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The following appeared as an article in TRUSTS & TRUSTEES Volume 11, Issue 8, July and August 2005.

Civil Partnerships and the Finance Act(s): tax planning opportunities?

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Civil Partnerships and the Finance Act(s): tax planning opportunities?

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As mentioned in our previous article (TRUSTS & TRUSTEES February 2005 Volume 11 Issue 3), the Civil Partnership Act 2004 made only fleeting reference to matters of taxation. Instead the Government promised that the more substantive tax matters would be dealt with in “the first available Finance Bill”.

The 2005 Budget and two Finance Bills have now come and gone and, true to its word, the first Finance Act 2005 considers this issue. Section 103 grants the Treasury power, by regulation, to make changes to all primary and secondary tax legislation in England and Wales, Scotland and Northern Ireland to ensure equal tax treatment for civil partners and married couples. This power extends to changing any legislation enacted up to the end of the parliamentary session following that in which the Finance Act 2005 is passed. So far regulations have been published in draft form dealing with the registration procedures, Council Tax and certain pension schemes but many more regulations must therefore be expected shortly.

However until such regulations are in force there is, yet again, a distinct lack of certainty as to exactly what tax consequences will arise from entering into a civil partnership, albeit the Government seems unwaveringly committed to nothing short of full equality with marriage. The only note of caution perhaps comes from Section 103(1) of the Finance Act itself which to paraphrase, states that, civil partners will be treated “*in the same way as (or a similar way to)*” married couples (emphasis added).

Assuming, therefore, that the Treasury does indeed make such equalising regulations, what are the key tax planning points that potential civil partners (and their advisors) should consider before tying the civil partnership knot?

THE BAD NEWS ...

Private residence relief

While unmarried couples, be they opposite or same sex, can each own a separate property which will attract relief from capital gains tax under Section 222 TCGA, civil partners are likely to be restricted to just one property. They will therefore have to choose which should attract the relief, bearing in mind the likely timing of the sale of either property and the anticipated increases in value going forward. There may also be merit in crystallising historic gains in one or both of the properties, perhaps by putting it into trust or transferring it to the other partner. With the dramatic house price rises that have recently been witnessed, the amount of tax at stake could be large and couples should plan ahead and seek specialist advice.

Settlor interested trusts

Income and gains arising in trusts in which the settlor's civil partner has an interest are likely to be taxed upon the settlor under Section 660A ICTA (now Section 625 ITTOIA) and Section 77 TCGA. It is unclear whether these provisions will apply to trusts set up before the Civil Partnership Act comes into force on 5th December this year, although it is likely to be the case. Prospective civil partners should therefore review their existing trust arrangements, particularly where there is a possibility that one can benefit from a trust made by the other, to assess the effects that entering into a civil partnership might have on their personal income and capital gains tax position.

It is worth bearing in mind that these provisions will not only impact upon more conventional trust structures but also other “arrangements”, particularly those designed to extract value from a business via a lower rate income tax paying spouse/civil partner. The recent Arctic Systems case¹ which the taxpayer again lost on appeal to the High Court,

considers this in some detail, as does the Revenue publication *A Guide to the Settlements Legislation for Small Business Advisers* (see http://www.inlandrevenue.gov.uk/practitioners/guide_sba.pdf). Interestingly Park J, in delivering his judgment in Arctic Systems, disagreed on a number of points with Dr Brice, who gave the leading judgment for the Special Commissioners. The case is now subject to approval.

Company control

The reach of Section 417 ICTA (which defines certain terms relating to close companies) is likely to be extended to take into account civil partners when it comes to assessing company control. In turn this might, for example, bring an offshore company within the scope of Section 13 TCGA, whereby gains can be attributed to participators. The multitude of other possible consequences is too numerous to list here, but needless to say those with complex business affairs contemplating a civil partnership would be well advised to seek expert assistance in advance.

...AND THE GOOD NEWS

Inheritance tax

It would be extremely surprising if some of the earliest civil partnerships regulations did not grant a full exemption from inheritance tax to UK domiciled civil partners, on a par with the spouse exemption. This is probably one of the biggest attractions for same-sex couples contemplating a civil partnership, giving them peace of mind that after the death of one party the other will not be faced with a 40 per cent charge on any of the deceased's estate exceeding the nil rate band.

Aside from that alone, civil partners would also have open to them the various inheritance tax planning techniques currently only available to married couples. In particular, Will-based methods such as the nil rate band discretionary trust

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arrangements would be applicable, generating a saving of at least £110,000 and potentially far more.

In addition, individuals would also expect to be able to benefit from gifts made by them to their civil partner without falling foul of the gift with reservation of benefit provisions contained in Part V Finance Act 1986. This would mirror the exemption granted to spouses by Section 102(5)(a) Finance Act 1986.

Capital gains tax – no gain no loss

Whether for asset reallocation for inheritance tax or income tax planning purposes, or for any other reason, civil partners are expected to benefit from no gain no loss capital gains tax disposals. Currently the disposal of assets standing at a gain from one member of a same-sex couple to the other will trigger a capital gains tax charge. However, Section 58 TCGA is likely to be amended to make reference to civil partners as well as to husbands and wives, and it is probable that this treatment would also extend to assets transferred during the year of separation of civil partners.

Stamp Duty and Stamp Duty Land Tax

Whilst it is perhaps a little inappropriate to consider this good

news, where a civil partnership is dissolved (which could not be before December 2006 at the earliest by virtue of Section 41 CPA) there will most probably be an exemption from stamp duty and SDLT in respect of transfers in connection with the dissolution. This would mirror the exemptions for married couples contained in Section 83(1) FA 1985 and regulation 4(H) of the Schedule to the Stamp Duty (Exempt Instruments) Regulations 1987 (dealing with stamp duty) and FA 2003, Schedule 3 paragraph 3 (dealing with SDLT).

CONCLUSION

The above are just a few of the key taxation issues that should be on the agenda for same-sex couples and their advisors to consider when contemplating a civil partnership. But it is by no means an exhaustive list – it is likely that there will be consequences in many other areas as diverse as the transfer of assets abroad (under Section 739-746 ICTA), pension schemes (particularly with “A” Day fast approaching) and gifts in consideration of entering into a civil partnership. To echo the sentiments already expressed above, those considering a civil partnership, particularly with more complex or high-value affairs, would be wise to seek professional advice before finally signing the civil partnership

document. The fact that the earliest that a civil partnership can be entered into is 5th December 2005 (and, in reality, 21st December after the 15 day waiting period) gives those wishing to structure their affairs effectively about four months in which to do so.

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Endnotes

1. *Jones v Garnett (HMIT)* [2005] EWHC 849 (Ch)