

**Law Commission and Scottish Law Commission
Joint consultation: Building families through surrogacy – a new law
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We welcome the opportunity to input into this consultation on surrogacy arrangements. Although we have not come across any individuals involved in such arrangements, we wish to share our thoughts on a plethora of tax, National Insurance and related welfare benefits issues that we think need to be addressed.
- 1.2 This response should not be taken as a detailed consideration of the areas we touch upon. Rather, it should be read as a discussion document, which aims to:
- highlight where we think there could already be hidden tax and other problems relating to existing surrogacy agreements;
 - flag up issues to watch when considering reforms to the law;
 - suggest areas for further, detailed consultation; and
 - highlight that if a specific tax relief might be considered for payments made under surrogacy arrangements, this should form part of any consultation.
- 1.3 We recommend that HM Treasury, HM Revenue & Customs (HMRC) and the Department for Work and Pensions (DWP) are involved in further detailed consultation on tax, National Insurance and welfare benefits issues. We also suggest that the Department for Education be consulted in the context of how payments under surrogacy arrangements could impact on student finance entitlement and repayments. Furthermore, engagement with the Department for Business, Energy & Industrial Strategy (BEIS) is necessary in relation to parental pay and leave issues.

- 1.4 At the very least, we recommend that the issues we raise are thought about in detail by the relevant government departments and that it would be helpful to determine an official position on tax, National Insurance, benefits and other related matters based upon the law as it stands. Surrogacy arrangements have seemingly developed over the years without any apparent thought to these peripheral, yet extremely important, issues. The present lack of clarity is not sustainable, particularly if there is growth in the number of surrogacy arrangements. The inability to understand their position and the risk of becoming non-compliant with tax, benefits and other law may be acting as a deterrent to potential surrogates.
- 1.5 We would like to meet with the Law Commission and Scottish Law Commission to discuss these matters further and would be pleased to help shape the further consultation we recommend. We note in section 9 of this response that the tax and benefits treatment of surrogacy arrangements in Northern Ireland will require similar consideration.

2 About Us

- 2.1 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.
- 2.2 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.
- 2.3 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.

3 Introduction

- 3.1 We wish to contribute to this consultation as it discusses various types of payment made by intended parents to a surrogate. It is our understanding that under the present law, such payments should be restricted to reimbursement of reasonable expenses related to the

surrogacy, but it appears that payments over and above are sometimes in fact made (with the court retrospectively authorising those payments).¹

- 3.2 The consultation also opens a wider discussion on the nature and extent of payments that could be made through future changes in the law.
- 3.3 When value changes hands between parties – be that sums of money or in-kind amounts such as gifts – there are almost invariably tax, and often National Insurance contributions (NIC), consequences that must be considered. Furthermore, for low-income recipients, there may be impacts on entitlement to means-tested credits or benefits.
- 3.4 It is these tax, NIC and welfare benefits aspects of the surrogacy consultation that fall within LITRG's remit. We make no comment, and none should be taken as implied, on the ethical aspects of surrogacy arrangements and the issues surrounding whether they should be purely altruistic or whether further payments should be permissible between the parties.²
- 3.5 We simply wish to point out that there are tax, NIC and benefits issues to be considered. We offer our experience and knowledge of these systems to point out those issues, together with some thoughts as to solutions that might be considered.
- 3.6 Arguably, this response only scratches the surface of the tax, NIC and benefits issues that could arise. We therefore recommend that HM Treasury, HMRC and the DWP consult on them in detail so that clarity and consistency of treatment can be achieved alongside any general changes in surrogacy law.
- 3.7 Please note that our comments below are not set out in answer to any of the specific consultation questions. The points we make do not fit well within the questions asked, because we are largely putting forward further matters for consideration that are not covered within the consultation document. Our comments do, however, broadly relate to the matters discussed in Chapter 14 ('Payments to the surrogate by the intended parents: the current context') and Chapter 15 ('Payments to the surrogate by the intended parents: options for reform').
- 3.8 We would like to meet to discuss this response in more detail.

¹ See, for example, para 14.7 of the consultation document.

² Note also that we use the terminology in the consultation document itself, set out in Chapter 1. For example we refer to surrogates as women and use the female pronoun when referring to them (per para 1.82 of the consultation document).

4 Tax implications for the surrogate of payments made by the intended parents

4.1 *The present 'expenses' regime*

- 4.1.1 In tax terms, the consultation document seems to imply that there might be no tax consequences of the present 'reasonable expenses' regime. We think this is the implication because the only mention of tax in the document is on page 360, footnote 16 which says: 'We note that consideration will have to be given to the tax implications of any payments to surrogates in excess of expenses', and this is set in the context of Chapter 15 being about options for reform rather than about the present system.
- 4.1.2 However, we think that it is likely that there are some significant questions to be asked about tax matters within the existing expenses regime. The consultation outlines that in the Law Commission's review of court files of parental order applications, in 'very few' cases were itemised breakdowns of expenses with accompanying receipts given.¹ Further, even if sums received were broadly categorised by type of expense, 'accompany receipts... were not then provided'.² Perhaps most worryingly, it was 'frequently' found that 'a round figure was pre-agreed by the parties (for example £15,000)'.³ The court has the ability to authorise retrospectively payments in excess of reasonable expenses, given that it is unlikely to be in the best interests of the child not to permit the parental order in favour of the intended parents.⁴
- 4.1.3 It seems to us that there are already likely to be tax issues resulting from such arrangements, and that any amounts received by the surrogate in excess of expenses incurred wholly and exclusively in connection with the arrangements are likely to be taxable as 'miscellaneous income' under the Income Tax (Trading and Other Income) Act 2005, Part 5, Chapter 8. As an aside, we note that the £1,000 'trading allowance'⁵ applies to miscellaneous income. However, with the consultation suggesting that amounts of £10,000 to £20,000 or even more might be paid, it seems to us that there is likely to be some taxable element, unless actual expenses equal to the amount received can be proved.
- 4.1.4 Of greatest concern is the existence of arrangements under which the parties pre-agree a round figure and pay it by instalments, as outlined in para 14.20 of the consultation

¹ See para 14.17 of the consultation document.

² See para 14.18 of the consultation document.

³ See para 14.20 of the consultation document.

⁴ See para 14.7 of the consultation document.

⁵ Income Tax (Trading and Other Income) Act 2005, s 783AB

document. The tax system generally treats such round sums as taxable in full, with the recipient then having to claim for any specific deductions that may be made against it.¹

4.1.5 However, it is not apparent to us that there have ever been any cases of HMRC seeking to tax such sums, as we can find no commentary on surrogacy arrangements in tax publications (including HMRC Manuals²), nor in decided tribunal/court tax cases. This could be because:

- HMRC have considered the issues and have concluded there is no tax liability;
- HMRC have investigated cases, concluded that tax was due, and the surrogates concerned have settled their case with HMRC, paying any relevant tax and penalties as necessary without seeking to appeal;
- the cases have not hit HMRC's 'radar'; or
- HMRC believe there might be some tax issues but have made a value judgment not to pursue them given the potential tax at stake as against adverse publicity by pursuing surrogates to court for tax on such sums.

4.1.6 If it is the case that these issues have simply not come to HMRC's attention, it might on one hand be considered unhelpful to invite their scrutiny. This approach, however, of 'letting sleeping dogs lie' is not sustainable, particularly given that the consultation considers future changes in the law relating to payments, which naturally generates interest in their tax treatment.

4.1.7 Moreover, it is inevitable that eventually a surrogate and the extent of payments received from intended parents – particularly if amounts in excess of reasonable expenses are authorised by the court – will come to HMRC's attention. It is better to seek clarification now of the tax issues and address both how existing and future arrangements are treated. Not only is tax on sums in excess of genuine expenses at stake, but the surrogate also risks penalties for failure to notify HMRC of a tax liability, and the associated compliance implications (such as filing of Self Assessment tax returns).

4.1.8 The above therefore suggests that, irrespective of any change in the law to allow further or different types of payment, there needs to be a review to clarify the present tax treatment and to ensure that the surrogate is not put in a vulnerable position in terms of an unexpected tax liability, related penalties and associated bureaucracy/administration.

¹ An example of this can be seen in the context of employers paying round sums to employees rather than reimbursing specific expenses, as explained on GOV.UK: <https://www.gov.uk/expenses-and-benefits-cash-sum-payments/round-sum-allowances>. While it is unlikely that the surrogate could be considered an employee of the intended parents, given the unenforceable nature of the contract by the intended parents, it is not difficult to envisage that HMRC could use a similar approach to interpret how expenses paid to surrogates should be taxed.

² See <https://www.gov.uk/government/collections/hmrc-manuals>

4.2 ***Options for reform***

4.2.1 Chapter 15 of the consultation document discusses options for reform in terms of payments which might, in future, be permissible by intended parents to a surrogate. These might include:

- Costs: payment of an allowance, or costs actually incurred
- Essential costs relating to the pregnancy
- Additional costs relating to the pregnancy
- Costs associated with a surrogacy arrangement and pregnancy
- Lost earnings
- Lost entitlement to social welfare benefits
- Compensation for pain and inconvenience, medical treatment and complications, and death of the surrogate
- Gifts
- Payment for being a surrogate (the sum either being agreed between the parties or a fixed fee, set by the regulator)

4.2.2 We make some comments on the potential tax treatment of each of these below and then move on (see 4.3 below) to discuss how we think tax issues could be addressed before any options for reform are fixed.

Costs – we take the first four bullets above together

4.2.3 As noted in 4.1.4 above, we think that the tax system – unless there was a specific relief or exemption written into law (see our comments at 4.3 below) – would treat round sum allowances paid to cover expenses as taxable in full, with the surrogate having to claim actual costs incurred as a deduction from the allowance. This would involve the surrogate in a compliance exercise – mostly likely involving them notifying HMRC of a potential tax liability and completing a Self Assessment tax return. If, therefore, the idea of paying a round sum allowance to cover expenses is to help remove from the surrogate the administrative burden of having to keep receipts for individual sums, that aim will not be achieved. The surrogate would still have to keep those records for tax purposes in any case.

4.2.4 Similarly, even if the intended parents are reimbursing actual expenses incurred on production of receipts, care needs to be taken to ensure that the costs are indeed deductible – i.e. that they are incurred wholly and exclusively in relation to the income. It is not clear how many of the costs that might be reimbursed in surrogacy arrangements would meet this wholly and exclusively criteria. For example, the consultation references *Mallalieu v Drummond (Inspector of Taxes)* [1983] 2 AC 861 at para 15.41, suggesting that maternity clothing would not be a deductible expense in the context of benefits legislation. However, this was of course primarily a tax case and, on the interpretation applied in the consultation document, it would therefore suggest that maternity clothing is not deductible for tax purposes. Therefore, even if those costs were actually incurred by the surrogate, they may not be deductible against the ‘income’ (i.e. reimbursement or round sum allowance) paid by the intended parents. This might suggest that the intended parents should pay a grossed up

value to the surrogate, allowing for any income tax she might have to pay so that the net amount is available to spend on the required clothing.

- 4.2.5 Note, however, that we think that the matter of whether expenses are wholly and exclusively incurred by the surrogate is a complex area and requires further detailed consideration. This is because some of the kinds of expenditure a surrogate incurs, such as clothing (touched on above) and food and drink (to nourish herself and the foetus(es)) are considered by HMRC to have ‘an intrinsic duality of purpose’¹ and may therefore – as is suggested in relation to maternity clothing – not be deductible against income. This is notwithstanding that it might seem reasonable within the context of a surrogacy arrangement for the intended parents to cover or supplement those costs – for example, in helping the surrogate to cover the cost of following a healthy diet. As suggested elsewhere in this response, HMRC’s view on such matters in relation to surrogacy arrangements needs to be sought and confirmed, and further consultation carried out as to how it would be desirable to treat them moving forward.

Lost earnings

- 4.2.6 Compensation for loss of earnings as part of, say, a claim for personal injury is not usually taxable provided it does not include any element of profit. In working out the amount to be paid, account therefore has to be taken of any income tax that would have been paid by the recipient, had they in fact earned that sum. The compensation should therefore be the equivalent of net earnings under what is known as the *Gourley* principle.²
- 4.2.7 If earnings are lost such that the surrogate consequently does not earn enough to obtain a ‘qualifying year’ for National Insurance purposes, the compensation for lost earnings might need to include an amount to cover the surrogate for paying class 3 (voluntary) NIC. See also section 7 below for further comment on NIC.

Lost entitlement to social welfare benefits

- 4.2.8 We discuss below (see section 6) how we think reimbursement of expenses, or payment of other fees through surrogacy arrangements, might affect entitlement to means-tested benefits. If the intended parents compensate the surrogate for loss of such benefits, the tax treatment of such compensation would need to be confirmed.
- 4.2.9 We also comment below (see section 7) on how a loss of entitlement to certain benefits might mean that the surrogate in turn loses entitlement to National Insurance credits.

¹ See HMRC’s Business Income Manual, sections BIM37900 to BIM37970. These can be found within the section on ‘wholly and exclusively’, see: <https://www.gov.uk/hmrc-internal-manuals/business-income-manual/bim37000>

² *British Transport Commission v Gourley* [1956] AC 185

Compensation

- 4.2.10 The tax treatment of compensation payments is a complicated area. Payments might be considered to be income or they might be capital. If the latter, as might appear to be the case here, it could be that they are exempt from capital gains tax.¹ By concession, this exemption is extended to compensation received by a person other than the individual who suffered the wrong or injury, such as the relatives of a deceased person.² The latter could be relevant in the event of payment of compensation to a surrogate's family in the event of her death, for example.
- 4.2.11 However, the consultation refers to various types of compensation potentially being payable to the surrogate, some of which may not fall within the wording of the legislation which refers to a 'wrong or injury suffered by an individual'.³ We are not certain whether payments for inconvenience, in particular, would fall within this definition. For instance, para 15.48 of the consultation document proposes 'compensation' for each insemination or embryo transfer. It seems that this may not fall within the definition of wrong or injury, given that it is an act the surrogate has willingly undertaken, so *prima facie* seems more to be a payment for her services as a surrogate rather than being 'compensation'.⁴ However, other types of payment, such as an amount to compensate for suffering caused by the pregnancy, such as birth complications, would seem to more naturally fit within the definition of 'injury suffered by an individual in [his] person'.
- 4.2.12 The specific nature, and hence the tax consequences, of each type of proposed 'compensation' therefore requires detailed consideration, and again we recommend that these form part of a future consultation.

Gifts

- 4.2.13 Gifts from one person to another are not normally taxable as income in the hands of the recipient. However, there may be circumstances in which gifts can be taxable.
- 4.2.14 In relation to the miscellaneous income provisions, HMRC manuals say:

¹ By virtue of Section 51(2), Taxation of Chargeable Gains Act 1992, which provides that 'sums obtained by way of compensation or damages for any wrong or injury suffered by an individual in his person or his profession or vocation' are not chargeable to capital gains tax.

² Extra-statutory Concession D33, see HMRC Manuals CG13030 for an overview:
<https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg13030>

³ As above, Section 51(2) TCGA 1992

⁴ Please note that this should not be read to mean that we do not understand there may be physical discomfort or risk associated with these procedures. We merely wish to highlight that tax law as it stands may not interpret such payments as compensatory in nature and therefore this requires more detailed consideration.

‘A casual receipt is taxable under the miscellaneous income sweep-up provisions where it is received for a service performed as agreed/arranged for reward. This contrasts with a simple gift as a ‘thank you’, for example, after performing a casual service where there was no agreement/arrangement/common expectation that such was for reward.

‘Voluntary gifts are not taxable under the miscellaneous income provisions. This can be a difficult area depending on the facts of the specific case.’¹

- 4.2.15 It is probable from the above that HMRC would not seek to tax the value of a recuperative holiday, for example, gifted to the surrogate by the intended parents where this did not form part of any previous agreement between the parties. However, if it could be argued that the surrogate is engaged in a trade, as might be the case if payment of fees were permissible for her services, the value of such a holiday might be brought into charge to tax, even if gifted by the intended parents without obligation. Much depends on whether the gift can be shown to be a trading receipt and whether it is income or capital in nature.²
- 4.2.16 Gifts may also be taxable as earnings, or potentially as a benefit in kind depending on the nature of the gift, if there is an employer/employee relationship between the parties.³ However, as mentioned in our earlier discussions on the nature of the relationship between surrogates and intended parents, we think it is very unlikely that the surrogate could be regarded as an employee as, for example, she will still have control over how she lives her life while pregnant.
- 4.2.17 If a gift of a chargeable asset were made by the intended parents to the surrogate, there could also be capital gains tax implications for the intended parents on such a disposal.⁴ While we include it here for completeness, we do not go into this in further detail, as it appears from reading the consultation document that surrogacy arrangements would usually not include gifts of chargeable assets.
- 4.2.18 Finally, it is worth noting that gifts can have inheritance tax implications. It would seem that most gifts under surrogacy arrangements would be of a value such that they would be exempt from inheritance tax, if the donor’s annual exemption of £3,000 (and/or that of the

¹ HMRC Business Income Manual, BIM100110. See <https://www.gov.uk/hmrc-internal-manuals/business-income-manual/bim100110>

² See HMRC’s Business Income Manual, para BIM41801ff: <https://www.gov.uk/hmrc-internal-manuals/business-income-manual/bim41801>

³ See HMRC Manuals EIM01450 and EIM01460 for further information: <https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim01450> and <https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim01460>

⁴ See for example HMRC Manuals CG66450: <https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg66450>

previous tax year of another £3,000) is available. Otherwise, the gifts would likely be potentially exempt transfers and inheritance tax would only become a concern on the donor's death within seven years of the gift (and even then only if the donor had made gifts in excess of their inheritance nil rate band, currently £325,000). This therefore seems unlikely to be an issue in the context of most surrogacy arrangements, however we mention it here for completeness. Note that any gifts would become part of the surrogate's estate for inheritance tax purposes, once made (to the extent that they are not comprised of ephemeral items such as holidays which have no lasting monetary value).

Payment for being a surrogate

- 4.2.19 If a surrogate may be paid in future for her services as a surrogate, then unless a specific tax exemption is legislated for, she is likely to be taxable on such sums.
- 4.2.20 We note that the consultation paper discusses what it is that the surrogate is to be paid for, i.e. it cannot be payment for the sale of the child. It appears instead that the payment would be made for surrogacy services. Here, we believe there needs to be some consideration given to the nature of the contract and how it would be interpreted in tax terms.
- 4.2.21 Is it a contract of service – suggesting, in tax treatment terms – an employer/employee arrangement and the application of PAYE being required by the intended parents? It would perhaps be surprising to think of it in these terms, however for tax purposes, it would be necessary to weigh up the hallmarks of employment versus self-employment.¹ Is, for example, the surrogate under the supervision, direction and/or control of the intended parents? Perhaps not, but clearly the surrogate is unable to 'send a substitute' to fulfil her part of the arrangement, which is often one of the factors that HMRC consider to denote an employment contract rather than one of self-employment.
- 4.2.22 Then again, is it truly possible to say that the surrogate is 'self-employed'? Is she engaged in a 'trade, profession or vocation' in the context of surrogacy services? A one-off surrogacy arrangement might indicate that she is not trading. But would HMRC consider that a series of surrogate pregnancies might constitute a trade?
- 4.2.23 In the event that the arrangement is neither one of employment or self-employment, we believe that any payment for being a surrogate would constitute miscellaneous income and therefore be taxable under the Income Tax (Trading and Other Income) Act 2005, Part 5, Chapter 8.
- 4.2.24 It is therefore clearly necessary to establish what position HMRC would be likely to take regarding the nature of surrogacy contracts and payment for surrogacy services. A clear

¹ An overview of the key indicators used to judge employment versus self-employment can be found on our website. See: <https://www.litrg.org.uk/tax-guides/self-employment/am-i-employed-self-employed-both-or-neither#toc-table-summary-of-key-points-on-employment-and-self-employment>

ability to profit financially from a surrogacy arrangement, if payment of fees were to be introduced, makes it much more likely that HMRC would take an interest in them in future.

4.3 ***A potential solution to be considered and consulted upon***

4.3.1 First, we think it is important to outline that the tax, NIC and benefits treatment of payments can influence people's behaviour.

4.3.2 We reiterate that this submission is not intended to stray into the ethical issues of surrogacy and whether any payments are, or should be, permissible by the intended parents. However, the tax, NIC and welfare benefits treatment of any such payments could influence the behaviour of the parties.

4.3.3 Taking just tax as an example, we could see the following effects:

- If the surrogate were treated as providing a service, with any 'income' from it being potentially taxable on the surrogate, this would necessitate the keeping of business records and would mean the surrogate would have to comply with requirements of the tax system such as notification of liability, completion of tax returns, potential enquiry by HMRC and the risk of penalties for non-compliance. These obligations would be (and arguably already are, given our comments above on the potential tax issues surrounding round sum expense payments, etc.) a disincentive to potential surrogates, who may be dissuaded from providing such services due to the associated tax hassle and bureaucracy.
- By contrast, some form of tax relief or exemption that were automatically given to surrogates, provided they meet its terms, could be helpful. Properly structured, this could remove the disincentive of having to comply with tax obligations. There is then, however, an argument that a tax relief or exemption could influence behaviour of potential surrogates, that is to say the ability to 'earn' a certain amount 'tax free' might be seen as a way of incentivising surrogates.

4.3.4 The above points could of course be seen as positive or negative in terms of their influence on behaviour, depending on your viewpoint. If the law wishes to encourage more surrogates by allowing payment for services (or even reimbursement of expenses without having to prove every amount with receipts), a positive incentive could be achieved by being able to put to potential surrogates that there is a specific tax relief or exemption which means that HMRC will not be bothering them and they will not have to fill in reams of forms.

4.3.5 But equally, even if there is no wish to provide a positive incentive in this way, a relief or exemption would remove the disincentive of a potential tax and administrative burden.

4.3.6 Even lack of clarity in the law as it stands, as we have raised concerns about above, can influence behaviour. If the tax treatment is clear and can be easily explained to, and dealt with by, a potential surrogate, it is much less likely to present a barrier to them entering into a surrogacy arrangement.

- 4.3.7 It is also necessary to consider on whom the tax burden falls. To the extent that payments by intended parents to a surrogate are taxable on the surrogate and reportable to HMRC, the burden falls, *prima facie*, on the surrogate. However, if the contract between the parties is written such that the surrogate is to be in no worse off a position than she had been but for the surrogacy arrangement – a ‘no detriment basis’ – the burden could in fact be shifted back to the intended parents. For example, in the event of a failure by the surrogate to report potentially taxable income to HMRC which incurs a penalty, the surrogate could argue that the penalty has arisen due to the surrogacy arrangement and seek payment from the intended parents. Similarly, any tax liability that she incurs might be passed back to the intended parents as a cost related to the arrangement. What would happen then if the intended parents were to reimburse such penalties or tax liabilities? One could argue that is a further taxable sum, which could necessitate a complicated ‘grossing up’ exercise. Given that having a family via surrogacy is likely to be a costly choice (for those who do not have, or who have run out of, other options), the addition of tax-related costs would increase the intended parents’ financial burden and render surrogacy unaffordable for more families.
- 4.3.8 Given the need to weigh up all these considerations very carefully, we do not recommend that there should be a tax relief or exemption for payments to surrogates. We do, however, recommend that if the possibility of introducing one is to be considered, this forms part of a general consultation surrounding the tax treatment of payments to surrogates both under existing and potential future arrangements. In this respect, it is key to understand HMRC’s position relating to current arrangements. In the event that a specific tax relief or exemption were to be introduced, it would be helpful if the government could give some certainty that they would be unlikely to look back at the tax treatment of payments made under any arrangements which pre-dated it.

Using an existing tax relief as a model

- 4.3.9 We think it is helpful here to draw a parallel with an existing tax relief – Qualifying Care Relief.¹ Looking at this relief, why it was introduced, what it does and what effect it has had might help to shape thinking around how a similar relief or exemption might be introduced in respect of surrogacy arrangements.
- 4.3.10 Qualifying care relief is available to certain providers of care services. Those providing foster care (or shared-lives care for vulnerable adults) are treated as self-employed by the tax system and their income therefore falls to be potentially taxable under the Income Tax (Trading and Other Income) Act 2005. Such carers are paid allowances for each person that they care for and, provided that their income falls within defined limits, do not have to produce receipts for specific expenditure relating to the person that they care for. This would, of course, be difficult to do given that the cared-for individual would eat meals with the family and so forth, and shares their accommodation. Itemisation would therefore be extremely difficult, if not impossible. The tax system allows certain flat-rate sums (covering

¹ Income Tax (Trading and Other Income) Act 2005, Part 7, Chapter 2

both expenses and a fee for provision of care) to be paid to the carer in respect of the children or adults and ‘qualifying care relief’ may be claimed in respect of the payments. In this way, only any sums in excess of the amounts permitted in the legislation are taxable.

- 4.3.11 This situation is at least partly analogous with the payment of various flat-rate sums to a surrogate, be that to cover expenses and/or as a fee for their gestational services. The surrogate could be seen as caring for the baby/babies prior to birth in a similar way to that which foster or shared lives carers do for children or adults within their care. That is, the foetus is effectively benefiting from a part of the surrogate’s overall living arrangements – food, heat, light/other accommodation costs. In addition, the surrogate is taking time and personal effort travelling to appointments and so forth, in an analogous way to a foster carer taking foster children to school or to visit their natural family.
- 4.3.12 Qualifying care relief was originally introduced via Finance Act 2003, Schedule 36 as foster care relief and was later extended to those providing shared lives care. The purpose of the relief was said to be for ‘the tax system [to] facilitate the recruitment and retention of foster carers’ and would ensure that carers would not be ‘unfairly taxed upon the legitimate expenses they incur’.¹
- 4.3.13 At that time, it was noted that there were ‘around 35,000’ foster carers in the UK.² Today, the Fostering Network states that there are ‘almost 55,000 foster families across the UK’.³ Although we are not aware of anyone directly studying whether it has been the introduction of the tax relief that has caused this increase, and we must therefore be wary of suggesting that the figures are evidence of cause and effect, there is an apparent correlation.
- 4.3.14 As above, our conclusion is that the tax treatment of surrogacy payments should be consulted on. Such consultation might consider the similarities with qualifying care relief and whether it would be appropriate to replicate this, or some other form of relief, for surrogacy arrangements.

¹ HM Treasury press notice, 27 March 2003, ‘Measures announced to take effect prior to Budget 2003’, see: https://webarchive.nationalarchives.gov.uk/20100202151101/http://www.hm-treasury.gov.uk/press_42_03.htm. Also see Budget 2003 document, para 5.26: https://webarchive.nationalarchives.gov.uk/20091003014320/http://www.hm-treasury.gov.uk/d/Budget_2003.pdf

² HM Treasury press notice, 27 March 2003, ‘Measures announced to take effect prior to Budget 2003’, see: https://webarchive.nationalarchives.gov.uk/20100202151101/http://www.hm-treasury.gov.uk/press_42_03.htm

³ Based upon 2018 statistics. The Fostering Network, ‘Fostering statistics’. See: <https://www.thefosteringnetwork.org.uk/advice-information/all-about-fostering/fostering-statistics>, accessed 25 September 2019

4.4 **Indirect tax**

- 4.4.1 Note that all of the above comments relate to direct taxes. A final tax matter to be considered in the context of paying for gestational surrogacy services is their potential treatment for VAT – an indirect tax.
- 4.4.2 Whilst the VAT legislation does not provide for exemption or reduced rating at this stage, thought needs to be given as to whether future payments for surrogacy services would be outside the scope of VAT or whether they might be potentially taxable or exempt supplies. If the amount that can be paid for surrogacy services is capped at a sufficiently low level, it may be that the VAT registration threshold (£85,000 for 2019/20) would not be exceeded in a year and surrogates would not need to concern themselves with it. However, if – as discussed at para 15.62 of the consultation document – the parties were free to negotiate sums amongst themselves, the higher the amounts paid, the more likely there are to be VAT implications where the registration threshold is breached. Similarly, if the VAT registration threshold were to be reduced in future, the matter could be brought into even sharper focus.
- 4.4.3 We therefore recommend that all of this is considered in more detail by HM Treasury and HMRC and the VAT treatment confirmed, so that surrogates again do not fall foul of the system.

5 **Interactions with other areas of law where taxable income definitions are used**

- 5.1 While thinking about tax considerations, as above, it is also necessary to think about the knock-on effects to other areas of law where sums are treated as taxable income. This is because other laws take certain taxable income definitions and reuse them as the definition of assessable income in another context. Two examples of this are the student finance system and child maintenance payments. We give an overview of the issues to consider below.

5.2 **Student loans**

- 5.2.1 One financial interaction not mentioned in the consultation document is the treatment of payments to a surrogate in relation to the student finance system. There are two potential issues here: entitlement to student finance and the repayment of existing student loans.

Entitlement to certain elements of student finance

- 5.2.2 First, entitlement to some student finance is, as we understand it, affected by the annual taxable 'household income' of the applicant. Depending on the applicant's living situation,

this could mean their parents' taxable income or their own (plus that of any partner they live with).¹

- 5.2.3 It is therefore possible to see that there could be an impact on student finance entitlement if additional taxable income were to arise in respect of a surrogacy arrangement – for example, a fee paid for surrogacy services. The exact impact, that is on whom it would fall, would depend on the make-up of the household.
- 5.2.4 Let us say the surrogate is 36. She had her son when she was 18 and he is now applying for university. If the surrogate were paid a fee for her services, that spike in household income for the year could have an impact on her son's entitlement to student finance.
- 5.2.5 Similarly, a surrogate might have a partner who wishes to re-train as a teacher and who is therefore looking at student finance options. Policymakers need to consider whether the surrogate's fee should be taken into account in such entitlement calculations.

Repayment of student loans

- 5.2.6 Student loan repayments can be complicated, but basically it is the case that income-contingent student loan repayments can be made in two ways: either via deduction from salary (paid by employers to HMRC who then account for them to the Student Loans Company (SLC)); or via a Self Assessment tax return (again, the repayments being made to HMRC and accounted for to the SLC).²
- 5.2.7 For most borrowers, who are not otherwise required to complete a Self Assessment tax return, their employer will be required to deduct repayments from their wages alongside other deductions such as income tax and NIC. In that case, the repayments are calculated using the earnings figure used for calculation of NIC.³
- 5.2.8 If a borrower is otherwise required to complete a Self Assessment tax return,⁴ they will make student loan repayments based upon their total income as found at step 1 of the calculation in the Income Tax Act 2007, section 23.⁵ This is then subject to certain deductions, excluding

¹ See, for example, the Student Finance England website: <http://www.sfengland.slc.co.uk/include-household-income-in-your-student-finance-application.aspx>

² Our guidance about repayment of student loans via the tax system can be found at: <https://www.taxguideforstudents.org.uk/student-loans>

³ Education (Student Loans) (Repayment) Regulations 2009, SI 2009/470, Regulation 41

⁴ HMRC do not issue Self Assessment tax returns purely to collect student loan repayments, as confirmed in their Collection of Student Loans Manual, CSLM16035: <https://www.gov.uk/hmrc-internal-manuals/collection-of-student-loans-manual/cslm16035>

⁵ Education (Student Loans) (Repayment) Regulations 2009, SI 2009/470, Regulation 29(4)

any unearned income up to £2,000 (though note that if it is more than £2,000, the full amount is included and there is no deduction from it for the first £2,000).

- 5.2.9 It follows therefore that payments from surrogacy arrangements could be taken into account in the calculation of student loan repayments. We believe that any amounts considered to be miscellaneous income are likely to be ‘unearned’ and therefore only taken into account to the extent that they exceed £2,000. However, if surrogacy arrangements are fee-paid in future and therefore considered to have the hallmarks of self-employment, the full amount reported on the Self Assessment tax return, subject to any appropriate deductions, would be taken into account in the repayment calculation.
- 5.2.10 We understand that the Department for Education is responsible for student finance policy, so they would need to be consulted in the context of any proposed tax relief or exemption which could in turn exclude surrogacy payments from inclusion in student finance entitlement and repayment calculations.

5.3 ***Child maintenance***

- 5.3.1 We understand that child maintenance calculations are primarily based on gross earned income (from employment or self-employment) and pension income. A variation order can, however, be applied for in certain circumstances, which may lead to other income being taken into account.¹
- 5.3.2 We would stress that we are not experts in child maintenance matters, but have in the past taken an interest in how they work because of the interaction with taxable income and the fact that taxable income data may be passed from HMRC to the Child Maintenance Service.
- 5.3.3 The surrogate could have other children who were not resident with her but with a former spouse, and she could be paying maintenance in respect of them.² It follows that there is a concern that any amounts received relating to a surrogacy arrangement in excess of strict expenses could be taken into account as either unearned (miscellaneous) income or self-employed income. If future payments for surrogacy services were to be treated as self-employment income, it appears that such amounts could have an automatic effect on maintenance payments. Any amounts that were unearned income could fall within scope of a variation order. Again, we make no comment as to whether they should be included in or excluded from these calculations – we merely wish to point out that the issues require consideration.

¹ The Child Support Maintenance Calculation Regulations 2012, SI 2012/2677

² On the other hand, she could be receiving maintenance payments and the payer might argue that her increased income might mean less should be paid.

6 Welfare benefits for the surrogate

6.1 High income child benefit charge (HICBC)

6.1.1 It is possible that surrogates have other children in respect of whom they claim child benefit. Child benefit is itself not means-tested, however since 2013, the HICBC has been in place. This is a tax charge on the child benefit claimant, or their partner, where their individual income is more than £50,000 in a tax year during which child benefit is paid.¹

6.1.2 This tax charge effectively results in the child benefit being clawed back according to the amount the individual's 'adjusted net income' exceeds £50,000 a year, with it being fully clawed back for incomes over £60,000 a year. Adjusted net income is basically the total of the individual's gross taxable income, less certain deductions such as trading losses or adjustments for individual pension contributions.² (The word 'net' in its title does not mean that it is net of tax or NIC.)

6.1.3 It follows that if payments arising from a surrogacy arrangement increase the surrogate's taxable income such that her adjusted net income exceeds £50,000 in a tax year, she could lose all or part of her child benefit as a result of the HICBC. This could be a problem under the current expenses regime if payments are retrospectively authorised by the courts in excess of deductible expenses, which results in an amount chargeable to tax as miscellaneous income. However, it is likely to become more of a problem if, in future, fees for surrogacy services are permissible.

6.1.4 A tax relief along the lines of qualifying care relief could mean that the resulting fee is not taxable (or is only taxable to the extent that it exceeds the agreed level of relief) and therefore would help to protect the surrogate from the HICBC.

6.1.5 If surrogacy payments were to give rise to the HICBC (or to increase it for a surrogate who is already liable to it in part), then clear information needs to be given to the surrogate so that she can weigh this up as part of the arrangement. As mentioned previously, if the intention is that the surrogate is to keep the whole fee for her services rather than lose any of it in tax charges, it appears that this further tax charge could again result in an additional grossing up calculation – effectively an extra cost passed back to the intended parents.

6.2 Tax credits

6.2.1 The definition of income for tax credits purposes by and large follows the tax system. Therefore, if surrogacy payments were to give rise to taxable income, it follows that they could affect entitlement to tax credits. This could affect the tax year(s) in which the

¹ A further overview of the HICBC can be found on our website. See: <https://www.litrg.org.uk/tax-guides/tax-credits-and-benefits/child-benefit#toc-what-is-the-high-income-child-benefit-charge-hicbc->

² See <https://www.gov.uk/guidance/adjusted-net-income>

surrogacy payments are received and/or the subsequent year, depending on the extent to which the income disregards cover the extra taxable amount.¹

6.2.2 Note that the tax credits system does not take into account capital held by the claimant(s), so to the extent that any sums received were treated as capital, they would not impact on a tax credits claim.

6.3 **Universal credit (UC)**

6.3.1 The consultation seems to be written on the assumption that any payments under the existing expenses regime from the intended parents to a surrogate would effectively be, for UC purposes, treated as self-employment income with expenses potentially being deductible against the amount paid.²

6.3.2 We would point out that there are two tests for UC in respect of self-employment. First, are the earnings from self-employment?³ For UC purposes, this means earnings that the claimant derives from carrying on a trade, profession or vocation and which are not already classed as employed earnings. According to DWP guidance, the concept of ‘trade, profession or vocation’ is taken from tax law.⁴ However, the guidance also notes that ‘A determination that a person has earnings from self-employment for UC is not decisive for other purposes and nor is the DM [decision maker] bound by a determination made by a DM in another government department’.⁵ A person could therefore be determined to be self-employed for one purpose and not for another.

6.3.3 Second, is the person **gainfully** self-employed? The gainful self-employment test refers to the self-employment (trade, profession or vocation) being ‘organised, developed, regular and carried on in expectation of profit’.⁶

6.3.4 Reading the DWP guidance and taking into account tax considerations established by case law, it is difficult to see how current ‘reasonable expenses’ based surrogacy arrangements

¹ See our Revenue Benefits website for an explanation of the disregards:

<https://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/understanding-the-disregard/>

² See consultation document, para 15.41.

³ The Universal Credit Regulations 2013, SI 2013/376, Reg 57.

⁴ See DWP ‘Advice for decision making: staff guide’, Chapter 4, paragraphs H4010-H4018:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/787442/admh4.pdf

⁵ See DWP ‘Advice for decision making: staff guide’, Chapter 4, paragraph H4017:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/787442/admh4.pdf

⁶ The Universal Credit Regulations 2013, SI 2013/376, Reg 64.

could be treated as a trade, profession or vocation and therefore we cannot immediately see why it is being suggested at para 15.41 of the consultation document that reimbursement of expenses should be looked at under UC rules ‘in a similar way to if the person was self-employed’. As per our earlier comments, we suggest that for tax purposes the surrogate is unlikely to be self-employed under the current law where there should be no financial gain and that, if any ‘surplus’ were to arise (such as by the court authorising payments where actual expenses cannot be evidenced), then these would likely fall to be taxed under miscellaneous income provisions.

- 6.3.5 Importantly, however, there are no miscellaneous income rules for UC. If an arrangement falls as neither employment nor self-employment, there is nothing within the regulations that we can see to take into account miscellaneous income or deduct expenses as if they were self-employed.
- 6.3.6 For UC, it would seem more likely that it should be interpreted that any payments would be treated as an increase in the surrogate’s capital. This might in turn restrict or remove the surrogate’s entitlement to benefit, but not in the same way as if it were treated as income.¹ Under the existing expenses regime for surrogacy arrangements, this should only be an issue if round sum amounts are paid rather than direct reimbursement of actual expenses.
- 6.3.7 This position might of course change in future if it were possible to pay a fee for the service of surrogacy itself, depending on whether or not that could be interpreted as self-employment. For example, the introduction of a profit-seeking motive implied by taking a fee for the service is perhaps more indicative of self-employment than the present expense arrangements.
- 6.3.8 We recommend that confirmation is sought from DWP about the UC and other benefits (see below) treatment of existing ‘reasonable expenses’ surrogacy arrangements, as well as consulting with them and more widely about the treatment of any future arrangements taking into account changes in the law as regards the nature and amounts of payments that might be made.

6.4 ***Other benefits – for example, carer’s allowance***

- 6.4.1 Other benefits also require consideration. The surrogate may, for example, be a carer and be claiming carer’s allowance (or indeed they might, during the surrogacy period acquire caring responsibilities – for example, for an ageing parent).
- 6.4.2 Carer’s allowance is not paid where the carer is ‘gainfully employed’. In this context, this means that they must not be earning above a set amount each week (£123 for 2019/20) otherwise they will be treated as gainfully employed.² This earnings cap is calculated after

¹ Our Revenue Benefits website explains how capital affects UC entitlement. See <https://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/capital-rules/>

² SI 1976/409, Reg 8. See www.legislation.gov.uk/uk/si/1976/409

tax, National Insurance and certain expenses, including expenses related to self-employment.¹ Again, whether any payments in relation to a surrogacy arrangement are treated as earnings needs consideration in this context. Given that we think, as above, it is doubtful that amounts received under the present expenses regime could be classed as self-employed earnings (unless there is an amount in excess of expenses retrospectively authorised by the court), we do not think surrogates who are carers would currently lose entitlement to this allowance. However, this needs to be confirmed with the DWP. If payment for surrogacy services were to be permitted in future, making the arrangements appear more like self-employment, entitlement to carer's allowance could be impacted.

6.4.3 We have not researched in detail similar considerations for other benefits, but we think it is vital that HM Treasury, HMRC and the DWP look at the treatment of surrogacy payments in the round.

6.5 ***Compensation payments and benefits***

6.5.1 In our tax discussions above, we consider in outline the issues relating to compensation payments and whether the types of payments outlined in the consultation document might fall to be exempt as capital compensation payments for injury, etc. Similar consideration needs to be given to how various types of compensation payment might be treated by the benefits system.

6.5.2 Unlike tax credits, UC and other means-tested benefits not only look at the claimant's income but also their capital. However, not all capital is brought into consideration, with certain amounts being disregarded. For the purposes of UC, commentary about such disregards can be found in DWP staff guidance.² It is noteworthy that the Universal Credit Regulations allow for personal injury compensation payments to be disregarded entirely from the capital assessment, but only in specific circumstances. Some further personal injury payments may be disregarded for up to 12 months.³

6.5.3 Benefits legislation therefore need to be studied carefully to determine the correct treatment of the various proposed types of compensation that may be made through surrogacy arrangements, and whether any change in the law would be thought desirable.

¹ Our website explains this further here: <https://www.litrg.org.uk/tax-guides/disabled-people-and-carers/caring-someone/tax-and-benefits-carers#toc-what-is-the-earnings-threshold->

² DWP's Advice for decision making: staff guide, Chapter H2. See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/832009/admh2.pdf and in particular paragraph H2028 which refers to personal injury compensation payments. For the legislation, see The Universal Credit Regulations 2013, SI 2013/376, Reg 75: <https://www.legislation.gov.uk/uksi/2013/376/regulation/75>

³ DWP's Advice for decision making: staff guide, Chapter H2, para H2093

6.6 **Childcare costs**

- 6.6.1 At paragraph 14.22 of the consultation document, Figure 2 gives a list of expenses that have been seen to have been claimed by a surrogate, and paid by intended parents. Included within this list are childcare costs associated with clinic visits/inseminations and/or childcare costs if the surrogate is ill during the pregnancy.
- 6.6.2 We are concerned that this might cause knock-on effects to the benefits claims of the surrogate. For example, for tax credits purposes, up to 70% of a claimant's childcare costs may be supported through the childcare element of working tax credit provided various conditions are met. One of these conditions is that the claimant must actually incur and pay for the childcare.¹ Where there is a surrogacy agreement that specifically includes covering the surrogate's childcare costs in certain circumstances as mentioned above, it is therefore doubtful that those would be qualifying childcare costs for tax credits purposes.²
- 6.6.3 In the past, tax credits claimants have fallen foul of this rule in respect of employer-supported childcare schemes through which an employer provides vouchers to cover the cost of childcare. HMRC have taken the approach that any costs covered by such vouchers have not been paid for by the tax credit claimant and therefore should have been excluded from their claim. Tax credits claimants who have failed to realise this have therefore faced HMRC compliance interventions, and have incurred significant tax credits overpayments and consequent debt.
- 6.6.4 Similarly, childcare costs of UC claimants are supported, subject to conditions being met. The Regulations specify that the 'claimant pays charges... for relevant childcare'.³ In addition, the childcare costs must essentially be incurred for the purpose of enabling the claimant to take up paid work.⁴
- 6.6.5 It therefore seems that the childcare costs mentioned in Figure 2 at para 14.22 of the consultation document should not be supported through UC as the claimant neither incurs them herself (due to the promised reimbursement by the intended parents), nor are they incurred for the purposes of enabling her to work. However, it is easy to see that a surrogate

¹ For more information, see our Revenue Benefits website: <https://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/understanding-childcare/calculating-costs/>

² Indeed, if the costs are being covered by a third party, it follows that the claimant should not also get tax credits in respect of them. The point we are concerned with is that claimants should understand the implications of their childcare costs being paid by another party and therefore not fall foul of a 'double claim' scenario together with consequent debt due to overpayments and compliance burdens.

³ The Universal Credit Regulations 2013, SI 2013/376, Regulation 33(1)(a).

⁴ This is a simplification, as there is a second limb to this criteria relating to claimants being treated as being in paid work. See the Universal Credit Regulations 2013, SI 2013/376, Regulation 33(1)(b).

who is a UC claimant might not appreciate these details of the Regulations and may therefore make the same mistake as tax credits claimants have made in the past with childcare vouchers, and include ineligible childcare costs in their claim.

- 6.6.6 Similar points need to be considered in relation to the tax-free childcare scheme, which allows eligible individuals to pay into an account which earns a government ‘top-up’ of 20p for every 80p the accountholder pays in. This scheme is subject to its own detailed qualifying criteria, but as with UC, there is a requirement that childcare only qualifies in relation to the scheme if, wholly or mainly, it is for the purposes of allowing the accountholder (or the accountholder and their partner) to work.¹
- 6.6.7 Again, it is therefore important that surrogates who are tax-free childcare accountholders realise this distinction and do not use such funds to pay for childcare costs related to the surrogacy. This in turn means that, even if the surrogate is a tax-free childcare accountholder, the intended parents would have to pay the full amount of childcare costs related to the surrogacy, and not merely pay 80p in the pound with the expectation that the government top-up of 20p will apply.
- 6.6.8 However, the above might change in the event that the law is amended in the future to allow fees for surrogacy services to be paid. If this means that such income is treated as arising from self-employment (a point that would need to be established, as discussed above), perhaps the childcare costs would then qualify as enabling the surrogate to ‘work’. That is, would she be considered to be ‘working’ in the context of the surrogacy itself, thus converting the childcare costs relating to the surrogacy into qualifying costs for the purposes of UC and/or tax-free childcare?
- 6.6.9 These are questions we cannot attempt to answer at this stage. Again, we simply seek to point out that they require consideration.

6.7 ***Conclusions relating to benefits***

- 6.7.1 As above, we recommend that there should be a consultation on the tax treatment of surrogacy arrangements and that if consideration is to be given to a specific tax exemption or relief, this should be included in any such consultation. DWP should consult in parallel with HM Treasury/HMRC on the benefits consequences of the payments and it would be preferable to aim for having rules across the board that are aligned, so that parties to surrogacy arrangements do not have to understand different rules and treatment for each.
- 6.7.2 We believe the welfare benefits treatment of payments requires consideration alongside the proposed consultation on a suitable tax relief which might follow along the lines of qualifying care relief for foster and shared lives carers. Any tax-relieved or exempted payments could, for example, also be explicitly listed as outside the scope of welfare benefits assessment (i.e.

¹ This definition is not worded the same, however, as that for UC. It can be found in the Childcare Payments Act 2014, s 2(2). See: <http://www.legislation.gov.uk/ukpga/2014/28/section/2>

disregarded). For foster and shared lives carers, this is unfortunately a rather grey area at present, given that the Universal Credit Regulations are not clear on their treatment. However, GOV.UK includes a statement that foster carers are not treated as self-employed and the payments they receive for fostering are therefore not included as income for UC.¹ The position for shared lives carers has not been confirmed in public as far as we are aware.

7 National Insurance

- 7.1 A surrogate's National Insurance position could be impacted as a result of the surrogacy arrangement and the nature of any payments made. Below, we outline some initial thoughts as to the areas that might need to be considered, but broadly we recommend that as part of a tax and benefits specific consultation on surrogacy, that NIC and National Insurance credits are considered in detail.
- 7.2 As discussed in our comments on the tax position resulting from surrogacy arrangements, the nature of the relationship between the intended parents and the surrogate is unclear, but we think that at present surrogates are likely to be neither employed nor self-employed in the context of the surrogacy arrangement. It seems this would equally apply to NIC, given that the legislation defines a 'self-employed earner' as 'a person who is gainfully employed in Great Britain otherwise than in employed earner's employment'.² While this might be considered to have broader application than the self-employment test for tax purposes, it is difficult to see how it could be argued as applying to surrogacy arrangements under the present expenses regime which ought not to have any element of financial gain or profit-seeking motive. However, given that the courts have approved payment of amounts in excess of reasonable expenses, it might be argued that in such cases the surrogate was gainfully employed in the context of the surrogacy arrangement. The present situation relating to NIC therefore requires consideration and clarification.
- 7.3 If the law is changed to allow a surrogate to be paid a fee for her services, it seems far more likely that she would fall into the category of being 'gainfully employed' according to the National Insurance legislation and therefore, assuming this were treated as self-employment rather than employment, Classes 2 and 4 contributions could be due on the fee. If a relief were to be introduced for surrogacy arrangements similar to that of qualifying care relief, as discussed above, such contributions may not be due if the fee were fully relieved for tax purposes and the National Insurance provisions were to similarly allow relief. However, the surrogate may nevertheless wish to make Class 2 contributions voluntarily to keep up her

¹ See <https://www.litrg.org.uk/tax-guides/disabled-people-and-carers/caring-someone/foster-carers-and-shared-lives-carers/can-i-0>

² Social Security Contributions and Benefits Act 1992, s 2(1)(b). Note that consideration also needs to be given to Northern Ireland.

contributions record, depending on other factors such as whether or not she would otherwise be entitled to National Insurance credits.¹

- 7.4 We also believe that consideration needs to be given to situations in which a surrogate is entitled to welfare benefits that qualify her for National Insurance credits. For example, UC carries entitlement to Class 3 National Insurance credits, which maintains a claimant's contribution record for the purposes of the state pension.² It follows that if payments by the surrogate from the intended parents lead to loss of benefit entitlement, any compensation paid should arguably factor in a value for those lost credits. The most straightforward way of calculating such compensation might be for the intended parents to pay for the surrogate to make Class 3 contributions instead.

8 Other points to be considered, connected to the above

- 8.1 We understand from the consultation document that surrogacy contracts are not enforceable and the provisional proposal is that this should remain the case.³ There is, however, a proposed exception to this, in that it is proposed that financial terms of a surrogacy arrangement entered into under the new pathway to parenthood should be enforceable by the surrogate. Consultees are invited to say whether or not they agree to this proposal, at question 88.
- 8.2 We do not wish to comment on the legal nature of the contracts and whether financial terms should be enforceable by the surrogate. That question is outside the scope of this response. However, it is necessary to consider whether this could change the tax, benefits and National Insurance treatment of the contracts. Enforceability on the part of the surrogate suggests to us that it would be more likely that receipts would be taxable, for example, as it would rule out arguments that amounts might be considered voluntary payments or gifts and therefore potentially not taxable (see earlier discussion).
- 8.3 We also believe that some thought needs to be given to one particular scenario – that in which the surrogate decides she wishes to keep the baby when it is born, or keeps the baby because the intended parents do not take it for some reason. Although the surrogate might not be obliged to do so if she could in any event enforce the financial terms of the agreement, it is not difficult to envisage that she might wish to return all or part of any sums paid to her in respect of the surrogacy. In the event that the receipts were taxable, or to be

¹ Information on how qualifying care relief interacts with National Insurance contributions can be found on our website: <https://www.litrg.org.uk/tax-guides/disabled-people-and-carers/caring-someone/foster-carers-and-shared-lives-carers-0#toc-will-the-relief-affect-my-national-insurance-contributions-nic>

² Social Security (Credits) Regulations 1975, SI 1975/556, Reg 8G

³ Per Chapter 9 of the consultation document, in particular see paras 9.127-9.129.

taken into account for benefits, how would both systems then deal with them being paid back? Would they be treated as an ‘expense’ for tax purposes, and therefore mean the surrogate had no net liability (and no reporting requirement)? Would the benefits system, having potentially taken them into account in the calculation of earlier awards, be able to cope with a later recalculation of benefits to exclude them?

- 8.4 Even if this is only a rare scenario, we would stress that it needs to be considered as part of this review of the law. Otherwise, when it does occur, the surrogate would be left in an extremely complicated situation.

9 Northern Ireland

- 9.1 We note that the consultation paper at para 18.19 refers to the Northern Ireland Law Commission being non-operational and as such they have not been able to work on this project.

- 9.2 In the context of tax and benefits law, the specific impacts of surrogacy arrangements in Northern Ireland would need to be considered – some of the law, for example, the application of ITTOIA 2005, which we reference above, will be the same. However, some other aspects, such as welfare benefits, will require specific consideration.

10 Miscellaneous issues

10.1 *Statutory pay and leave*

- 10.1.1 Chapter 17 of the consultation document refers to various issues surrounding parental pay and leave in respect of surrogacy arrangements. We wish to point out here that the BEIS is also currently holding a ‘Good Work Plan: Proposals to support families’ consultation which covers parental pay and leave issues more generally.¹

- 10.1.2 Part of that consultation document looks at the possible introduction of a new neonatal leave and pay for parents of babies who have to spend time in hospital when they are first born or within their early days. It is encouraging to see that intended parents in a surrogacy arrangement (where they are eligible for and intend to apply for a Parental Order) are amongst those listed as potentially eligible for neonatal leave and pay.² If surrogacy law is amended to include the new pathway to parenthood proposed in the consultation document, consequential changes in other areas of the law such as this will need to be

¹ See: <https://www.gov.uk/government/consultations/good-work-plan-proposals-to-support-families>

² See BEIS Good Work Plan consultation document, page 33:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819041/good-work-family-support-consultation.pdf

considered if it means that the terminology no longer matches the new pathway process. Our response to the neonatal leave and pay consultation also points out some potential issues such as the lack of any similar provision for the self-employed.¹

10.1.3 We would therefore agree that the issues raised in Chapter 17 require detailed consultation and reform. Given the present BEIS review, we would encourage engagement with them and a broader consultation with stakeholders on particular statutory pay and leave issues relating to surrogacy. Many who would otherwise take an interest in statutory pay and leave issues (for example payroll professionals and those representing small business), and who would therefore potentially have comments to make on this subject, may not be aware of this Law Commission/Scottish Law Commission paper on surrogacy law.

10.2 ***The meaning of legal parenthood in UK tax law, and problems with establishing domicile***

10.2.1 The CIOT recently awarded fellowship status to one of its members, Sam Dewes, for his thesis entitled: 'Is this my child? Who is my parent? Legal parent-child relationships in UK tax law in an era of complex family networks'.

10.2.2 In that thesis, Sam looked at the meaning of legal parenthood in the context of UK tax law as well as its effect on establishing an individual's domicile (an important factor for tax purposes²). We understand that Sam is submitting his own response to the consultation outlining the issues in more detail. We do not reiterate his points here, but wish to underline the need for them to be considered, consulted on in detail and addressed.

LITRG
7 October 2019

¹ Our response to the neonatal leave and pay part of the BEIS Good Work Plan consultation will be available on the submissions section of our website after the submission deadline of 11 October 2019. See <https://www.litrg.org.uk/latest-news/submissions>

² Our website gives a very brief introduction to why domicile is important for tax purposes. See: <https://www.litrg.org.uk/tax-guides/migrants/residence-and-domicile/what-domicile>