# Main Residence Relief from Capital Gains Tax: Climbing the Ladders and Avoiding the Snakes

Main residence relief goes back to the introduction of Capital Gains Tax (CGT) in 1965. Contained as it is in just seven sections in the legislation, it has been the subject of a number of decided cases in the Courts – and of a rather greater number of pronouncements on their practice from Her Majesty's Revenue and Customs (HMRC). For many families it remains the most significant tax relief – certainly in one's lifetime – and indeed it is almost 'taken as read' when one comes to sell a house or a flat. As illustrated by well-publicised use by Members of Parliament (in particular) of what has come to be known as 'flipping' (that is maximising the opportunities given to second homes through timely use of main residence elections, as spelled out below), the opportunities for maximising the benefits of the relief are significant. Equally, the possibility of getting things wrong is more common than one might think.

The title is of course a reference to the game of *snakes and ladders*. Planning for the relief is certainly no game and, rather than the capricious throw of the dice, the well-advised taxpayer will be able to plot his or her way carefully through the rules. It's the purpose of this Briefing to give the briefest of guides to what can be a very complex relief - and to major on a few tips and traps.

**Overview**

Relief, in whole or in part, is given to a gain which arises on the disposal of a dwelling-house (or part) which is or has at any time in the taxpayer's period of ownership been his/her only or main residence. A *'dwelling-house'* will include a flat – or indeed a caravan or houseboat. The dwelling-house may comprise a number of buildings. However, in practice, outhouses and garden sheds etc will naturally be relieved. The subsidiary buildings such as the gardener's cottage must fall within *'the curtilage'* of the main house to attract relief on the disposal of the house. While HMRC have said that they define curtilage in terms of distance from the main house, allowing up to something like 27 feet only, that is not necessarily the right test and certain Court decisions on planning matters suggest that the *'curtilage'* should not be defined so restrictively. HMRC have also said that buildings within the curtilage might be expected automatically to pass on a conveyance without the need for separate mention.

The vital issue is that of *'occupation'.* In a celebrated 1998 Court of Appeal decision (*Goodwin v Curtis*), it was held that occupation of the property for just five weeks (coupled with advertisement for sale after merely 11 days) was insufficient to amount to residence. Indeed, in decisions over the last few years taxpayers have lost appeals because they could not show a sufficient degree of occupation to constitute residence for purposes of the relief. This is certainly an area that HMRC look at closely.

**Garden or Grounds**

As well as the dwelling-house, relief is expressly given to land which the taxpayer has with the residence, and uses for their own occupation and enjoyment as its garden or grounds, up to '*the permitted area*'. This is defined as 0.5 of a hectare (or, in 'old money', 1.23 acres) or *'such larger area as is required for the reasonable enjoyment of the dwelling-house as a residence, taking into account its size or character'.* This is an objective and not a subjective test: for example, one cannot say that, being keen on riding, *'I need an additional six hectares or so by way of paddocks and stabling for my horses'.*

Certainly with substantial houses in the country, their value is going to be enhanced by a decent area of land going with them. More specifically, however, there will be cases where there is actual or potential development value which pushes up the value of land in a

particular area. This will increase both the value of the tax relief and therefore the attention of HMRC in challenging claims for garden or grounds. Each case must be taken on its own merits, with the benefit of expert surveyor's evidence as to what is customary for a particular size and character of a house in that part of the country and with good photographic evidence before the house is sold (and, possibly, the land developed).

**The Period of Ownership**

The base date for Capital Gains Tax is 1 April 1982, which will not present an issue for most taxpayers. And, indeed, the vast majority of people will occupy just one property as their main residence and will straightforwardly get relief on the whole of the gain. But it is the unusual cases which evoke interest and therefore the need for planning. For example, an individual may not have occupied the property as the residence throughout the period of ownership. Expressly by statute, that does not matter to the extent that the non-occupation falls within the last 18 months of ownership, so long as at some point the property has been occupied. Further, by HMRC concession, non-occupation in the first 12 months of ownership (subject to extension by a further 12 months) is allowed, either where the taxpayer is having a house built on the land or where there is alteration or redecoration of the house before occupation is taken up.

Also, statute provides three periods of permitted absence:

(a) a period or periods not exceeding in total three years;
(b) any period throughout which the taxpayer was employed outside the UK; and
(c) any period or periods not exceeding four years in total, throughout which the taxpayer could not reside in the property in consequence either of the situation of his/her place of work or of any reasonable condition imposed by the employer requiring him/her to reside elsewhere.

To benefit from any of these permitted periods there must be a *'time'* both before and after the period when the dwelling-house was the only or main residence.

Where the taxpayer has *'job-related'* living accommodation apart from the owned property and intends in future to occupy that property as the only or main residence, the period of job-related accommodation is treated as though the taxpayer was then occupying the owned house as a residence.

Where there are both relieved and non-relieved periods and the gain must be apportioned, HMRC apply a straight-line basis of apportionment.

**Lettings**

While the taxpayer is absent from the house it may be let. There is express statutory relief for that part of the gain attributable to the letting insofar as it does not exceed the lesser of (a) the relieved part of the gain and (b) £40,000. Therefore, if the house is let for up to one half of the period of ownership, there would be no restriction on the relief provided that the statutory relieved gain does not exceed £40,000. The relief applies only where the let accommodation forms part of the main residence and is not a separate dwelling. So, for example, a gain arising on the gardener's or caretaker's cottage which falls outside the curtilage of the main house could not benefit from the lettings relief.

Unlike the *'permitted periods of absence'* there does not, for lettings relief to operate, need to be a *'time'* before and after the period of letting.

***Example***

*Harry has just sold a flat which he was given by his parents ten years ago, for a gain of £100,000. The flat was used as follows:*

- *Years 1 and 2: the flat was let before Harry moved in, then being away at university.*

- *Years 3, 4 and 5: Harry occupied the flat while he was training to become a chartered accountant.*
- *Years 6 and 7: Harry lived outside the UK for employment purposes, though he kept the flat for his occasional trips back to England (too spasmodic for the flat to amount to a residence). He did not return to live in the flat when the employment came to an end.*
- *Years 8, 9 and 10: Having got engaged, Harry first lived with and then married Anna, in Anna's family house in the West Country (which she owns).*

*Only £65,000 of the gain will be relieved. The £20,000 attributable to the period of letting is less than the lesser of (a) the tax-free gain (which is the sum of £30,000 while he was living there and £15,000 for the last 18 months) and (b) £40,000, so £40,000 applying. The gain on the period of actual occupation is obviously relieved. The gain attributable to the two years employed outside the UK is* ***not*** *relieved, as after that time, Harry did not occupy the flat as his residence. The gain for part of the final period is relieved, as it falls within the last 18 months of ownership and gives a further £15,000 of relief.*

**Married couples and civil partners**

In general terms husband and wife, while married and living together and, similarly, members of a registered civil partnership can have only one main residence relief running between them. That represents one tax advantage given to unmarried heterosexual couples or same-sex couples not in a civil partnership living together (so that, for example, the man owning a flat in London and the woman a house in the country both of which they occupy as a residence, each could get up to full relief on disposal). However, each spouse or partner can get the full benefit of the lettings relief described above.

**Ownership by personal representatives or trustees**

The disposal of a house by personal representatives (that is, executors or, in the case of an intestacy, administrators) is in the normal case unlikely to throw up a gain over the market value at death. If it does, however, there is a relief in certain circumstances if (broadly) a beneficiary of at least 75% of the sale proceeds has been in occupation. Otherwise any gain will be taxed at 28%, with the benefit of the single person's allowance for the year of death and the two following tax years (£11,100 for 2016/17).

More interesting is the disposal of a dwelling-house by trustees where there has been occupation by a beneficiary at any time in their period of ownership. It does not matter what type of trust is concerned, that is whether it is discretionary or with (a) fixed interest(s) in income. What matters is simply that the property has been the only or main residence of '*a person entitled to occupy it under the terms of the settlement'.* There is no *pro rata* test in the case where just one of a number of beneficiaries occupies the property. Where the occupying beneficiary has more than one residence and an election needs to be made then the trustees must join in the election.

**The Second Home**

Some people will own more than one residence. The taxpayer is allowed to make a conclusive election between the two (or more) for any period of time as to which one should be treated as the *'only or main residence'.* In the case of a married couple (or civil partnership) each of whom has an interest in one or more dwellings, the election is a joint one. In an executor or trust situation, the election must be made jointly with the occupying beneficiary. In the absence of an election the issue will be determined as a matter of fact after the disposal of the first property.

The election should be made as between a particular combination of residences within the two year period after that combination first begins. Once a notice of election has been given to HMRC, it may be varied by a further notice – although the period covered by the further notice cannot start more than two years before the date of that further notice.

While there is an argument that HMRC are wrong in insisting that a notice of election must be made within two years after the particular combination of residences arises, it is obviously sensible to submit the election in time.

One should appreciate that the test for the election is occupation and not ownership. Suppose the taxpayer rents his main residence and owns his subsidiary residence. If, paradoxically, if he fails to elect for the latter to be treated as *'his only or main residence',* he will get no relief at all.

The effect of the 18 month rule mentioned under Period of Ownership above can create some interesting planning opportunities.

***Example***
*James and Caroline are married with a family and spend most of their time in their country house which Caroline inherited from her late mother in 2000. However, they do also spend a certain amount of time in London. Having first stayed with friends they decided in June 2006 to buy a small flat, where they spend between five and ten days (and nights) a month, probably sufficient to constitute a residence. They sold the flat in June 2011. They did, on advice from their accountant, elect on 1 July 2007 that the London flat should be treated as their main residence, which they varied on 1 October 2007 back in favour of the country house their actual main residence. The benefit of so doing (HMRC's own example used to have as sufficient a period of notice of just one week, but this has now been changed to 'a short space of time') is this: 35% of the gain arising on the London flat will be relieved (that is the gain attributable to the 3 months plus the last 18 months, out of a total period of ownership of 60 months). The only detriment is that, if and when Caroline sells her family home, the gain attributable to three months' ownership will not be relieved.*

There is an avenue open for second homes showing a large gain to be relieved in very specific circumstances, through the use of furnished holiday accommodation (FHA). To qualify, the property must in brief be:

- let on a commercial basis, that is with a view to a profit;
- available to the public as holiday accommodation for at least 210 days in the tax year; and
- actually let for at least 105 such days, but so that any individual lettings for a continuous period of more than 31 days do not in aggregate exceed 5 months in the tax year.

The property need not be in the UK and can be anywhere within the European Economic Area (broadly the EU plus Norway and Iceland).

***Example***
*Judy has for many years now owned a second home which shows a significant gain. She gives the cottage to her husband Jim. This is treated as a no gain no loss disposal between them, so that he is treated as acquiring the cottage for the price which Judy paid originally (so preserving the gain in his hands), but on the date of the inter-spouse disposal. Jim would then manage the property as qualifying FHA and after a year or so would give the property to their daughter, Louise, holding over the gain so that again Louise takes on her mother's historic base cost. Louise occupies it as her only or main residence, sells it and gets full relief. While this may seem like 'aggressive planning', in fact, it is perfectly permitted by the legislation and, if done correctly, should attract full relief.*

**Disqualifications**

***The motive test***
Relief is disapplied where the dwelling-house was acquired wholly or partly with a view to realising a gain on its future disposal. Similarly, any part of a gain which is attributable to expenditure incurred wholly or partly with a view to realising a gain does not attract relief. These provisions are rarely applied in practice by HMRC – and are more likely to be so where

a taxpayer is trying to prove an allowable loss on a property which had it been sold at a gain would be free of tax. After all, anyone buying a property to live in is hoping to realise a gain over a period of time – and that will apply also to improvement expenditure.

There could conceivably be someone like a 'serial homeowner' who makes it his business to buy houses, do them up and then sell them on without any serious intent of making them his home. And, once such a person has done that more than a couple of times (and especially within a shortish timescale) he is likely to attract the attention of HMRC. HMRC may choose to apply the motive test or alternatively argue that the profit should be taxed not as capital but as income of a trade.

***Business use***

Any gain that is attributable to part of a property used exclusively for business purposes is excluded from relief. So, for example, a wing of a house used for an accountancy or a medical practice would fall into this category. However, the use of a room for both trading and social purposes, eg by a journalist (even such as to secure a measure of Income Tax relief for expenses incurred), will not prejudice the CGT relief.

**Conclusion**

In the very straightforward case, that is an individual or a married couple/civil partnership owns their only home and occupy it for residential purposes, there will be no issue with getting the relief. In more complex cases, however, one needs to consider:

- whether all of the garden or grounds will attract relief within the statutory test and if not what might be done about it;
- whether any periods of absence will not matter on ultimate disposal, given both the permitted periods of absence and the last 18 months concession;
- if there is occupation and especially ownership of two or more properties, has a main residence election been submitted, even if likely to be in favour of the actual main residence? It is important to do so as the balance of occupation may change in the future. And, especially on disposal of the first property to be sold, it is important to maximise relief. (The accrued gain on any property owned at death is 'washed out', that is, there is a deemed disposal and reacquisition at market value with no chargeable gain, which is the rule on all assets, not just the home.)
- particularly with second homes and elections, but also more generally, how to plan creatively well in advance of any disposal;
- whether the timescale and all the circumstances are such that HMRC could legitimately challenge a claim to relief through the motive test;
- whether any part of the property has been used exclusively for business purposes.

As ever, expert professional advice is required in any difficult case.

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