EXPLANATORY MEMORANDUM TO

THE TAX AND CIVIL PARTNERSHIP REGULATIONS 2005

2005 No. 3229

1. This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before The House of Commons by Command of Her Majesty.

2. Description

For tax purposes, the Government has announced that civil partners will be treated the same as married couples. Therefore, from the start of the civil partnership scheme on 5th December 2005, tax charges and reliefs and anti-avoidance rules will apply equally to married couples and civil partners, and those treated as such. This instrument changes primary tax legislation so as to help achieve that effect.

3. Matters of special interest to the Joint Committee on Statutory Instruments *or* the Select Committee on Statutory Instruments

None

4. Legislative background

4.1 The Government's tax treatment of civil partnerships will follow the social policy set out in the Civil Partnership Act. It creates a new legal relationship that allows same-sex couples to gain formal recognition of their relationship. Those who register as civil partners of each other will be able to access a wide range of rights and responsibilities and this will also extend to tax matters.

4.2 On 31st March 2004 Government made the commitment that, for tax purposes, civil partners will be treated the same as a married couple. This Instrument is the step to bring about the necessary changes to tax primary legislation. Changes to secondary legislation are to be dealt with in a parallel Instrument. These changes will apply from the commencement of the civil partnership scheme, on 5th December 2005.

5. Extent

This order applies to all of the United Kingdom.

6. European Convention on Human Rights

The Paymaster General has made the following statement regarding Human Rights:

In my view the provisions of the Tax and Civil Partnership Regulations 2005 are compatible with the Convention rights.

7. Policy background

7.1 The Civil Partnership Act 2004 received Royal Assent on 18 November 2004. The purpose of the Civil Partnership Act 2004 is to enable same-sex couples to obtain legal recognition of their relationship by forming a civil partnership. The Civil Partnership Act 2004 also contains provisions enabling certain overseas same-sex relationships to be treated as civil partnerships. Civil partners will be subject to many of the same legal rights and responsibilities as spouses.

7.2 Two people may register as civil partners of each other provided:

- they are of the same sex;
- neither of them is already a civil partner or married;
- they are not within the prohibited degrees of relationship;
- they are both over the age of sixteen (and the consent of the appropriate persons has been obtained if either of the parties are under eighteen).

7.3 The Government held a three-month public consultation on the proposal to create a same-sex civil partnership registration scheme in England and Wales. This ran from 30 June 2003 to 30 September 2003 and generated substantial public and media interest. There were 3,167 responses to the public consultation. The Government's response to the consultation was published in November 2003 and can be found on the DTI's website at http://www.womenandequalityunit.gov.uk/lgbt/partnership.htm

7.4 The Government announced on 26 November 2003 that it intended to bring forward a Civil Partnership Bill. On 3 June 2004 the Scottish Parliament agreed to the inclusion of Scottish provisions in the Westminster Civil Partnership Bill, following a public consultation in Scotland. Northern Ireland Ministers also agreed to include Northern Ireland provisions in the Westminster Civil Partnership Bill after a public consultation in Northern Ireland. The responses to those respective consultations can be found on the DTI's website at http://www.womenandequalityunit.gov.uk/lgbt/partnership.htm

7.5 The policy intention behind this Regulation is to ensure that civil partners have equal treatment as spouses in the area of taxation. The Regulation seeks to fulfil those policy objectives by changing primary tax legislation.

7.6 All clauses are to change existing primary legislation to ensure that tax charges and reliefs and anti-avoidance rules will apply equally to married couples and civil partners, and those treated as such, and to ensure that tax legislation is compatible with the Human Rights Act 1998.

7.7 The amendments that go beyond providing equivalent treatment for civil partners are: section 11 and 22 of IHTA 1984; sections 257A, 257BA, 257BB and 347B of ICTA; sections 77(4) and 169F of, and paragraph 2 of Schedule 5 to, the TCGA 1992; and section 625 (2) of ITTOIA 2005.

7.8 For IHT purposes, gifts made before the marriage takes place can be recognised for the purposes of section 22. This principle will apply equally to civil partnerships. And for section 11 the scope of dependant relatives is also extended.

7.9 For marriages and civil partnerships entered into on or after 5th December 2005, the section 257A allowance is to go to the one with the higher income. The clauses deal with interim claims and end of year adjustments. Provision is also made for those married before 5th December 2005 to elect to opt into the new scheme, but also to leave the present scheme untouched for those who do not want change.

7.10 As for payments made for the maintenance of a child of the family, in order to qualify under section 347B the person making the payment need not be a party to a marriage but only a parent.

7.11 Amendments to clauses also provide for a civil partnership equivalent of "marriage settlement" in relation to section 22 IHTA 1984 sections 77(4) and 169F(5) of, and paragraph 2(4) of Schedule 5 to, TCGA and section 625(2) of ITTOIA. This is to provide for both civil partnership settlements and marriage settlements an extension as regards issue to include children from previous relationships and adopted children (whether adopted by one or both parties).

8. Impact

8.1 To acknowledge public interest a Regulatory Impact Assessment has been produced for this and the other parallel statutory instrument even though they have negligible impact on the costs of business, charities or voluntary bodies.

8.2 They do not have a significant financial impact on any public bodies.

8.3 A full Regulatory Impact Assessment for civil partnership was published alongside the Civil Partnership Act 2004 and can be viewed at http://www.dti.gov.uk/access/ria/index.htm#equality]

9. Contact

Mark E Taylor at HMRC Tel: 0207 147 2386 or e-mail mark.e.taylor@HMRC.gsi.gov.uk can answer any queries regarding the instrument.

FULL REGULATORY IMPACT ASSESSMENT (RIA)

1. Title of proposal

Regulations.
Tax Effects of the Civil Partnership Act (2004)

2. Purpose and intended effect

- The policy objective

1. These Regulations give tax parity between civil partners as defined in the Civil Partnership Act 2004 (CPA) and married couples and in each case those treated as such. They apply throughout the UK with effect from 5th December 2005, the implementation of the civil partnership scheme.

- Background

2. The CPA received Royal assent on 18th November 2004. Its effect is to enable same-sex couples to obtain legal recognition of their relationship by forming a civil partnership. The Act also sets out the legal consequences of forming a civil partnership, including the legal rights and responsibilities of civil partners. The rights that would follow registration of a civil partnership apply not only during a relationship, but also on the break-up of a relationship or the death of a partner.

3. Civil partnership is an equality measure for same-sex couples, who are unable to marry. It provides for the legal recognition of same-sex partners who wish to enter into interdependent relationships that are intended to be permanent, and provides a framework whereby they acknowledge their mutual responsibilities and manage their financial arrangements.

- Rationale for government intervention

4. Because civil partnership is a parallel status to marriage, the Government's policy is that civil partners should be subject to all the same legal rights and responsibilities as spouses.

5. The Government believes that the tax system should, wherever possible, adapt to reflect changes in society and recognises that there are implications for the tax system arising from the new legal relationship that can be established under CPA. To ensure fairness, it made the commitment that legislation would be introduced to ensure that civil partners would be treated the same as married couples for tax purposes. There are, in addition, limited circumstances in which unmarried couples are treated as if they were married. Tax changes will also recognise this and treat as civil partners some same-sex couples living together.

6. Finance Act 2005 provides the powers to lay these Instruments to ensure that civil partners are treated the same as married couples for tax purposes and to ensure that tax legislation is compatible with the Human Rights Act 1998.

7. CPA recognises evolving social policy and brings to certain same-sex couples a new legal status. But the current tax code does not recognise that status and not to address this new legal status is to invite legal challenge. (See equality and fairness at paragraph 13 below.)

8. Numbers. There is little reliable data in relation to the lesbian, gay and bisexual population so the Government has had to make a number of assumptions in calculating the likely take-up of civil partnership registration. Take-up is based on the assumption that 5% of the GB population over 16 is lesbian, gay or bisexual and with the assumption that, overall, around 3.3% will be in registered civil partnerships, as compared to around 33% of the heterosexual population aged 16 and over who would be married. Allowing for an initial surge of applicants, it is estimated that by the end of the first 12 months there are likely to be between two and four thousand partners registered. (One to two thousand partnerships.) The Government expects between 11,000 and 22,000 people to be in a civil partnership by 2010. The full take-up assumptions are available in the final Regulatory Impact Assessment published by the DTI.

3. Consultation

- Public consultation

9. On 30 June 2003, Deputy Minister for Women and Equality, Jacqui Smith MP launched the Government's consultation paper, "Civil Partnership: a framework for the legal recognition of same-sex couples". This paper contained the Government's proposals for a civil partnership scheme for same-sex couples in England and Wales and sought the views on the proposals. Overall 83% of respondents supported the principle of a civil partnership scheme.

10. As a result, on 31st March 2004 an Inland Revenue press notice set out the Paymaster General's commitment on tax matters:

11. "For tax purposes, registered same-sex couples will be treated the same as married couples. The Civil Partnership Bill is social policy legislation, so any tax consequences will be dealt with in the first available Finance Bill."

12. On the 16th March 2005 a Budget Note confirmed that the tax changes will take effect from 5 December 2005 – the date the CPA comes into force.

3. Options

Equality and Fairness

13. The new tax legislation flows from the CPA that itself corrects a current inequality, allowing same-sex partners to enter into interdependent relationships that are intended to be permanent and obtain the new legal recognition of civil partners.

14. Legal Challenge – Human Rights. When choosing between a range of possible approaches, account needed to be taken of Article 14 of the European Convention on Human Rights. Challenges might be brought under this Article by same-sex couples denied access to marriage claiming that they were discriminated against in comparison with opposite-sex couples. And (conversely) challenges might be brought by opposite-sex couples denied access to the new CPA relationship claiming that they were discriminated against in comparison with same-sex couples. Following CPA all couples now have the opportunity of gaining legal recognition of their relationship.

15. Not to recognise the new legal concept of parity by denying them tax parity may discriminate against civil partners on grounds of sexual orientation contrary to Article 14. Attaching a package of tax rights and responsibilities to the new status that fell short of the rights and responsibilities flowing from marriage, might be challenged by them as discrimination in comparison with (opposite-sex) married couples. As a result of these proposed changes, tax legislation is now considered to be fully Human Rights Act compliant.

16. **The preferred way forward** is that for all tax purposes, the legal and financial implications of the new legal relationship should be the same as for a marriage. There should therefore be complete parity between a couple that are civil partners and a couple that are husband and wife living together, that parity to take into account the relatives of the couple.

17. **Do nothing.** This option would fail to address the new legal status and would not reflect current social policy and the legal problem described at paragraph 18 - Equality and Fairness.

18. **Giving tax parity with married couples to all same-sex couples whether or not civil partners.** This approach would be based on a decision not to recognise the new legal status available to some same-sex couples. It is likely that provisions would thus need to apply to all unmarried couples in most or all cases (that is, including opposite-sex couples who are not married). But this would in turn alter the focus of the provisions away from the desire to address the treatment of registered same-sex couples, and hence not achieve the policy objective. It might also be complex to achieve and apply in practice, for instance, because it might entail new and detailed rules to determine when two persons should count as a 'couple' or (as the case may be) 'partnership' for tax purposes.

19. **Full parity between civil partners and married couples.** (The preferred option.) Currently, married couples and unmarried opposite-sex co-habitants are treated differently for tax purposes, mainly affecting how they might arrange their own financial affairs and how relatives, associates and connected persons might arrange their own. Each party may be deemed to have an interest in assets or income not directly under their own control but held by or arising to others within defined family relationships.

20. Married couples are protected from certain charges that might otherwise arise say from the transfer of an asset one to the other. If they were not married, a transfer of value might be a taxable transaction.

21. But there is another side to the coin. Where a married couple holds assets or receives income, legislation might deem ownership or receipt to the other spouse

and this could give rise to a charge. Further, on marriage defined family relationships are extended. Opting to marry therefore alters their tax status.

22. On exercising the option to form a civil partnership, same-sex couples take on a package of legal rights and responsibilities, no distinction being drawn from a married couple. And the registration process ensures that there will be legal certainty about who has opted in and who has not and when the legal relationship begins and ends. Clear rights and obligations will be created. This level of certainty enables an assessment of when liabilities accrue and cease.

23. **Cherry Pick** – **winners & losers**. Tackling individual issues one-by-one on a pick and mix basis would involve a range of approaches, from issuing guidance to legislative changes. This would be administratively cumbersome and would not support the principle that there should be parity between civil partners and married couples. It would not be possible to justify individual concessions or limited, rather than full scale changes across the board.

5. Costs and benefits

- Sectors and groups affected

24. Recognition of this new legally defined personal relationship will have the same direct and indirect affects on any business sector involved with those who are to be, are or were married. For example, those catering for wedding receptions right through to those dealing with the legal consequences of separation.

- Benefits

Economic

25. As with marriage, there will be tax winners and losers. It is expected that to the Exchequer there will only be a minimal cost or yield depending upon the financial interests of the civil partners.

INHERITANCE TAX (IHT)

26. Transfers between married couples in lifetime or on death are exempt from inheritance tax without limit. On a par with married couples civil partners will be able to make gifts or bequests to their partners with the benefit of these IHT exemptions.

27. There are consequential changes elsewhere in the IHT code as extending all other provisions currently applying to spouses follows as a natural corollary. For example, IHT anti-avoidance provisions that apply to marriage will be applied to civil partnerships.

CAPITAL GAINS TAX (CGT)

28. CGT will apply to civil partners in the same way as for married couples. Equal treatment may have advantages or disadvantages for the individuals concerned. But that is the consequence of the general principle that there are to be no tax

differences between the treatment of spouses and civil partners. Some examples follow.

29. Private Residence Relief. Only one property owned by a couple, whether that property is owned solely or jointly, may be treated as the principal private residence of either of them at any time for CGT purposes and thus qualify for private residence relief.

30. Civil partners will be “connected persons” (Section 286 TCGA1992) in the same way as husbands and wives. They will also be connected with certain other persons, such as close relatives of their civil partner, in the same way as husbands and wives. Furthermore, where one partner settles property into a settlement under which the other partner can benefit, the settlor may be liable to CGT by reference to capital gains realised by the trustees if the relevant conditions as to the residence of the settlor, and certain other conditions, are met.

31. Transfers of assets between persons who are civil partners who are living together will be on a no-gain no-loss basis, and thus not attract an immediate CGT charge. Before entering the partnership the original owner would have been potentially liable to CGT.

STAMP DUTY/SDLT

32. There is an exemption from stamp duty and Stamp Duty Land tax for transactions carried out in connection with divorce such as the transfer of the marital home from joint ownership into the sole ownership of one of the ex-spouses. There will be a similar exemption for transactions carried out in connection with the dissolution of a civil partnership.

MARRIED COUPLE’S ALLOWANCE

33. Married Couple’s Allowance (MCA) is currently available to married couples where one of the spouses is born before 6 April 1935. We currently give MCA on claim, to the husband. From 5th December 2005, civil partners will have similar rights and MCA will be available to married couples and civil partners. From that date civil partnerships, and also new marriages, meeting the age criteria will, on claim from the spouse or civil partner with the higher income, receive the allowance.

34. For a couple who married before 5th December 2005, the husband will continue to receive MCA. However from tax year 2006-07 the couple will be able to elect instead for the spouse with the higher income to claim MCA under the new rules. This rule change provides existing claimants with increased options. There is no financial advantage to be gained from this. Indeed it is possible the couple may reduce their overall entitlement to MCA if the wife has a higher income and exceeds the income limit. The income limit for 2005-06 is currently £19,500.

BLIND PERSON’S ALLOWANCE

35. The Blind Person’s Allowance (BPA) contains a provision that any unused allowance (because the person does not have sufficient income) can be transferred to their spouse. Surplus BPA would be transferred to a registered partner.

Social

36. In the main this proposed tax legislation reinforces the social policy decision that same-sex couples making the commitment to become civil partners should be treated on a par with married couples.

37. Certain administrative processes are to be changed to extend the principle of social parity.

38. Currently a “tax approved” pension scheme can only pay pension related benefits to a member's surviving spouse widow/widower or and/or dependants (or such benefits can be paid to the surviving spouse and dependants). Schemes may, if they choose, offer Generally such a benefit can paid to a benefits to bereaved financial dependants only if that individual has a financial dependency on the deceased member. And it is up to the scheme to decide on this. Where there is a surviving civil partnership benefits can be paid in the same way as to a surviving spouse, widow/widower, without the financial dependency test.

39. Banks and building societies are required by law to deduct tax at the lower rate (20%) before paying interest to savers, unless they have authority to pay the interest gross. The category of people who can sign a gross registration declaration (on form R85) on behalf of a person who lacks the mental capacity to operate their own bank or building society account would be extended to include civil partners.

40. There are three minor areas where the ISA rules for spouses will be amended to cover a civil partner: firstly the eligibility of a spouse of a Crown employee serving overseas to subscribe to an ISA; secondly the ability of a husband or wife to subscribe to an ISA account on behalf of their spouse who lacks the mental capacity to operate their own ISA account, and thirdly the restriction on purchasing investments from their spouse. (Additional tax relief will arise on the subscriptions into ISAs made under these two facilities but this would be negligible. There are unlikely to be large numbers of civil partners of Crown employees serving overseas, or of mentally incapacitated ISA holders.).

41. Married couples frequently own property jointly and receive income from it. To avoid the need to establish for income tax purposes how much of the property is held by each they are treated as if it is held equally and so any income arising is taxed 50/50. However, if the couple is not in fact entitled to half the income each, they can elect to have income from property they hold jointly taxed on a basis other than 50/50. Civil partners will be treated in exactly the same way.

- Costs

Economic

SETTLEMENTS

42. The anti avoidance Settlements legislation prevents people avoiding tax by transferring their income to other people who pay less tax. There are special rules for husbands and wives and it follows these should be extended to civil partners.

COMPANY CONTROL TESTS

43. Section 416 of the Income and Corporation Taxes Act 1988 (ICTA) provides various tests for identifying who controls a company. It also deems a company to be under the control of a person if it is controlled by an associate of that person. The term “associate” is defined in section 417 and includes husband and wife. Following the logic of treating civil partners in the same way as married couples the definition of "associate" also includes a civil partner in a civil partnership.

TRANSFER OF ASSETS ABROAD

44. Civil partners will be treated in the same way as legally married persons under the transfer of assets abroad legislation in sections 739-746 ICTA .

45. This legislation aims to prevent individuals avoiding income tax by means of the transfer of assets. It applies where, as a result of a transfer and/or any associated operations, income becomes payable to persons resident or domiciled outside the UK. The legislation provides that an income tax charge may arise on the husband or wife of an individual who makes a transfer of assets, where the spouse is involved in the transfer or associated operations. This will in future apply equally to registered members of civil partnerships.

46. In addition, we extend to civil partners our practice of not normally seeking to tax under section 739 UK domiciled individuals in relation to income of their non-domiciled husband or wife, where that spouse would be outside the section 739 charge because of his or her entitlement to the remittance basis.

INTERMEDIARIES (ALSO KNOWN AS IR35) LEGISLATION

47. The Intermediaries legislation ensures that workers who would have been taxed as an employee had they been working under a contract with the client cannot avoid paying tax and National Insurance on the same basis as other employees, by using a limited company (or other intermediary, such as a partnership) to sell their services. If a particular engagement falls within the legislation, then the intermediary is responsible for operating PAYE and paying Class 1 NICs.

48. The legislation has reference to families which includes husband and wife and couples living together as husband and wife. It follows these should apply equally to civil partners and same sex couples living together as civil partners.

NET TAX COSTS

49. There is the assumption that by the third year, the scheme will be fully up and running. Our estimate is that the tax cost from then (once the scheme is no longer novel) will be up to £5 million per annum. For the period from implementation to the end of the tax year 2005/06, and for the next two tax years, 2006/07 and 2007/08, we have estimated the costs as negligible or up to £5 million. No estimate can be made of the tax yield that might arise from couples deciding to form a civil partnership despite its tax disadvantages. (See Annex A)

50. Changes will be made to IT systems, guidance, forms, leaflets, and learning material etc. to accommodate these tax changes. We estimate start-up costs and the first 5 years support costs will total up to £3.25 million

6. Small Firms Impact Test

None. In essence no difference is seen between a civil partnership run small business and one run by the more traditional husband and wife team.

7. Competition assessment

None

8. Enforcement, sanctions and monitoring

51. The CPA brings in what is seen as an opt-in scheme to establish this new legal status. In that respect for same-sex couples it works in the same way as for opposite-sex couples who decide to marry. The same compliance requirements therefore apply.

Compliance Costs for Business

52. In respect of IHT and Settlements legislation (anti-avoidance legislation), any costs are regarded as falling on individuals rather than business. And the CGT changes are perceived to have negligible business impact there being no discernible additional costs that business will incur as a result of the changes. Professional advisors will need to be aware of and take on board the changes in much the same way as they do with annual Finance Acts and advising married couples. We cannot see that there will be additional costs to them in doing this.

53. The tax rules for "small self-administered pension schemes" (SSASs) are likely to change because of the need to give the same tax treatment to civil partners and surviving civil partners as is currently given to spouses and surviving spouses. Amendments may also be required in scheme documentation to extend the definition of "connected person" to include a civil partner. Other minor amendments may be required but would depend on the terms under which pension benefits are ordinarily paid to surviving spouses. It is likely that SSAS practitioners will have to amend their compliance systems to recognise the new requirements relating to civil partners. There will also be a similar impact on "self-invested personal pension schemes" (SIPPs) as SIPP practitioners will have to amend their compliance systems. These changes are expected to have minimal costs.

9. Implementation and delivery plan

54. To help civil partners know what they have to report and claim, existing pamphlets, publications, explanatory notes with returns and claim forms will be expanded. Where they advise a married couple they will give that same level of advice to civil partners.

55. To help HMRC staff fully understand the new legal status and how it affects civil partners, guidance and training are being revised.

10. Post-implementation review

56. Cost of the measure. Estimates based on the number of registrations will be informative, but not wholly accurate as we must assume that we will not be made aware of those cases in which no liability arises, there being no reporting

requirement. In addition, on forms and Returns, where references to 'marital status' need to be changed to reflect the new civil partnership status, the term 'marital or civil partnership status' will be used unless there is a specific need to identify people in one or other category. This will ensure that people who do not wish to reveal their sexual orientation are not required to do so. Thus, calculating the cost of tax parity will be further obscured. Yet given the background and drivers to the CPA - tax parity - it seems illogical anyway to quantify the cost to the exchequer.

Testing whether the regulations are effective.

57. To be sure that our Instruments bring 100% tax parity, through the HMRC web site and feed back from front line staff we shall be canvassing stakeholders for their views on the implementation of the policy and whether there have been any unintended consequences. We have in place a mechanism for recording and dealing with matters that arise.

58. A date for review will be set within 2 years from implementation to look where possible at what the real costs and benefits are and to be sure that any unintended consequences have been fully dealt with.

59. HMRC has a programme in place to ensure that the compliance cost assessments made for all RIAs are reviewed after the policies are implemented. The assessment of compliance costs in this RIA will be part of this process and will be carried out within 2 years of implementation.

11. Summary and recommendation

60. The Instruments recognise the existence of the new legal status, reinforce and support the social policy of parity, and ensure legislation is HR Act compliant. The cost to the Exchequer is negligible, and that to the civil partners being no more nor less than that to their parallel, a married couple.

12. Contact Points

Telephone enquiries and comments to:

Mark E Taylor 0207 147 2386

Sara Woollard 0207 147 2380

Annex A

Measure	Cost by 2010 £m per annum	Measure benefits taxpayer?
Capital Gains Tax (note 1)	0.75	Y
Inheritance Tax (note 1)	1	Y
ISAs	0	Y
Stamp Duty (note 2)	0.5	Y
MCA	1	Y
Pension Schemes	1	Y
Building Societies	0	Y
Blind Person's Allowance	0	Y
Settlements & Ownership	Possible cost to partners	Note 3
Total	**4.25**	

Notes

1. For CGT, this figure is the absolute maximum and not expected in practice. It will reflect that transfers of chargeable assets between civil partners become tax neutral. For IHT, gifts and bequests between them become eligible for the same exemptions as applies between husband and wife.

2. For Stamp Duty, this is a very provisional figure: costs are expected to be minimal.

3. Where beneficial interest in settlement income or shares is concerned, this figure relies on taxpayer behaviour. Like married couples, civil partners will have certain interests aggregated and possibly attributed to the other party for the purposes of assessment. The overall cost to those registering is likely to be minimal.

REGULATORY IMPACT ASSESSMENT

CERTIFICATE TITLE

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo

Paymaster General

13th October 2005