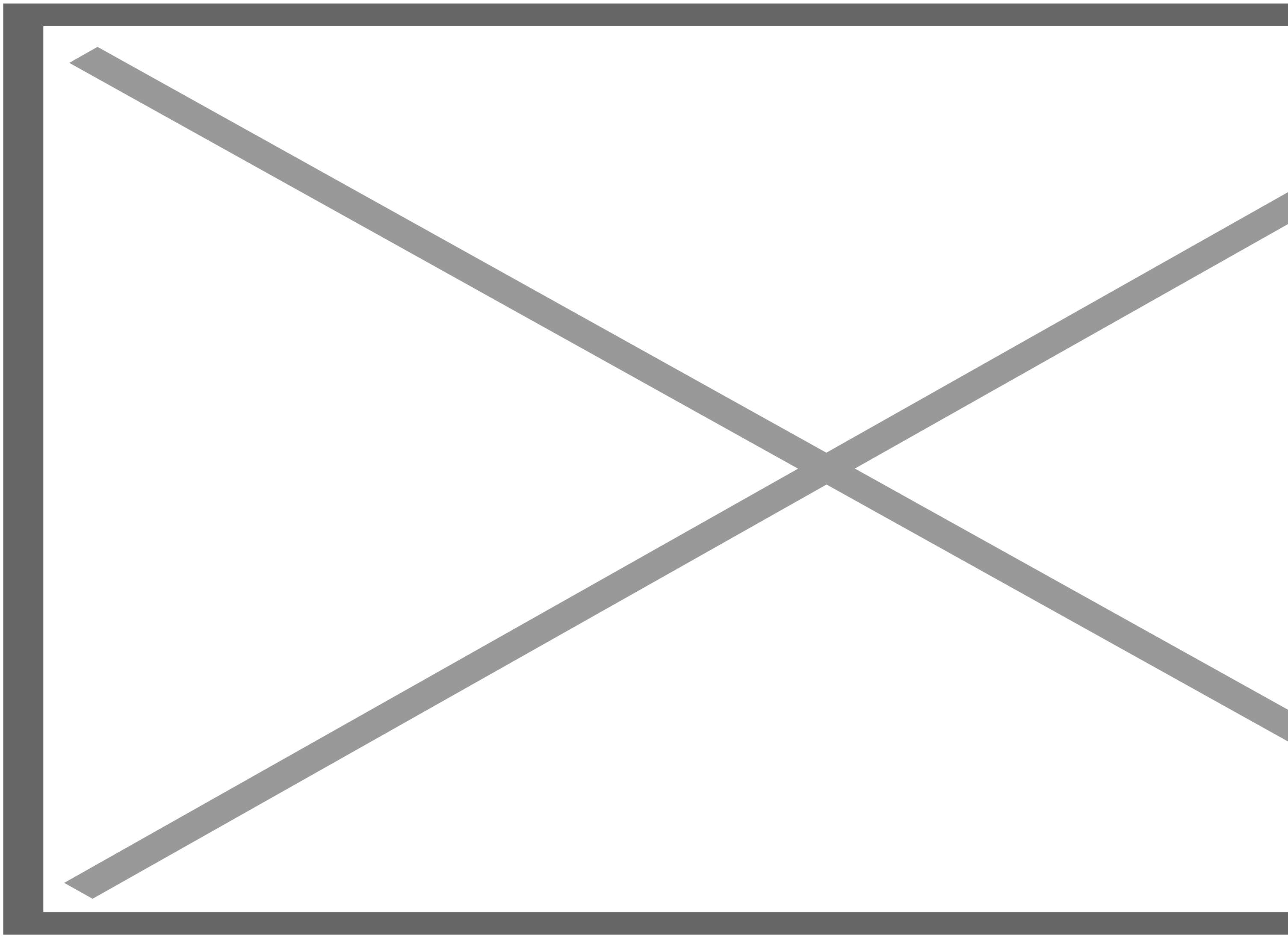
Put a ring on it?

Personal tax



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Kelly Sizer and Tom Henderson consider the tax status of coupledom, and how it can affect income, allowances and benefits

Key Points

What is the issue?

‘Couple’ status has different meanings and consequences across the tax and benefits systems.

What does it mean for me?

If a client’s relationship status changes, advisers need to be aware of the potential tax and benefits consequences.

What can I take away?

Awareness of the consequences when couples form, so to be able to flag wider issues to clients, such as notifying HMRC of a change for tax credits.

The coronavirus pandemic sadly forced many couples to cancel, delay or significantly scale back their wedding plans. But how many have spent the extra time considering in detail some of the tax consequences of their decision to get married (or to enter into civil partnership)? It would hardly be most people’s first thought when planning nuptials!

In the Low Incomes Tax Reform Group’s (LITRG) work, we see some of the problems that couples encounter with the tax and benefits systems. This is not helped by the fact that there are different rules to get to grips with.

By and large, the UK’s means-tested benefits system looks through a couple’s legal status to their underlying relationship. Cohabitation as a couple is usually a sufficient indicator of relationship status for a couple to be regarded as a single ‘unit’ for benefits purposes, although other factors may be taken into account.

On the flipside, the tax system generally ignores cohabitation. Two important exceptions are the high income child benefit charge and the ‘family’ tie under the statutory residence test. Both of these take into account partners where the individuals are ‘living together as if they were a married couple or civil partners’ (Income Tax (Earnings and Pensions)

Act 2003 s 681G and Finance Act 2013 Sch 45 para 32 respectively). The definition of these types of relationship is drawn more from social security law, as discussed further below.

This article considers some of the issues for couples to think about, in relation to income, allowances and benefits. It does not cover transactional tax aspects such as stamp duty land tax (and devolved equivalents) or capital taxes.

Marriage or civil partnership?

Broadly speaking, for UK tax purposes a civil partnership is treated the same as a marriage, with the law referring to both where such relationships are to be recognised for tax purposes. There is no general provision defining the two as equivalent. The law necessarily has some minor distinctions, recognising the different administrative processes surrounding the two types of relationship. For example, on breakdown of a relationship, references to divorce are made for married couples, or dissolution for civil partners.

Married couple’s allowance

A minor esoteric difference between married couples and civil partners can be found in relation to married couple’s allowance (MCA).

For those married before 5 December 2005, the default position in law (Income Tax Act (ITA) 2007 s 45) is that the husband claims MCA. In turn, any restriction of the allowance is calculated by reference to the husband’s adjusted net income where it exceeds a certain threshold (£30,400 for 2021/22). When civil partnerships were introduced from 5 December 2005, the law (now found in ITA 2007 s 46) was amended such that civil partners could also claim MCA. If any restriction is required, it is calculated by reference to the partner with the higher adjusted net income.

Couples who married before 5 December 2005 can irrevocably elect for the ‘new’ section 46 rules to apply if they wish (ITA 2007 s 44).
In December 2020, the MCA legislation was amended to take account of the possible conversion of an opposite-sex marriage into a civil partnership. This means that if a couple who married before 5 December 2005 were to convert their marriage to a civil partnership, the ‘old’ section 45 rules continue to apply unless the couple elects otherwise.

In any event, to qualify for MCA, at least one of the couple must have been born before 6 April 1935. For anyone registering new marriages or
civil partnerships who meet the age requirement, we must remember that the MCA is only available for complete ‘tax months’. So if a couple married on 24 May 2021, only 10 months (6 June 2021 to 5 April 2022) of MCA is due in the first tax year of marriage, pro rata. If, following the Office of Tax Simplification’s recent report (see tinyurl.com/457d8mfn), the government does decide to change the tax year end, this legislation (ITA 2007 s 54) may need amending. But probably it would be administratively simpler and not terribly costly to repeal it altogether and just allow the few couples who are entitled to claim the whole MCA for the year of marriage!

MCA is transferable between spouses and civil partners, though it is only possible to elect in advance for half or all of the minimum amount of the allowance (£3,530 for 2021/22) to be transferred. If there is any surplus unused after the end of the tax year (or on establishing the tax liability of a deceased spouse or civil partner), this can then be transferred.

Marriage allowance

For most couples, MCA will not be available. Instead, an election may be possible for the transferable tax allowance for married couples and civil partners (ITA 2007 Part 3 Chapter 3A), for which the government uses the shorthand ‘marriage allowance’.

The marriage allowance is only available to those couples where there is no liability by either party to tax at a rate higher than the UK basic rate (or intermediate rate if Scottish taxpayers).

If the member of the couple giving up part of their allowance is non-resident and instead qualifies for UK personal allowances by virtue of ITA 2007 s 56(3), there is an additional requirement. This is that their ‘hypothetical net income’ (that is, what would be their ‘Step 2’ income per ITA 2007 s 23 if they were UK resident and domiciled) must be below the personal allowance for the year.

The partner with the lower taxable income gives up 10% of their personal allowance (£1,260 for 2021/22). The recipient partner receives a tax reducer (£252 for 2021/22) which can be set against their tax liability – so reducing the amount of tax they pay.

It is important to note that the recipient partner does not have their own personal allowance increased as a result of the claim. LITRG have seen taxpayers being caught out as a result of misunderstanding this point – not helped by the wording of guidance on GOV.UK.

Pension problem

Such misunderstandings can be a particular problem when people claim a pre-6 April 2016 deferred state pension lump sum, where the rate of tax chargeable depends on the individual’s net income less allowances (that is personal allowance and blind person's allowance, if eligible); in other words, 'Step 3 income' in the ITA 2007 s 23 tax calculation. This is under F(2)A 2005 ss 7-10.

Broadly speaking, the effect is that the tax chargeable will be the same as the individual's marginal rate of tax. People might therefore think this should be 0% if they pay no tax as a result of a marriage allowance election. However, the marriage allowance tax reducer is only deducted much later in the ITA 2007 s 23 tax calculation (at Step 6), so the rate payable on the lump sum may still be 20% even as a non-taxpayer. As this kind of state pension lump sum can now be in the tens of thousands of pounds, this mistake can lead to a shock five-figure tax bill.

Transfer of the blind person's allowance

The blind person's allowance (BPA) is available to individuals registered as severely sight-impaired with a local authority in England and Wales. If living in Scotland or Northern Ireland, the requirement is that the individual's sight is so bad as to stop them performing any work for which eyesight is essential.

The key point to recognise here is that, despite the name of the allowance, you do not have to be completely without sight to qualify.

For 2021/22, the blind person's allowance is £2,520, given in addition to the standard personal allowance. Unlike the personal allowance, it is not reduced where the individual's adjusted net income exceeds £100,000.

If a person is entitled to the blind person's allowance but their income is too low to make full use of it, marrying or entering into a civil partnership will enable them to elect (ITA 2007 s 39) to transfer the surplus allowance to their partner.

Joint income: let property

As discussed in PIM1030 (see tinyurl.com/ 4mum6psk), couples who are not married and not in a civil partnership who are joint owners of let property may agree any split of property income between them (assuming the property is not let as part of a partnership business), even if this is different from the underlying beneficial ownership. They would then be taxed accordingly on that split and no formal election is required, though it would be sensible to record the agreement in writing.

Where the joint owners of a let property are married or civil partners, the share of any profit or loss will be treated as arising to each owner in equal shares by law, even if the underlying beneficial entitlement is unequal. However, the parties may both elect, on form 17, to be taxed in accordance with their respective beneficial interests instead, if these are unequal. Therefore, this is a case in which couples who are not in a civil partnership or marriage actually have more flexibility when it comes to splitting rental income from jointly held property. This could translate to an overall tax saving if, by agreeing a certain split of income, better use can be made of tax allowances and lower rate bands.

Joint income: savings interest

Where the joint account holders are not in a civil partnership or marriage, each partner is taxed on the share of interest to which they are entitled. In most cases, this will be 50:50, even if contributions to the account are unequal.

Interest paid on joint bank accounts held by those in a marriage or civil partnership will, as in the case for jointly held let property, be taxed in equal shares unless an election is made to be taxed in accordance with beneficial interests instead. Note that the election must reflect a real difference in beneficial ownership – the election cannot be made arbitrarily. Again, this is done on form 17.

Readers can refer to SAIM2420 (see tinyurl.com/w8bayvwm) and TSEM9800 (see tinyurl.com/wj66um5y) for further information.

Tax credits and universal credit

A change in relationship status can affect benefits claimants, as it can alter whether claims should be made on a single or joint basis. Marriage or entering into a civil partnership will affect existing tax credits claimants who have previously been making single claims, if HMRC would not already have regarded them as a 'couple' and therefore needing instead to make a joint benefits claim.

The point at which two individuals making single claims become a couple is not straightforward – not least because sometimes each party can have a different view of the status of their relationship!

The Tax Credits Act 2002 s 3(5A) definition of a couple for tax credits purposes is:

- those who are married or civil partners (and are neither separated by court order or in circumstances that are likely to be permanent); or
- two people who are 'living together as if they were a married couple or civil partners'.

One might therefore think that an engaged couple who are not physically living in the same household could each continue to make a single tax credits claim until the point they marry or enter into a civil partnership. Unfortunately, the position is not as clear cut as this, as the term living together could be interpreted as not being confined to living as a household under the same roof, but could also take into account the degree to which the individuals concerned share their lives together in other senses, such as their financial and emotional relationship.

In addition, the analysis may not be straightforward; for example, a couple might divide their time between the homes of each member of the couple.

HMRC guidance at TCTM09340 (see tinyurl.com/379twbwj), based on social security case law, sets out a series of 'signposts' to consider, including:

- living together in the same household;
- stability of the relationship;
- financial support;
- sexual relationship;
- dependent children; and
- public acknowledgement (for example, whether friends and family members regard the two people as a couple).

For many relationships, it might be that 'couple' status and hence the need to make a joint claim is reached long before entering into marriage or civil partnership. However, if prospective partners have led very separate lives up to the point of entering into a legal union, such that they would not be regarded as a couple, the point at which they marry or form a civil partnership will trigger the need to end their single tax credit claim (even if they continue to live apart).

Universal credit is replacing tax credits as the main working-age benefit. HMRC will not now accept any brand new tax credit claims (with the exception of ‘frontier workers’). This means that where a change in circumstances triggers the need to make a joint claim, that claim will have to be for universal credit, and existing single tax credits claims will end.

Finally, it is worth noting that the universal credit legislation has a slightly different definition of a couple than for tax credits. It is therefore technically possible to get a different outcome as to joint or single status and the rules for each need to be checked carefully.