potentially subject to regular IHT charges. Care would have to be taken that the gift to the child was not considered to be part of a reciprocal arrangement or S 620(3) ITTOIA 2005 would invoke the settlement rules on the donor.

- A gift into a settlement for their cohabitee would not result in the income from the settlement being assessed on the donor.

Appendix 8: GOV.UK screenshots taken relating to couple B example

Changes that affect your tax credits

Your tax credits can go up, down or stop if there are changes in your family or work life- you must report these changes to the Tax Credit Office.

Why your tax credits change

Your payments can go up because:

- your income goes down by more than £2,500
- your benefits stop or go down
- you have a child
- your childcare costs go up

Your payments can go down or stop because:

- our income goes up by more than £5,000
- you haven't renewed your claim
- your award notice shows you've been overpaid
- your child is now 16, 18 or 19 and you haven't told the Tax Credit Office they're in approved education or training
- you or your partner start claiming UC

Work or family changes you must report

You could miss out on tax credits you're entitled to if your circumstances change and you don't report it.

Circumstance	When to report the change
Baby born or you take responsibility for another child	Within 1 month
Benefits (yours or your child's) start, stop or change	As soon as possible
Child is certified blind (or no longer certified)	As soon as possible
Child leaves home- eg moves out, taken into care	Within 1 month
Child or partner dies	Within 1 month
Child over 16 joins an approved careers service	Within 3 months
Child over 16 leaves an approved careers service	Within 1 month

Child over 16 stays in or leaves approved education or training	Within 1 month
Childcare costs start, stop, change by £10 or more per week or you start or stop getting help with them	Within 1 month
Childcare provider changes but is still registered	As soon as possible
Childcare provider is no longer registered or approved	Within 1 month
Holiday or trip abroad (usually 8 weeks or more)	Within 1 month
Ill or in hospital for more than 28 weeks (adults only)	Within 1 month
Income changes	As soon as possible
Job changes	As soon as possible
Job starts or stops	Within 1 month
Leave the UK for good (or lose the right to reside here)	Within 1 month
Prison sentence	Within 1 month
Relationship starts or ends- eg you live with a new partner, get a permanent separation or divorce	Within 1 month
Work hours fall below 30 or more a week (combined hours if you're in a couple with children)	Within 1 month
Work hours fall below or increase above the minimum required to qualify	Within 1 month
Work hours increase to 30 or more a week	As soon as possible
You don't return to work after a gap or leave	Within 1 month
You or a member of your family become or stop being disabled	As soon as possible
You're claiming childcare costs and you or your partner start working for 16 hours or less except in certain situations	Within 1 month

You'll have to make a new claim for tax credits if:

- you start or end a relationship
- your partner dies
- If you stop work or go on leave

You're still entitled to Working Tax Credit when you stop work or go on leave- but only for a certain period of time. When this period ends, tell the Tax Credit Office if you're not back at work.

Overpayments

If you receive tax credits you're not entitled to, this is called 'being overpaid'. You must repay any overpaid money, and you may receive a penalty.

This could be up to £300 if you report a change late or up to £3,000 if you give wrong information carelessly or on purpose.

If your income goes up by more than £5,000 report it immediately or you may get an overpayment.

Changes of address or bank details

Report a change of address or bank details as soon as possible. You can report a change of bank details from 30 days before the change. Wait until your address changes before you report it.

How to report changes

To report a change call the Tax Credit Helpline.

Last updated: 14 January 2015

Appendix 9: Discussion of a single definition of a couple for all tax and benefits purposes

The case for equalising the treatment of married couples and people who are living together as couples

Even if they are comparatively recent, many tax reliefs owe their origin to long standing provisions. For example, the exemption from IHT liability for gifts between husband and wife goes back well into the days of Estate Duty, quite possibly to its introduction in 1894. Clearly the political, economic and social context has changed enormously since then, so that the underlying assumptions need to be challenged in order to ensure that they remain up to date. And it hardly has to be said that living together without being married is a commonplace status today for a wide variety of reasons. Indeed it may be as common as marriage itself in some areas of the UK. That being so, there could be a strong case for suggesting that, subject to the sort of limitations considered below, the reliefs – and the charges, eg in the income tax settlements legislation – that apply to married couples should apply equally to people who are living together as couples.

But the arguments are not all one way, and it has to be accepted that any such change would meet fairly vocal opposition. Apart from any moral or religious objection of principle, some would make a case for saying that married couples are not only healthier and happier themselves than other couples, but, perhaps more importantly, that they are considerably less likely to divorce than couples living together are to separate while their children are young and that their children grow up healthier and better educated with fewer behavioural or criminal problems.[138]

Against this, it is argued that this outcome is not related to marriage as such, but rather to the fact that on average married couples are better educated and have higher incomes than other couples and that it is these latter factors which explain the differences. In response, the proponents of marriage would accept that these factors are certainly relevant, but that they do not fully account for the better outcomes of the children of married couples.

It is not the purpose of this paper to pursue these arguments, but we recognise that they exist. Any proposals to treat couples living together in the same way as married couples would therefore almost certainly meet resistance from some quarters (though this report in fact stops short of making such a recommendation, as it would need to be supported by more detailed analysis – for example, of winners and losers; and not just those on low incomes, but across the income spectrum).

A single definition of 'couple'

The statistics[139] show that the number of identified unmarried couples has risen to the point where they cannot be brushed aside as irrelevant, and that ignores the many who have not been identified as such. These show that of a total of around 28M dependent children, nearly 4.4M live with cohabiting couples. These children (particularly on the death of one of their parents or caretakers, as shown in this report in the context of bereavement support from

138 See Institute for the Study of Civil Society: http://www.civitas.org.uk/hwu/cohabitation.php

139 http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-383612

the State) might find themselves in very different financial circumstances to those who live with married parents – but the children cannot take a decision for their parents to marry.

There are two dimensions to pursuing a single definition, if that were to be considered. The first is – which couples are to be equated with, and treated in the same way as, married couples. It has to be this way round because there is relatively little dubiety about what constitutes a married couple, and therefore what their legislative rights and obligations are.

The starting point for defining a qualifying unmarried couple might be the tax credits definition (see section 4 of this report), for example. But this definition does not include couples who are living apart together (such that they are emotionally together, but physically live separately), even though they can show that they satisfy the other criteria pertaining to a couple.

Conversely, the tax credits test can bring in those who are emotionally separated but who may still be living under the same roof, even when they are behaving as completely separated individuals. Such separated couples need the means through legislation or administrative clarification to be treated as separate – for example a declaration process as suggested in our conclusions chapter to this report.

The second dimension would be the length of time the couple had been together. Anyone who had been treated as a couple for tax credits or benefits purposes or for the HICBC for any period would clearly qualify as a couple for this wider purpose for that period, unless they were emotionally separated but still physically living together. Equally anyone who had been treated as not being a member of a couple would clearly not. But there would be many people for whom neither test would have been relevant previously and whose case for coming within the new rules would need to be established.

The Claimants Compliance Manual[140] suggests that there are no hard and fast rules as to the length of time people are together before they can be considered as a couple for tax credit purposes, but that a short term relationship of less than three months is unlikely to meet the criteria. But if there were a single definition of a couple for all tax and benefits purposes, it may well be that a rather longer relationship would be appropriate. It would be for consideration what this period might be: certainly five years would be the longest which this minimum period should be, but two or three years might be sufficient. There might have to be special rules for if a death curtailed the usual period.

There is one further angle that would need to be examined. Some couples who live together rather than get married do so because one or other or both of them are married to someone else and cannot get divorced or are in the process of so doing. Clearly no-one should be able to benefit both as one of a couple who are living together and as a married person and there would need to be rules to decide which they were. Equally, and probably more difficult, the person with whom one of them was living would not be able to claim if the person to whom that person was married could also claim. A clause would be necessary along the usual lines of being

> "married to each other and are neither –
>
> (a) separated under a court order, nor
>
> (b) separated in circumstances in which the separation is likely to be permanent"

in order for the unmarried couple status to be the one which would prevail in applying the definition.

140 http://www.hmrc.gov.uk/manuals/ccmmanual/CCM15220.htm

We note here a possible link in that, in Scotland, a statutory definition of a cohabitee has been introduced in relation to rights upon death (see section 4.1.2.2). It might be considered that this could be adopted or adapted for use more widely.

Implications of equalising the treatment of married and unmarried couples for tax and benefit purposes

As noted in the main body of this report, we are not recommending that treatment of unmarried and married couples is equalised for the purposes of tax and benefits. We have performed no costings of making such a change. Indeed, identifying all the couples who might be involved could be challenging in its own right.

Such a wide-ranging change would, presumably, have to be executed on a cost-neutral basis. There would, therefore, be both winners and losers – but for most unmarried low-income taxpayers, already in a couple and so subject to restrictions in tax credits, for example, it seems likely that the ability to use a partner's NIC to obtain eligibility to other state benefits would favour them and cost the state more.

Appendix 10: An administrative option, for couples to declare that for all tax and benefits purposes they wish to be treated as a married couple

An administrative option

There is a possible administrative solution to uncertainties about a couple's status and its duration – an election to be treated as a couple for **all** tax and state benefits purposes.[141] This route could be available whether or not the couple had been identified already as a couple for any such single purpose.

We have not attempted to work out procedures for its implementation and indeed have stopped short of recommending that such a facility is introduced, but it is an option potentially worthy of further debate. Clearly there would be issues to consider and the enabling legislation would need to include provisions about:

- the qualifying time of coupledom before an election could be made
- the form of the election
- the obligation to withdraw the election if there is a permanent separation
- preventing switching in and out of elections at will
- perhaps allowing or even ensuring that in-date years for all taxes of the couple are adjusted in accordance with the election
- resolving, or better, preventing disputes about rival claims to coupledom
- either specifically preventing or specifically allowing an *electio mortis causa*
- excluding relationships which would not be allowed in law, and those which are based purely on amity.

141 Including the proposed Transferable Allowance and Tax-free Childcare provisions.

Appendix 11: Single earner couples

One of the most marked features of the changes in the personal tax system under the Coalition Government has been the very sharp increase in the income tax PA from £6,475 in 2010/11 to £10,000 in 2014/15 (and a proposed £10,600 in 2015/16). This has been of considerable advantage to single people without dependants, and to two-earner couples, both married and cohabiting, provided both their individual incomes exceed their allowances.

There are many millions of two-earner couples including state pensioners and part-time workers, usually women, whose income is well below existing PA levels and who will therefore not have benefited at all from the increase in PAs.

A major way of improving the relative position of single earner couples and those couples where one earner is on a very low wage (both married and cohabiting) would be to allow full transferability of the PA. This would of course have a very significant cost, but no more than continuing to increase the PA to the advantage of those who are relatively better off. And the cost could be phased in by confining the transferability to groups of single earner couples such as those with a child under a certain age (which could be increased over time), those with a disabled child, those with caring responsibilities for older or dependant people, and those where one or other had a physical or mental disability.

If there is reason for transferring both the MCA and BPA to cope with family unit need, why not also the unused PA up to its full value, rather than as a fractional Transferable Allowance? If it is argued that the PA is indeed personal and directed solely at that person, then the same logic should apply to the BPA – that is, that it is directed at the blind person. If it is argued that the MCA is provided to help the main earner (or likely main income pensioner given the current age profile for claiming this allowance) support his or her partner, then the same argument can be used for the PA.

Under the current system, millions of pensioners do not use all their allowances. HMRC figures[142] suggest that around 6 million state pensioners pay tax, implying that the other 6 million[143] do not. Although there will clearly be some who have an income of £9,999 or £10,499, many will be wives who have only their married woman's State Pension of some £3,528 a year.

In looking at the cost of this proposal to enable unused PAs to be transferred, we should remember that much pension credit is paid out to supplement the incomes of those hovering near the poverty line. If pensioners made full use of their combined allowances, their net household income would rise and the need for pension credit would correspondingly reduce. The same argument would apply to working age families claiming tax credits and childcare benefits – more mothers (or fathers) could stay at home with young children, the household income being boosted by the other person's £10,000 allowances. It is administratively cheaper to leave people with more of their money in the first place than take it from them and then give it back. This income-boosting becomes more necessary as HMRC figures (ibid) show the significant decline in income among the 75 + age group.

Finally, this report notes that the impact of the HICBC is particularly noticeable on single earner couples (or couples

142 https://www.gov.uk/government/publications/income-and-tax-for-individuals-of-pension-age-by-gender-region-and-country-2010-to-2011

143 http://www.ons.gov.uk/ons/dcp171766_341468.pdf

where there is one higher earner and one low earner). The existing extension of the HICBC charge to cover all couples is sound in principle, but by counting heads to identify the individuals on whom the charge is raised but not combining their incomes, there is a huge inequity of outcome.