CHANGES TO PRINCIPAL PRIVATE RESIDENCE RELIEF FROM 6 APRIL 2020

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Introduction

1. Principal Private Residence Relief ("**PPR**") is a major capital gains tax relief which is found in sections 222 to 226A of the Taxation of Chargeable Gains Act 1992 ("**TCGA**"). In summary, it applies in certain circumstances when a person sells their main residence. The new parameters of the relief are particularly important in the context of the recent announcement by the Chancellor of the SDLT holiday for residential properties[2], which came into effect on 8th July 2020 to stimulate the property market. Sellers should consequently be aware of the recent changes to the PPR rules which came into effect on 6th April 2020, as the changes may affect their eligibility for relief from CGT under the PPR rules.

Key provisions and concepts

2. Section 222 of the TCGA provides:

> *(1) This section applies to a gain accruing to an individual so far as attributable to the disposal of, or of an interest in—*
>
> *(a) a dwelling-house or part of a dwelling-house which is or has at any time in his period of ownership been, his only or main residence.*

3. Relief therefore applies to a dwelling house which is the only or main residence of an individual. A "dwelling house" is not defined, but in most cases this will be straightforward. It does not however include a partly built

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2 For more information on the details of the SDLT holiday, as well as FAQs, please see the webinar by Patrick Cannon and Rebecca Sheldon on the topic dated 15th July 2020, available from https://www.taxchambers.com/

building which is currently uninhabitable, see *Makins v Elson* (H *M Inspector of Taxes)* [1977] STC 46.

4. The meaning of "residence" has been litigated frequently. Nourse J in *Frost v Feltham* [1981] STC 115 at 117 held that *"a residence is a place where somebody lives."* In *Levene v IRC* 13 TC 486 at 505, it was held that a residence is "*one's settled or usual abode*." A similar sentiment was expressed in *Ricketts v Registration Officer for the City of Cambridge* [1970] 2 QB 463, where it was held that a residence is "*where he sleeps and shelters and has his home*."

5. Although permanence is an important factor, there is no minimum period required for a dwelling to qualify as a residence, see *Moore v Thompson* [1986] STC 170. For example, in *Dutton-Forshaw v HMRC* [2015] UKFTT 478 (TC), the taxpayer was successful in establishing residence even though he only occupied the property for two months. Moreover, in *Morgan v HMRC* [2013] UKFTT 181 (TC) at paragraph 20 by Judge Gort, it was held that "*Mr Morgan need only show that at the time when he moved into the property, it was his intention to make it his permanent residence, even if he changed his mind about it the following day."* However a tribunal must consider the quality as well as the length of the occupation, see *Regan v HMRC* [2012] UKFTT 570 (TC).

6. It is also important to note that the garden or grounds must be no more than the permitted area to be covered by PPR: this is up to half a hectare, though it can be more if this is required for the "reasonable enjoyment" of a property (see section 222(2) and (3) TCGA 1992 and for commentary. This is a question of fact to be determined at the date of the disposal, see *Varty (Inspector of Taxes) v Lynes* [1976] STC 508.

7. Where the relief applies, no part of any gain is a chargeable gain (subject to possible reduction in the level of relief where a dwelling house has not been the individual's only or main residence throughout the period of ownership, see below). If a taxpayer owns more than one property, they can give notice to HMRC within 2 years of occupying the additional property and choose which residence the relief will apply to. It is however important to note that the relief will only apply to one residence per person. In continuation of a previous HMRC practice, section 24(2)(a) FA 2020 allows an election to be made outside the 2 year time limit if the second property is one in which the interest held had negligible market value, such as a rented property.

8. Where the qualifying dwelling has not been the only or main residence of a relevant individual throughout the period of ownership, the relief applies only to a fraction of the gain. This is calculated as the total gain multiplied by the period of occupation over the period of ownership. Subject to some

conditions, there are however qualifying periods of absence (which are counted as though the relevant individual had remained in the dwelling for that period). This includes a period of no more than 3 years for any reason, a period of no more than 4 years for employment, employment abroad for any number of years (with the latter two also extended to the employee's spouse), see 223(3) TCGA and staying in job-related accommodation, see 222(8) TCGA.

Changes to Principal Private Residence Relief

Reduction in final qualifying period

9. In addition to the qualifying periods stated above, it used to be the case that the final 18 months of ownership of a dwelling were exempt, provided there had been at some stage any period of occupation of the dwelling. However, changes to this rule were announced in the 2018 Budget to reduce this from 18 months to 9 months from 6 April 2020.

10. Section 24(3) Finance Act 2020 now enacts this proposal so that the period is reduced to 9 months for disposals from 6 April 2020. The changes will not however apply where the disposals are made by disabled persons or persons in care homes, as defined under section 225E TCGA, which still allows a 36-month period.

11. The reduction in the final qualifying period by half in most cases is likely to cause issues. In particular, houses can take longer to sell in certain regions (and despite the SDLT holiday announced, there may well still be areas where homes are taking longer to sell in the current housing market than in previous years as a result of Covid 19). In addition, divorce, separation and relationship breakdown are complex and may not be resolved in the requisite period. The reduction will also increase the CGT liability for those who have 2 or more residences at the same time who are disposing of one of their properties which, whilst no longer their main residence, has been so in the past and consequently accrued PPR.

Lettings relief

12. Letting relief used to be available on the lower of the amount of PPR available, the chargeable gain arising from the letting, or £40,000, see section 223(4) TCGA. FA 2020 abolishes this relief with effect from 6 April 2020 and replaces it with a much more limited relief. Lettings relief will instead now be limited to the circumstance of when a tenant is in shared occupation with the owner (otherwise than in the course of a trade or business): see new

section 223B TCGA. The relief is still available separately to husband and wife on the sale of a jointly held property.

13. This will impact those who have chosen to wholly let out a former main residence to tenants, as relief will now be restricted to those individuals who share occupancy with their tenants. The government in their response to the consultation on the changes emphasised that as far as absences are concerned, a "*pragmatic approach will be taken by HMRC. Short holidays, hospital stays and the occasional working away from home by the owner of the property would not affect the view that occupation of the property was shared*." However, the CIOT has expressed concern that the new rules will give rise to *"potentially difficult questions of fact as to what type of letting may constitute a business for these purposes and therefore lead to a denial of the relief."*

Transfers between a married couple or civil partners

Up to 5 April 2020 a transfer between spouses or civil partners of on interest in a dwelling house which, at the time of transfer, was their main residence had special treatment for the purposes of PPR. The transferee's period of ownership was treated as commencing when the transferor first acquired an interest in the property, and the history of occupation in that period was also acquired by the transferee. However if the property was not the main residence at the time of transfer, this rule did not apply and therefore the past history fell away. The transferee acquired the interest at the time of transfer and assuming he or she had no existing interest of their own in the property, a new period of ownership then commenced, but with the transferor's old base cost still prevailing. This enabled a degree of tax planning in that the parties might be able to elect for the property to be their main residence, subject to the requirements for a valid election. By this means all the gain since original acquisition could conceivably become exempt.

From 6 April 2020, the rule is changed and section 24(2)9b) FA 2020 provides that on any such transfer of an interest in a dwelling house on or after that date, the period of ownership and history of occupation of the transferor is now taken on by the transferee.

Delay in taking up residence after acquisition

A final provision in section 24 Finance Act 2020 enacts HMRC Concession D49. This allows for a delay of up to two years, starting from completion of the purchase, before moving into a property as main residence without that delay affecting the PPR relief on the property. The concession applied where:

- the delay in taking up residence is because a dwelling house is being built on that land,

- the delay in taking up residence is because of the continuing occupation of the previous residence while arrangements are made to sell it,
- the delay in taking up residence is because alterations or redecorations are being carried out.

This is now put into statutory form by new section 223ZA TCGA.

Conclusion

14. The changes may have a significant practical impact on those who are currently considering selling their homes as a result of the SDLT holiday. Advice should consequently be taken to ensure that the correct approach is taken to calculating PPR under the new rules, in particular given (as can be seen by the wealth of cases cited) this is a heavily litigated area of law.