

CGT on your PPR

Lesley Stalker considers the capital gains tax position on the disposal of property that has been an individual's principal private residence

Even taking into account the current climate, property, especially in the South East, continues to be a popular investment vehicle, and it's common for clients to own more than one home. And while it is definitely not a seller's market right now, people still need to move for whatever personal or financial reasons. Without judicious tax planning, the price escalations of the previous decade can mean a lot of CGT is payable on any gains.

The basic capital gains tax treatment on the disposal of a PPR is that any gain is exempt from CGT provided the property has been the individual's only or main residence throughout their period of ownership. This of course also means that any loss incurred is not an allowable loss.

In addition to periods of residence, the last three years of ownership are also exempt from capital gains tax, irrespective of the use of the property during this period. This additional exemption applies provided the property has been the individual's PPR at some point during their period of ownership.

If an individual buys a property that is to be their main residence, but they do not move in immediately, HMRC will allow them to treat the first 12 months as exempt if they do not move in because they are having the property built; are altering or redecorating it; or because they remain in their previous home while they are selling it.

In addition to the above, there are other periods of ownership that will also be exempt from capital gains tax provided the property has been the individual's only or main residence at some time *both before and after* the period of absence, and that during the period of absence no other residence qualifies for the relief. These qualifying periods of absence are any or all of the following:

- Three years for any reason (not necessarily a consecutive period).
- Up to four years if the duties of a UK employment require them to live elsewhere.
- Any period of absence abroad where the duties of their employment require them to live abroad.

If these periods are exceeded, only the excess is counted as a period of non-residence. Note that if the individual moves directly from one place of employment to another, meaning that it is not possible to return to the property immediately after an employment-related absence, the condition for residence *both before and after* is waived.

It is therefore possible for an individual to have quite prolonged periods of absence from his property without losing any part of the PPR exemption.

TCGA 1992, s. 224 (2) provides that the calculation of the exempt periods should be made on a 'just and reasonable' basis, and it has until relatively recently been routine tax planning to compare the calculation based on a time apportionment basis with that based on valuations of the property taken at the relevant dates and submit the calculation on the basis most beneficial for the client. However, HMRC became of the opinion that in times of escalating property prices, such valuations could reduce the chargeable gain by unacceptable amounts. Their manual (CG64767) therefore now states that only calculations based on time apportionment should be accepted. In addition the help sheets accompanying SATRs confirm that valuations should not be used in such calculations. Therefore the exemption for a period of absence is now to be calculated purely on a time apportionment basis – note however that periods before 31 March 1982 are ignored for this purpose.

Example

- Mr A purchased his PPR in January 1999 for £200,000.
- He lived in the property until January 2000.
- He rented the property out from January 2000 until January 2008, when he sold it for £700,000.

January 2008

Proceeds £700,000

January 1999

Cost £200,000

Capital gain £500,000

Exempt gain £222,222

Chargeable gain £277,778

Period of ownership

	Years		
	Total	Exempt	Chargeable
	9		
PPR exemption		1	
Last three years exempt		3	
Chargeable period	9	4	5

Property rented out

If an individual rents out the whole of his property, other than during the last 3 years of ownership or during another allowable absence period, the relevant fraction of the gain on disposal is chargeable. Where however a property has been an individual's PPR and it has been rented out, there is a lettings exemption available, which is the lower of an amount equal to the PPR exemption and £40,000. This 'lower of' calculation is easily overlooked. Note also that husband and wife are both entitled to this exemption; therefore the relief on the disposal of jointly-owned property is the lower of an amount equal to the PPR exemption and £80,000.

Example

In the example above, if the property had been rented out during the non-owner occupation period there would be a lettings exemption available of £40,000 to reduce the chargeable gain to £237,778. If the property had been owned jointly with Mr A's wife, this lettings exemption would be increased to £80,000, reducing the chargeable gain to £197,778.

Note however the restriction applying to the lettings exemption in the following example:

Mr B and Mrs B jointly purchased a property in January 1999 for £200,000. They lived in the property until January 2000. They rented the property out from January 2000 until January 2008 when they sold it for £350,000.

In this situation the PPR exemption is £66,667; therefore, although the lettings exemption is £40,000 each, this is restricted to £66,667 in total, resulting in a chargeable gain of £16,666. This will of course be apportioned



It's not a seller's market right now, but people still need to move for whatever personal or financial reasons

jointly between husband and wife, and will be covered by their annual CGT exemptions if not utilised elsewhere.

January 2008

Proceeds £350,000

January 1999

Cost -£200,000

Capital gain £150,000

Exempt gain £66,667

Lettings exemption restricted to £83,333

£66,667

Chargeable gain £16,666

Period of ownership

	Years		
	Total	Exempt	Chargeable
	9		
PPR exemption		1	
Last three years exempt		3	
Chargeable period	5		5
	9	4	5

More than one property

A PPR election can be made within two years after acquiring a property. Provided the property is *available* for the individual to occupy, whether it is in the UK or abroad, he can elect within this time limit that it should be treated as his PPR irrespective of whether he is actually occupying it as such. Note however that an election cannot be made for a property the individual has never lived in.

Once an election has been made it can be revoked at any time, and that revocation can be back-dated by up to two years.

If no election is made, an individual's PPR will be a question of fact.

By the judicial use of PPR elections, there are therefore considerable tax planning opportunities available to individuals owning more than one property available for their private use.

Example

Mr & Mrs C jointly own three properties.

Property 1 has been their PPR since January 2000. In January 2007 they purchased property 2 in France, which they have used as a holiday home. In January 2008 they purchased property 3, which they moved into immediately and commenced to rent out property 1.

If no elections are made, property 2 will be fully chargeable to CGT on disposal; properties 1 and 3 will qualify for the PPR exemption for the periods of residence and for the last three years of ownership, with property 1 qualifying for the lettings exemption also.

An election can however be made that property 2 be treated as their PPR for a short period of time (say six months), provided that election is made by January 2010 (within two years of the purchase of property 3). The election for such a short period of time is unlikely to have a significant detrimental effect on the CGT calculations for either property 1 or property 3, and can be revoked at any time. The election will however secure the availability of the PPR exemption on property 2 for the last three years of ownership.

Property used for business purposes

The PPR exemption is not available for any part of a property that is used *exclusively* for business purposes. This restriction of the exemption can be rectified if the business part of the property is used for personal purposes for at least part of the time. This should of course be reflected in the percentage of expenses claimed against rental income received for the business use of the premises.

Selling a property to make a profit

There are two pitfalls to be aware of:

1. The PPR exemption does not apply if a property was acquired with the intention of making a profit. For this reason frequent buying, renovating and selling of properties can be attacked by HMRC as being a trade.
2. The PPR exemption covers grounds not exceeding half a hectare or a larger area only if it is appropriate to the size and

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character of the property. Therefore if part of a garden is sold for a building plot for example, it may be possible to claim the PPR exemption if:

- a) the land is covered by the exemption and has been used as a garden prior to sale; and
- b) the land is sold before the property and remaining garden are sold; and
- c) the vendor can demonstrate that the sale was made out of financial necessity.

HMRC will generally not allow relief for land which is physically separated from the property (for example by a road).

Tax planning points

1. Don't overlook the PPR exemptions available for employment-related absences, and especially for absences of up to three years *for any purpose*. This three-year absence need not be consecutive, or be during the last three years of ownership to qualify.
2. Where property has been both a client's PPR and has been rented out, consider transferring into joint names between husband and wife or civil partners to obtain the benefit of the lettings exemption for both. Watch to ensure that no PPR exemptions will be lost by such a transfer.
3. Don't overlook the restriction of the lettings exemption to an amount equal to the PPR exemption, if lower.
4. Where clients own more than one property available for their use, routinely review the CGT planning opportunities available on making and subsequently revoking PPR elections.
5. Routinely make PPR elections for clients within the two-year time limit; this provides flexibility, as they can later be revoked without time limit.
6. Where property is used for business purposes, ensure it has an element of private use in order to protect the availability of the PPR exemption. Ensure that reliefs claimed against rental income reflect this.
7. Where land is being sold separately to property, ensure it is sold *before* the property and garden are sold in order to preserve the PPR exemption wherever possible.
8. If clients are buying and selling property in quick succession, ensure they establish evidence to show their intention to live in the property and that this is their intention rather than purchasing it with the intention of making a profit.

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