SEPARATION AND CAPITAL GAINS TAX – HAS THE CIVIL PARTNERSHIP ACT 2004 LED TO AN UNEXPECTED CHANGE IN RELATION TO COUPLES WHO SEPARATE?

Keith M Gordon[1]

Background

It is well known that transfers between husbands and wives can be largely ignored for capital gains tax purposes. Although the disposal is not a non-event as far as the tax is concerned, inasmuch as there is an actual disposal and an actual acquisition[2] – both parts of the transaction deemed to be effected at a particular value[3] – it is generally assumed that (for capital gains tax purposes at least) such transfers give rise to no tax difficulties.

The rule relating to transfers between spouses was introduced in the Finance Act 1965 when capital gains tax was first created and was unchanged in the two consolidations of the capital gains tax legislation that followed. The wording has changed recently, however, following the introduction of civil partnerships in 2005. This article examines whether or not the changes made in 2005 go further than merely extending the rules applicable to married couples to members of civil partnerships.

---

1 Keith Gordon MA (Oxon) FCA CTA(Fellow) is a barrister, chartered accountant and tax adviser. He practises from Atlas Chambers; website: www.atlaschambers.com; Tel: 020 7269 7980; Email: keith@keithmgordon.co.uk;.

2 This point becomes particularly relevant when it comes to identifying shares and securities in accordance with the rules in Chapter I of Part IV of the Taxation of Chargeable Gains Act 1992.

3 being such amount as would secure that on the disposal neither a gain nor a loss would accrue to the one making the disposal (section 58(1))

Section 58(1)

The original version of section 58(1) read as follows:

> (1) If, in any year of assessment, and in the case of a woman who in that year of assessment is a married woman living with her husband, the man disposes of an asset to the wife, or the wife disposes of an asset to the man, both shall be treated as if the asset was acquired from the one making the disposal for a consideration of such amount as would secure that on the disposal neither a gain nor a loss would accrue to the one making the disposal.

That wording is identical to that found in the provision's original incarnation in the Finance Act 1965, section 20(5). This has changed, however, under the provisions of the Tax and Civil Partnership Regulations 2005 (SI 2005/3229). Regulation 107(2) provided as follows:

> (2) In subsection (1), for the words from the beginning to "both" substitute —
>
> "If, in any year of assessment, —
>
> (a) an individual is living with his spouse or civil partner, and
>
> (b) one of them disposes of an asset to the other, both".

Currently, therefore, section 58(1) reads as follows:

> (1) If, in any year of assessment, —
>
> (a) an individual is living with his spouse or civil partner, and
>
> (b) one of them disposes of an asset to the other,
>
> both shall be treated as if the asset was acquired from the one making the disposal for a consideration of such amount as would secure that on the disposal neither a gain nor a loss would accrue to the one making the disposal.

As far as married couples and civil partners who are living together[4] at the time of the transfer, it is submitted that section 58(1) continues to provide that transfers between the couple are effected at nil-gain and nil-loss. However, what is not immediately clear is whether the law has changed in respect of transfers between the couple made after, but in the tax year of, their separation.

Transfers after separation

Prior to 2005, the law was totally clear. In the year of separation, the nil-gain nil-loss rule applied to transfers between husbands and wives whether or not they were living together at the time of the transfer (provided, of course, that they had not divorced by then). This rule allowed separating couples limited scope to reorganise their affairs in a tax-efficient (or at least, a tax-neutral) way even after the marriage had irretrievably broken down.

Following the 2005 changes, however, it is not immediately clear whether or not the rule continues to apply to couples after they separate.

Under any interpretation of section 58(1), two conditions need to be satisfied if the nil-gain nil-loss rule is to apply. First, an individual must be living with his (or her) spouse or civil partner and, secondly, there must be a disposal of an asset by one to the other. The plain meaning of the subsection is that the two conditions must be satisfied at the same time – in other words there must be a disposal of an asset between a cohabiting couple (who are married to, or civil partners of, each other). I will call this interpretation "the narrow interpretation".

On the other hand, it is possible to read those conditions as both being dependent on the preceding words 'in any year of assessment'. Under that reading ("the broad interpretation"), the two conditions need be satisfied only *during* the year of assessment, and not necessarily at the same time. This latter reading clearly carries the advantage of reflecting more closely the meaning of the pre-2005 version of the legislation. However, is it necessarily the correct interpretation?

---

4 Section 288(3) provides that 'living together' is to have the same meaning as in section 1011 of the Income Tax Act 2007. That reads as follows:
Individuals who are married to, or are civil partners of, each other are treated for the purposes of the Income Tax Acts as living together unless–
(a) they are separated under an order of a court of competent jurisdiction,
(b) they are separated by deed of separation, or
(c) they are in fact separated in circumstances in which the separation is likely to be permanent.

Arguments favouring the broad interpretation

The broad interpretation has a number of arguments in its favour. First of these is the history of the section. As previously noted, it reflects the effect of the provision prior to the change in 2005. Given that the ostensible purpose of the 2005 change was to put civil partners on the same tax footing as married couples, it is arguable that, absent any clear statement to the contrary and where the statute can be given such a meaning without straining the words, one ought to read the post-2005 legislation so that it simply extends the pre-2005 rules to gay and lesbian couples. This must be even more the case given that the amendment to the legislation was effected by secondary legislation.

The broad interpretation also has the advantage of giving meaning to the words "in any year of assessment". Therefore, it would be in accordance with the doctrine *ut res magis valeat quam pereat* – it is better for a thing to have effect than to be made void. However, this doctrine is generally applied to substantive provisions rather than mere words within a subsection.

The broad interpretation requires that:

1. at some time ***in a year of assessment***, the couple is living together and

2. at some time ***in the same year of assessment***, there is a disposal of an asset between the members of the couple.

Furthermore, the provision has pragmatic advantages if applied in accordance with the broad interpretation. For example, if a couple were to separate, it can often be difficult to identify the precise date in which the circumstances of their separation are such that it is likely to be permanent. Provided that these circumstances can be pinpointed to a particular tax year then the actual date becomes unnecessary because any transfers between the couple during that tax year will be effected on a nil-gain nil-loss basis whether or not the couple has actually separated at the time.

Arguments favouring the narrow interpretation

On the other hand, the narrow interpretation does reflect the more natural reading of the subsection. Whilst it is not particularly conclusive, it is noteworthy that the Regulatory Impact Assessment accompanying SI 2005/3229 noted that:

> "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."[5]

Although the narrow interpretation renders obsolete the words "in any year of assessment", there are times when the Courts would hold statutory words to be mere surplusage and would interpret the legislation as if those words had been omitted.

Additionally, one of the arguments supporting the broad interpretation can equally be applied in support of the narrower interpretation. Whilst separating couples can more easily determine the date on which their separation became final rather than the tax year, there will be cases in which the separation can be shown to take place early in April in any one year but the actual date cannot be more precisely determined. In such cases, the broad interpretation would mean that delaying the date until after 5 April would give the couple an extra year of nil-gain nil-loss transfers. (There again, it has to be accepted that taxing individuals on a fixed year will always give rise to such anomalies.)

The words 'in any year of assessment'

The correct interpretation of section 58(1) depends, therefore, on the status of the opening words 'in any year of assessment': are they operative or mere surplusage?

In the original version of section 58(1), those words are not directly operative but serve as a basis for the later words in the section '… in the case of a woman who ***in that year of assessment*** is a married woman living with her husband …'. The words 'in any year of assessment' is found elsewhere in the Taxation of Chargeable Gains Act 1992 although, it must be stated, the phrase when used elsewhere in the Act does tend to have a greater rôle.[6] Therefore, the retention of the words 'in any year of assessment' could indicate a deliberate intention to give the words some meaning – a meaning that is arguably absent from the words in the original version of section 58(1).

---

5 at paragraph 31

6 For example, section 87 applies "to a settlement for any year of assessment during which the trustees are at no time resident and ordinarily resident in the United Kingdom".

The scope of the Tax and Civil Partnership Regulations 2005

Alternatively, given that the change to section 58(1) was made by statutory instrument, it is appropriate to consider the *vires* behind SI 2005/3229. That can be found in section 103 of the Finance Act 2005. That section reads as follows:

> ***103 Civil partnerships etc***
>
> 103(1) In the case of any tax or duty, the Treasury may by regulations make provision for the purpose of securing that the events or persons specified in column 1 of the Table are treated in the same way as (or a similar way to) the corresponding events or persons specified in column 2 of the Table.

1. Events or persons	*2. Corresponding events or persons*
1. The formation of a civil partnership.	A marriage.
2. Persons who are, have been, or may in future be, civil partners of each other.	Persons who are, have been, or may in future be, married to each other.
3. Persons who are not civil partners of each other but who are living together as if they were.	Persons who are not married to each other but who are living together as husband or wife.
4. Persons who are not civil partners of each other.	Persons who are not married to each other.
5. A person who is not a civil partner of any other person.	A person who is not married.

> (2) The provision that may be made by regulations under subsection (1) includes provision for or in connection with varying, for the purpose specified in subsection (1), the treatment that would, apart from the regulations, apply–
>
> (a) on the occurrence of an event specified in column 2 of the Table, or
>
> (b) in the case of persons specified in column 2 of the Table.
>
> (3) The Treasury may by regulations make provision for the purpose of removing any inequality of treatment of persons based on gender or, in the case of a parent, marital status.

(4) Any power to make regulations under this section is exercisable by statutory instrument.

(5) A statutory instrument containing regulations under this section shall not be made unless a draft of the instrument has been laid before, and approved by a resolution of, the House of Commons.

(6) The provision that may be made by regulations under this section includes provision–

(a) amending any enactment, or

(b) applying any provision of any enactment with or without modifications.

(7) Any power to make regulations under this section includes power–

(a) to make different provision for different cases;

(b) to make incidental, supplemental, consequential or transitional provision or savings.

(8) The powers conferred by this section are exercisable in relation to enactments (including enactments contained in, or made under, this Act) passed or made at any time before the end of the Session following that in which this Act is passed.

(9) In this section–

"civil partnership" means a civil partnership which exists under or by virtue of the Civil Partnership Act 2004 (c. 33) (and "civil partner" is to be read accordingly);

"enactment" includes any provision comprised in–

(a) an Act of the Scottish Parliament;

(b) Northern Ireland legislation;

(c) an instrument made under any enactment.

It will be seen that subsection (1) initially limits the scope of regulations to those which achieve "the purpose of securing that the events or persons specified in

column 1 of the Table are treated in the same way as (or a similar way to) the corresponding events or persons specified in column 2 of the Table".

Subsection (2) provides that the rules for married couples can be varied by the regulations. However, such variations must be in accordance with the purpose of equalising the treatment between heterosexual and same-sex couples. Arguably, removing the nil-gain nil-loss treatment for separating couples during the year of separation fulfils this purpose, given that same-sex couples have not been and would not be treated any differently.

Similarly, the *vires* in subsection (3) would appear to justify a change in the meaning of section 58(1) as it would have the effect of removing an "inequality of treatment of persons based on gender".

In conclusion, it would seem that the *vires* are sufficiently wide to permit any change in the scope of the rule in section 58(1).

The Parliamentary intention – the dog that didn't bark

However, I would suggest that the most conclusive clue is the absence of any transitional provision dealing with any alleged change in the meaning of section 58(1).

Regulation 1(1) provides that section 58(1) was revised with effect from 5th December 2005. Were the scope of section 58(1) to have changed, it would mean that a married couple separating on 30th June 2005, say, would have been subject to the nil-gain nil-loss rule between 1st July and 4th December 2005 but not thereafter. Such an effect, whilst possible, would seem wholly unlikely. Had there been an intended change in the law, it is more likely that transitional provision been included (along the lines of the provisions in paragraphs (2) to (7) of regulation 1). One possible candidate is that the change in the law would have had effect for *separations* occurring on or after 5th December 2005.

Conclusion

Although the legislation is nowhere beyond doubt, my provisional view is that separating couples (whether married or members of civil partnerships) continue to enjoy (or be subject to) the nil-gain nil loss rule for transfers made after, but in the same tax year as, they separate. However, this is not a natural interpretation of the legislation. But it does reflect the history of the provision.