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SHORTER ARTICLE

TAX, MARRIAGE AND THE FAMILY

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SEPARATE TAXATION WITHIN THE FAMILY

TAX lawyers and family lawyers are being provided with much interest by the recent decision of the Court of Appeal in *Jones* v. *Garnett*.[1] The Revenue have obtained leave to appeal to the House of Lords. When that appeal is heard it is to be hoped that the Lordships will not be swayed by one particular point made both in the Court of Appeal (by Chancellor Morritt and Carnwath L.J.), where the taxpayer succeeded, and in the High Court (Park J.), where the Revenue had succeeded. As Carnwath L.J. put it:

> Most of the authorities pre-dated the introduction by the 1988 Act of separate taxation for spouses. The specific references to spouses in s. 660A show that arrangements between spouses are potentially within its scope, but the legislative purpose is not easy to discern. Like Park J, and the Chancellor, I find it odd that in this context spouses are still treated by s. 660A(2) as sharing the same interest, notwithstanding their separate treatment for other income tax purposes.[2]

Park J., rather curiously, had contrasted the position of the taxpayer's spouse, caught by the section, with that of the taxpayer's sister, not caught by the section.[3] Morritt C., more simply and more effectively, made the contrast with that of the taxpayer not being married to the other relevant person before noting that he had nonetheless to give full effect to the legislation.[4] None of the judges felt it necessary to point out that the rule does not apply to spouses who are living apart.[5] Readers will wish to note that the set

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[1] [2005] EWCA Civ 1553, [2006] S.T.C. 283 reversing Park J., [2005] EWHC 849 (Ch), [2005] S.T.C. 1667. For tax comments see M. H. Robson 2005 B.T.R. 15 (Special Commissioners) and G. Loutzenhiser [2005] B.T.R. 401 (High Court).

[2] *Ibid*., para. [106]; Carnwath L.J. was previously Junior Counsel to the Revenue 1975–80.

[3] *Ibid*., para. [41].

[4] *Ibid*., para. [64].

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of provisions dealing with "settlements" have now been rewritten as Income Tax (Trading and Other Income) Act 2005, Pt. 5, ch. 5, and that s. 660A (2) is now ITTOIA s. 625 and s. 660A(6) is ITTOIA section 626.

Here, it will be contended that, although the judges are quite right to draw attention to the situation arising from section 660A(2)/625 in which the spouse's rights cause the section to apply when similar rights in a non-spouse would not,[6] there is no reason to regard this situation as odd if one takes a look at the overall pattern of the rules currently in force and that such a view also reveals a reasonably clear legislative purpose. It follows that there is no reason, on this score, for the House of Lords to hold back from giving these rules their full and proper application. This is not to say that the rules are necessarily what would result from a review of the tax system, simply that it presents a pragmatic compromise in an area where compromise is unavoidable. Broadly, the compromise arises because the current law tries to do three things, *viz*. (a) give certain tax advantages to those who are married or civil partners; (b) provide that certain transactions within the very close family should not give rise to tax effects, which may be either advantageous or not depending on the circumstances; and (c) prevent that same very close family from taking undue advantage of the tax rules. So it is certainly not the case that "separate taxation" entails that married persons be treated the same as unrelated individuals throughout the UK tax system. This will be demonstrated by looking at the history of separate assessment for income tax and then some capital tax rules before returning to *Jones* v. *Garnett*. It can be further demonstrated by the recent changes to the tax system to take account of civil partnerships, made under two statutory instruments made under the provisions of the Finance Act, 2005.[7] The first amends 190 provisions in primary legislation, including the provisions at issue in *Jones* v. *Garnett*, the second amends 15 provisions in secondary legislation. The list of amendments provides a useful check list on the circumstances in which status matters in current UK tax law. While the calculation calls for some matters of judgement, an examination suggests that of the 205 regulations, just over 100 come within group (a) and just over 50 come within group (c).[8]

[5] Income and Corporation Taxes Act 1988, s. 660A(8); Income Tax (Trading and Other Income) Act 2005 s. 625(4) expressly excludes the widow or widower of the settlor, or a person to whom the settlor is not married but may later marry.

[6] This is because s. 660A(2)/625 refers to spouse and now civil partner.

[7] Tax and Civil Partnership Regulations 2005, SI 2005/3229 (amending primary legislation) and Tax and Civil Partnership (No. 2) Regulations 2005, SI 2005/3330 (amending secondary legislation) made under the powers in Finance Act 2005, s. 103.

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When examining these rules one should note that some apply to spouses or civil partners generally and others apply to them only while they are living together. Only in the rarest of situations does the tax system define rules in terms of cohabitation alone; only four of the 205 provisions being amended use that status.[9] This reluctance probably relies on the importance of certainty, which was one of Adam Smith's famous "canons of taxation",[10] but it is interesting to note that one of the four comes from an anti-avoidance provision introduced in 2000, so the Revenue are not averse to using this concept when it suits them. The current Law Commission review of cohabitation does not extend to tax matters.[11]

The principle of separate treatment of spouses for income tax was introduced by the Finance Act 1988 and came into force in 1990; it applies both for income tax and for capital gains tax. Much earlier, income tax had aggregated the incomes of the spouses so long as they were living together, a form of joint family taxation well known in other parts of the world. The legislative form in which this was put in the United Kingdom was that income of the wife was treated as that of her husband, a form which, with changing social attitudes, came to be regarded as deeply offensive. Over the years some changes were made. A married woman could require the Revenue to assess her separately from her husband; this did not affect the overall amount of tax they had to pay but did give her some degree of personal autonomy—and privacy—with regard to her tax affairs.[12] She had to be given a statutory right to repayment of any tax in respect of her income tax.[13] After 1971 there was a procedure by which they could be not just assessed but actually taxed separately, but only in respect of her earned income.[14] Finally, in 1988, the legislative change to separate taxation was made. As Nigel Lawson put it in his Budget speech, the two objectives were to give married women

[8] The broad picture is more informative than the apparently precise numbers—102 and 56. Each regulation amends one piece of legislation so one may effect one change while another effects several. Because the provisions have been rewritten as Income Tax (Trading and Other Income) Act 2005, pt. 5, ch. 5 no fewer that seven of the regulations affect this chapter, and three of them come within (c).

[9] Income Tax (Earnings and Pensions) Act 2003, sections 61 (introduced by Finance Act 2000, Sch. 12 para. [21] (4) and dealing with services supplied through intermediaries), 669 (a much older rule which exempts income support unless paid to a member of a couple involved in a trade dispute) and sections 673 and 674 (job seeker's allowance rules).

[10] *The Wealth of Nations* (Oxford 1976), Book 5, ch. 2, 825–8. On cohabitation see A. Barlow and G. James (2004) 67 M.L.R. 143 and public information campaign launched by the Department for Constitutional Affairs www.dca.gov.uk/family/cohabit.htm.

[11] See http://www.lawcom.gov.uk/cohabitation.htm.

[12] Income and Corporation Taxes Act 1988 s. 283.

[13] *Ibid*., s. 281.

[14] *Ibid*., s. 287.

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the same privacy and independence in their tax affairs as everyone else and to bring to an end the way in which the tax system could penalise marriage.[15] As the list of 205 regulations shows, these objectives were not carried out without some qualifications and exceptions.

The current Chancellor of the Exchequer, Gordon Brown, has had to undo some of this achievement. The current tax credits, introduced to address the dual problems of child poverty and "in-work poverty" and based on a belief that the best way to help families out of poverty is through work, consist of child tax credit (CTC) and working tax credit (WTC). WTC contains not only support for those in low-paid employment but also significant help with child care costs. Entitlement to credits turns not on marriage but on responsibility for a child (in respect of CTC)[16] and being engaged in "qualifying remunerative work" (for WTC)[17] and on the joint income of joint applicants.[18] It thus destroys privacy and independence in their tax affairs for members of the household—but does so whether they are married or not. Needless to say there is much feminist writing on these topics, though, sadly, it is not referred to in any of the United Kingdom Government papers.[19] There is also writing from a very different perspective which while praising the level of support criticises some of the effects and, in particular, the way in which support is increased for partners who separate as contrasted with those that remain together.[20]

Reasons for Revewing the Area

The *Jones* v. *Garnett* litigation is not the only reason for revisiting this area. A second is that since the last occasion this was done in this Journal[21] many of the tax rules have changed. One can no longer deduct any mortgage interest for income tax, the availability of personal reliefs in TA 1988 sections 257 *et seq*. no longer turns on whether one is married or not (unless one is 71 or over on 6th April 2006)[22] and, subject to the same exception, there is no longer

[15] HC Deb. vol 129 col. 997 (15 March 1988); the nine year battle by Sir Geoffrey Howe and Nigel Lawson to achieve this is told in Geoffrey Howe, *Conflict of Loyalty* (London 1995), pp. 566–7, and Nigel Lawson, *The View from No. 11* (London 1992), pp. 881–7.

[16] Tax Credits Act 2002, s. 8(1).

[17] Tax Credits Act 2002, s. 19(1).

[18] Tax Credits Act 2002, s. 7(4).

[19] *E.g*., E.J. McCaffery, "Slouching Towards Equality: Gender Discrimination, Market Efficiency, and Social Change" (1993) 103 Yale L.J. 595; A. L. Alstott, "Tax Policy and Feminism: Competing Goals and Institutional Choices" (1996) 96 Col. L.R. 2001, and "Property, Taxation, and Distributive Justice: What does a Fair Society owe Children—and their Parents?" (2004) 72 Fordham LR 1941.

[20] R. O'Neill, *Fiscal Policy and the Family* (London 2005).

[21] R. Kerridge, "Taxation and Marriage" [1988] C.L.J. 77; and "Tax, Marriage and the 1988 Budget" [1988] C.L.J. 477, dealing with changes made by the Finance Act 1988.

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any deduction for payments made under maintenance arrangements. Many of those now-repealed rules had the perverse effect that they gave a tax advantage to spouses living apart and so encouraged them to do so.

Another reason is the list of amendments already referred to and stemming from the introduction of civil partnerships. The enabling provisions in the Finance Act 2005 allow the Treasury to make regulations "for the purpose of removing any inequality of treatment of persons based on gender or, in the case of a parent, marital status". The Finance Act 2005 does not allow the Treasury to make regulations where marital status is in issue otherwise than as parent. Whether such provisions breach human rights rules will be matters for future academic analysis and possible litigation; however, the Finance Act 2005 enabling provision is consistent with a strict reading of the decision of the European Court of Human Rights in *PM* v. *United Kingdom*.[23]

Capital Taxes

The rules for capital gains tax (CGT) show the care with which the UK tax system approaches the problems raised by applying its tax rules in the family context. CGT is charged, in broad terms at the same rate as income tax, on the balance of an individual's gains and losses of each tax year in so far as they exceed the annual tax free allowance, £8,800 in 2006–7.[24] CGT may arise when a person disposes of an asset at a gain, "person", "dispose", "asset" and "gain" all being the subject of much detailed legislative elaboration. Where the disposal results in a loss, relief is given to the person making the disposal by allowing set off against relevant gains; unused relief may be carried forward to later years but not, in general, backwards. When a person makes a gift rather than a sale, the disposal is treated as taking place at market value; the market value rules also applies to other bargains not at arm's length.[25] At one time the tax arising on a gift might be deferred but this relief was used as the basis for excessive planning and was therefore withdrawn.[26] Before 1990 married persons living together were treated as one; there was one annual exempt amount and an

[22] The married couples allowance was included to make sure there were no losers when Finance Act 1988 came into force, part of the political difficulty to which Lawson referred; later history see J. Tiley, "Away from a Virtuous Tax System?" [1998] B.T.R. 317, 340 and 341; and on almost complete repeal see Finance Act 2000, s. 31.

[23] *Application 6638/03* [2005] S.T.C. 1566.

[24] Taxation of Chargeable Gains Act 1992, ss. 1–4.

[25] Taxation of Chargeable Gains Act 1992, s. 17.

[26] Finance Act 1980, s. 79 repealed Finance Act 1989, s. 124, which gave much narrower reliefs, now Taxation of Chargeable Gains Act, 1992 sections 165 *et seq.* and 260.

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automatic offset of losses unless either elected otherwise.[27] Since 1990 married persons have been treated as separate taxpayers, so each has their own annual exempt amount and there is no offset of losses.

CGT interacts with family policy in several ways. The concept of "connected persons" appears in several CGT rules but, for present purposes, the two most important are as follows: (a) subject to one very important exception, there is a mandatory market value rule on disposals between connected persons (TCGA1992 s. 18(2)); and (b) should the market value rule result in a loss, the loss is quarantined and can only be set off against a gain arising from a disposal to the same person while they are connected persons (s. 18(3)). Suppose that A owns a flat for investment purposes in a university town and allows B, his child, to use it while B is at university. The acquisition cost of the flat was £100,000 and it is now worth £150,000. If A sells it to B, still a connected person, there will be a gain of £50,000 whatever the price they actually agree on. Thus the tax system protects itself against the risk of connected persons shifting assets between each other so as to place gains—or losses—in the hands of those better able to use them.

Taxpayers are connected with their spouse, civil partner, brother, sister, ancestor or lineal descendant.[28] They are also connected with the spouse or civil partner of any one of those individuals and with those relations of the spouse or civil partner.[29] An individual's uncle, aunt, nephew and niece are not connected persons for CGT purposes.[30] A spouse or civil partner is a spouse or civil partner, whether living with the other spouse or separated. A spouse or civil partner, thus, ceases to be a connected person, and the spouse or civil partner's relatives cease to be connected, only at decree absolute. While the category of connected person includes a spouse or civil partner, it does not cover those who choose to live together without that status. So, in this context, the CGT system, on balance favours those who cohabit as opposed to those who marry.

The one very important exception, which has been part of the tax since its introduction in 1965, is that the market value does not apply where spouses or, now, civil partners are living together as such and one disposes of the asset to the other.[31] Here, even

[27] Finance Act 1965, s. 17(5), later Capital Gains Tax Act 1979, s. 44 repealed by Finance Act 1988, s. 104 and Sch 14.
[28] Taxation of Chargeable Gains Act 1992 s. 286(2).
[29] *Ibid*., s. 286(2).
[30] Although they are for Inheritance Tax purposes: Inheritance Tax Act 1984, s. 272.
[31] Taxation of Chargeable Gains Act 1992 s. 58, originally Finance Act 1965, Sch 7 para. [20]. The impact of this rule on other sections is responsible for many of the changes made the Tax and Civil Partnership Regulations 2005, note 7 above.

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though they are connected persons, the disposal is treated as taking place at such figure that neither gain nor loss accrues. This formula can be seen as recognising the most intimate family as a tax-free zone. So if A sells the flat not to B but to X, A's spouse or civil partner while living as such, there will be no gain and so no charge to A. X will take the property over at an acquisition cost of £100,00 not £150,000 whatever the price they actually agree on.

Family lawyers often find much frustration with the way in which this no-gain no-loss rule comes to an end when the spouses or civil partners cease living with each other. Since the lawyers may not be consulted in time, any transfers of chargeable property may instead fall foul of the mandatory market value rule for connected persons, which can give rise to an actual tax charge rather than the deferred tax charge. In such cases there may be some leeway in arguing whether the parties are treated as living together, *e.g.*, with a trial reconciliation. Reform should be considered. If, as we shall shortly see, dispositions for the maintenance of the family are exempt from Inheritance Tax, CGT could keep the deferral rule in s. 58 for such disposals, or even extend it to all disposals between the spouses for a period of two years from the separation.

Another cause of frustration and inequity is the exemption from CGT for the person's private residence.[32] The cause is the rule providing that where an individual is living with his wife or civil partner only one residence can qualify for the exemption; this is in contrast with those choosing to live together without marriage or civil partnership, X and Y, who can each have an exempt private residence. This clearly discriminates against spouses and civil partners—and so is "against marriage". There are further frustrations with regard to certain traps in the personal residence relief when the parties separate.[33]

Before leaving CGT one should note that here too there is rule about "settlements" under which gains are attributed to the settler, and, like the income tax rule in 660A (2), it applies where the benefit may accrue to the settlor or the spouse or civil partner of that settlor. There is no need for a rule like s. 660A(6) since that will be covered by s. 58 while they are living together and s. 18 when not.

Inheritance tax (IHT) need not take us quite so long. In broad terms IHT is charged when an individual makes a transfer of value, *i.e.*, a disposition which reduces the value of that person's estate. With two important exceptions, transfers within the family give rise

[32] Taxation of Chargeable Gains Act 1992, s. 222, esp subs. (6).
[33] J. Tiley, *Revenue Law* (Oxford 2005), s. 33.11.3, and K. Wylie, ICAEW Digest No. 229 (May 2002) para. [1.8].

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to IHT just as much as any other; this should cause no surprise since the whole purpose of the tax is to catch gratuitous substantial transfers. As with CGT and income tax the tax is charged on spouses (and civil partners) as separate individuals and has done so since the earliest days of the tax (1986) and its predecessor (CTT in 1975).

The first important group of exceptions was mentioned above in connection with CGT; this directs that certain dispositions for the maintenance of the family are not transfers of value at all.[34] The scope of these rules is not important here. What is important is the recognition that normal payments of family obligations should not give rise to IHT whether during the marriage or civil partnership or following its breakdown.

The second important exception is the exemption for transfers to the individual's spouse or civil partner. According to the Inland Revenue Notes of Clauses in 1974, Ministers had decided that there was no case for charging gifts passing between husband and wife. This applies so long as the status as spouse or civil partner continues and is not confined to periods where they are living together as such.[35] The rule seems to echo the policy of TCGA s. 58 (that transfers within the family should be tax free) but lasts much longer. The terms "spouse" and "civil partner" indicate "unequivocally" that the Revenue were under no obligation to extend the benefit to a cohabitee, even if of 31 years standing;[36] of course marriage just before death would have sufficed to give the exemption to property passing on the death. We shall have to wait and see whether this restriction can be challenged on human rights grounds where the death occurred after 1 October 2000.

Recognition of the family also comes about in a special exemption for gifts in contemplation of marriage or civil partnership and in various exemptions for property reverting to the settlor or the settlor's spouse or civil partner.[37] Other rules concern the special reliefs for business and agricultural property; these count the period of ownership of property acquired on the death of a spouse or civil partner in seeing whether the minimum period of ownership condition is met, and favour marriage or civil partnership.[38] They are tied to status, not living together. Some of

[34] Inheritance Tax Act 1984 s. 11 as amended 2005.
[35] Inheritance Tax Act 1984 s. 18; the reason for the tortuous wording of s. 18(1) is to give the maximum relief—see Tiley, *Revenue Law*, s. 75.01. There is a financial limit of £55,000 if the transferor is domiciled in the United Kingdom but the spouse or civil partner is not.
[36] *Holland* v. *Inland Revenue Commissioners* [2003] S.T.C. (SCD) 43, Sp. C. 350.
[37] Inheritance Tax Act 1984, sections 22, 53 and 54.
[38] Inheritance Tax Act 1984, sections 108 and 120; see also sections 109 and 121 for successive transfers.

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the rules create liabilities on a spouse, and now a civil partner;[39] naturally these do not apply to cohabitees.

Jones v. *Garnett*

In *Jones* v. *Garnett* Mr. Jones (H), the taxpayer, a skilled IT specialist recently made redundant, had decided to set up in business. To do this he and Mrs. Jones (W) bought an off-the-shelf company; there were good commercial reasons for using a company rather than trading on H's own account. The (two) shares were divided equally between H and W; H was the sole director and W the company secretary. H provided the company's technical and money-making skills as an IT consultant, while W used her good administrative skills. W was not made a director; she had no *right* to dividends and, as these were decided upon by H, it could be said that she received them at his discretion. Each received a small salary with dividends in the £20,000+ range, enough to provide them with income to live off without incurring liability to higher rate income tax and using the tax credit accompanying the dividends to settle any liability on the dividends, which were actually paid into their joint account. The company paid corporation tax. The Revenue invoked Income and Corporation Taxes Act 1988 s. 660A,[40] on the basis that the whole structure was an "arrangement" (and so a "settlement" a term which is here drawn very widely), that the property comprised in that arrangement included the shares, so that her dividend income arose from the property comprised in the settlement and hence was to be treated as his instead. There were two main issues: the first was the scope of the property in the settlement. H argued that the "arrangement" was not the whole structure but simply the issue of shares and that as W provided value for that transfer there was no "bounty" and so no "settlement".[41] The second issue was that that if the property was a settlement then it was an outright gift, and so saved by s. 660A(6).[42] The Revenue argued that other words in subsection (6) prevented this result. What was not in dispute was that if they had simply lived together rather than being married s. 660A would not have applied.

[39] *E.g.*, the rule as to liability for tax in Inheritance Tax Act 1984, s. 203.

[40] Now Income Tax (Trading and Other Income) Act 2005, pt. 5, ch. 5 or sections 619 *et seq*. Section 660A was inserted in 1995 to replace earlier provisions.

[41] One of the fascinations of the case is whether the House of Lords will do as they did in *White* v. *White* [2001] 1 A.C. 596 to the "reasonable requirements" gloss stemming from *O'D* v. *O'D* [1976] Fam. 83 and insist on a return to the words of the statute (Lord Nicholls, at pp. 606–7).

[42] Now Income Tax (Trading and Other Income) Act 2005, s. 626.

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Few words will be spent on the first issue. This is largely a matter of interpretation and application of existing authorities and with a sharp divergence of view between judges as expert as Park J. and the members of the Court of Appeal it is clear that matters are finely balanced.[43] One can reasonably believe that the matter is not quite as straightforward as Park J. would have us believe and still regard the Revenue case as a strong one. Others will find comfort in the approach of Carnwath L.J. that the Revenue's position in this case seemed to him to be a significant extension in that, for the first time, they were seeking to apply the concept to what had been found to be a normal commercial transaction between two adults, to which each was making a substantial commercial contribution, albeit not of the same economic value. Such a difference, by itself, was not enough to his mind to take the arrangement into the realm of "bounty", as it has been understood in the existing cases.[44] As there are many possible variations on the facts it is to be hoped that the House of Lords will give us a clear line.[45]

We now turn to s. 660A(6) by which "an outright gift by one spouse to the other from which income arises is only a settlement if the gift does not carry a right to the whole of that income or the property given is wholly or substantially a right to income". The legislature adds other words not relevant to this case—*e.g.*, that a gift is not an outright gift if it is subject to conditions.[46]

On the wide analysis of the arrangement argued for by the Revenue, Park J. would have agreed with the senior Special Commissioner that this was "substantially a right to income" and so not saved by subsection (6).[47] However Park J. preferred to reach the same result by saying that there was not an "outright gift" at all. On this wide analysis of the arrangement, Morritt C. would have agreed with Park J.;[48] however, if, as the Court of Appeal found, the narrow analysis was right, Morritt C. was clear that while the gift of the shares was not saved from s.660A(2) as an "outright gift" it was saved as being not "substantially a right to income."[49]

[43] "I do not think that there is anything particularly novel or alarming in my decision. I believe that it is a simple application of well-established principles" Park J., at [41]; and see the literature cited at Note 1.
[44] *Ibid.*, para. [108].
[45] The Revenue have, from the very best of motives, issued various statements of their views on the scope of these rules, the latest complete with 31 examples, 21 of which show the legislation applying and ten of which show it not applying (see guide published 18 November 2004 and summarised in Simons Direct Tax Service, C4. 318–319).
[46] Originally a separate subsection, Income and Corporation Taxes Act 1988, s. 685(4C) added by Finance Act 1989, s. 108; for scope see note to s. 108 in Simons Taxes Finance Act 1989 Handbook.
[47] [2005] EWCA 849 (Ch.), at [46].
[48] [2005] EWCA Civ 1553, at [93].
[49] *Ibid.*, at [97] and [100].

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Carnwath L.J. was concerned with the expression "outright gift" and wondered how it applied to a sale at an under-value. He noted the Revenue view that any outright transfer of a bounteous nature could be regarded as "gift", at least to the extent of the bounty, before adding icily that it was unnecessary to decide whether this was right; at first blush it seemed more like playing with language than interpreting it.[50]

So, approaching the provision with an open mind, what is the purpose of subsection (6)? Before separate assessment of spouses living together, the issue of the income tax effects of an arrangement such as that created by these taxpayers could not have arisen so long as they were living together. Once separate assessment was introduced, those drawing up the legislative changes had to decide how far spouses should allowed be to assign income between each other. The legislators could have decided to make all such assignments ineffective and treated all income arising from property transferred between the spouses as remaining with the original owner. They did not do so. They could not go to the other extreme and allow unrestricted assignment of income; that would have made a mockery of the tax system. To allow S1 to transfer, for example, earnings or dividends to S2, would simply have enabled taxpayers who were not minded to act on a commercial basis to rearrange their incomes to take the best advantage form the availability of personal allowances and lower ends of the progressive rate structure. The 1988 principles were after all based on separate taxation not aggregation followed by income splitting. Section 660A(6), now s. 626, is the resulting compromise; the transfer of assets is permitted to be effective for income tax purposes between spouses living together but it must be real.

The language of the section, which avoids being over-prescriptive,[51] requires the courts to draw the line—and they have tried to do so. In *Young (Inspector of Taxes)* v. *Pearce*[52] Vinelott J. had no trouble in finding that when two husbands, who owned all the ordinary shares in their company between them, engineered the issue of preference shares to their wives the arrangement, for which the wives provided no consideration of any sort, was a settlement and that while it was an outright gift it was also substantially a gift of income. In *Jones* v. *Garnett* the question dividing the judges was whether decision of Vinelott J. should be extended to the issue of ordinary shares—in these particular circumstances.[53] If the judges

[50] *Ibid*., at [107].
[51] Bearing in mind Lord Hoffmann's comments in [2005] B.T.R. 197, 205.
[52] [1996] S.T.C. 743.
[53] On division at Special Commissioner level, see [2005] SpC 432, [2005] S.T.C. SCD 9, paras. [81] and [141] On higher courts see notes 48 and 49 above.

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find themselves unable to draw the line as asked in subsection (6), the Revenue may see have little alternative but to ask Parliament to go for another solution and that is likely to be a rule which says that where property is transferred between spouses income arising from that property will be treated as the donor's; in order to avoid complaints of discrimination they might also consider whether to extend these rules to those who live together without being married.

We now wait for the House of Lords to take their turn. However they should approach the legislation fairly, *i.e.* without undue worry about the fact that s. 660A applies only to spouses and civil partners living together.

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