

AN ENGLISHMAN'S HOME IS HIS CASTLE

Introduction

Unlike many other European nations, private home ownership is part of our culture in the UK. One attraction of home ownership is taxpayers enjoying a tax free capital gain on the disposal of what HM Revenue & Customs ("HMRC") refer to as the Principal Private Residence ("PPR"). With soaring property prices the tax saving potential has increased markedly and this has led to considerable abuse of the rules with some notable examples in the press in recent years.

As a result HMRC are paying much closer attention to this issue as is evidenced by the tax cases on the matter and the consultation on potential changes to the underlying legislation.

Scope of PPR exemption

The PPR exemption extends to the house and garden. The total grounds are normally limited to half a hectare. The exemption may cover a larger area if that additional area is required for the reasonable enjoyment of the dwelling-house as a residence having regards to its size and character. The courts have considered various cases over the years with regard to the appropriate area and which ancillary buildings should be covered by the relief. Staff accommodation which was detached from the main house has been held to be covered by the exemption. Equestrian properties always give rise to issues with HMRC's argument being that a taxpayer doesn't need to keep horses to enjoy the house such that a claim for PPR extending to the 'pony paddocks' may be resisted. The sale of part of the grounds in excess of the half-hectare, whilst retaining the house, will undoubtedly give rise to questions from HMRC and a potential restriction of the PPR relief. Not unreasonably the argument is advanced that if the extra area is 'reasonably' required how can it be sold off separately to the house. In cases where the grounds are extensive and there are outbuildings it can make sense to take photographs showing how the grounds and buildings are being used.

Second homes

Taxpayers with two homes available to them have other points to consider. In such situations a taxpayer can elect which one qualifies as the PPR. This election must be made within two years of the beginning of the period when the two homes were available. There is limited opportunity to get a late election accepted. In the absence of an election the question is decided upon the facts. Once validly made the election can be varied in writing, within two years of the date of change. If a taxpayer has clear intentions with regard to the occupation and use of the individual properties this can enable them to make appropriate elections to enable them to minimise future Capital Gains Tax ("CGT").

Change is afoot

Taxpayers with two homes need to be careful – HMRC have indicated in recent consultation that they are considering abolishing the PPR election and leaving the position to be concluded on the basis of the facts. The proposal is perhaps HMRC's response to the MP 'flipping scandal'.

Time periods

Taxpayers need to understand which periods of ownership qualify for exemption under the PPR rules. As well as periods of actual residence there is also exemption for a further period of up to three years' absence. However, HMRC have issued consultation in connection with a proposal to reduce this period to eighteen months. A period of absence throughout which the taxpayer works overseas plus a period of up to four years where the taxpayer was required by reason of his employment to live elsewhere can also be included. Electing for a second residence to be the PPR, and then immediately changing the election back to the original property, has little or no effect on the status of the original property but three years' PPR relief on the second property can be obtained – this is what is known as 'flipping'. Care is needed as HMRC will look closely at the facts to ensure that each home is occupied as a PPR in line with the election.

Note that the PPR does not have to be in the UK. A property can be situated anywhere in the world and it will still be subject to CGT if it is not the taxpayer's PPR.

A PPR can be a static caravan, a houseboat or other more exotic structures as long as the facts support its treatment as a PPR.

Intention

HMRC will always look at the intention of the taxpayers when they are faced with potentially suspect claims. This typically arises with taxpayers flitting from one property to another – did they intend to live in it as a residence or is there some other motive. One of the commonest situations is with those developing property who believe they can do it repeatedly without considering tax. When does such an activity amount to a trade the profits on which are subject to income tax without the benefit of a PPR exemption? So fans of the DIY programmes and build your own experts beware – tax needs to be considered at every stage.

Many taxpayers believe, mistakenly, that all they need to do is stay in the house for a few weeks and all will be well. Unfortunately HMRC are looking for evidence of permanence. Simple checks with Royal Mail, DVLA, the Passport Office and the TV Licencing Bureau, as examples, can quickly scupper any claims to permanence.

There will undoubtedly be those unfortunate situations where intentions change quickly as a result of family bereavements or illness.

Use of home

Those taxpayers who claim expenses for the use of their home for business purposes need to consider the impact on the PPR exemption. With the increasing desire to work at home in pursuit of a better work life balance this issue is getting more common and potentially more material if a number of rooms in the house are given over to offices or workshops. The simple way to deal with this is to ensure that the relevant rooms are not solely used for business purposes but have some personal use.

Farmers

It is beyond the scope of this Briefing Note but the changes to the permitted development rights may be a welcome boost for certain farmers. It will enable them to unlock residential use of farm buildings which may result in a large number of PPR claims. Any landowners in such a position will need to take appropriate professional advice.

Letting relief

Where the PPR relief is available there is an additional relief which can also reduce the extent to which a capital gain on a property is chargeable if the residence has been let for a period. This is the equivalent to the lower of £40,000 or the amount of gain exempt by reason of the PPR claim.

Planning points

- Make sure that the timeline is complete and ensure that any qualifying absences are taken into account;
- Consider elections when more than one property is owned;
- If land is being sold separately from a house make sure that the land sale takes place first;
- Collate evidence in support of intention if there are moves in quick succession to each other;
- Ensure that there is a private use element of rooms used for business purposes;
- Take necessary photographs of the house and garden; and
- Make best use of the lettings exemption by reviewing the ownership arrangements. Also pay heed to the restriction of lettings relief.

This Briefing Note is not intended to cover the question of residential property owned by companies but be aware that there are some new rules which give rise to some very material tax changes in certain situations.

It is also worth noting that as with a lot of tax matters it pays to keep detailed records with regard to property ownership and its use.

If you have any questions in connection with this Briefing Note please contact Simon Littlejohns, Tax Partner, on 0121 633 2007 or your usual contact at Friend.

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