The Personal Tax Planning Review

CAPITAL GAINS TAX MAIN RESIDENCE RELIEF: THE ELECTION

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A taxpayer (which includes a married couple living together) can have only one main residence for the purposes of the relief during any one period. The relief is given on the disposal of the taxpayer's "only or main residence". What happens if for any period the taxpayer has more than one residence? All statutory references in this article are, unless otherwise stated, to the Taxation of Chargeable Gains Act 1992.

Subject to the election which is discussed below, s.222(5)(b) provides that the question is to be concluded by "the determination of the inspector, which may be as respects the whole or specified parts of the period of ownership in question ...". The taxpayer has the right of appeal to the General or Special Commissioners against the determination within 30 days of service of the notice by the inspector on him.

Such an appeal would be on the basis that the inspector had been unreasonable in determining that a particular residence was the main one over a given period of time by reference to the quality of occupation and enjoyment. Anybody tempted to appeal against a determination will need to take stock both of the potential tax or tax saving at stake and of the likely costs of appeal. In the normal course a determination is unlikely to occur until one of the dwelling-houses is sold and perhaps a claimed exemption disputed. The question is to be determined on the basis of fact. Among factors which an inspector, and indeed the Commissioners, will take into account will be where the balance of time is spent, where the principal furniture is kept, which is the main residence for mortgage interest relief and Community Charge purposes, and which address is normally given for correspondence (including with the Inland Revenue!).

Two preliminary points may be made before turning to the election. First, before any dwelling-house can enter into the election or determination process it must be a residence; to quote Lord Widgery LJ in *Fox v Stirk* and *Ricketts v Registration Officer for the City of Cambridge* [1970] 3 AER 7 at page 13 "some

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assumption of permanence, some degree of continuity, some expectation of continuity, is a vital factor which turns simple occupation into residence".

Second, however, and by contrast, a dwelling-house does not have to be owned in order to constitute a residence. This is recognised explicitly in Extra-Statutory Concession D21 discussed below. Accordingly, a person might well own one dwelling-house which he occupies as his residence and in addition have another residence which he does not own but which as a matter of fact is determined by the inspector to be his main one. Although no capital gain will arise on disposal of the main residence, since he has no interest therein, he will not be able to get the exemption on the dwelling which he does own, being merely a subsidiary residence. This does underline the importance of making the election, to which we now turn. Incidentally, the above is far from being an extreme situation and indeed such a case was referred to the writer on the day that this article was written.

Under s.222(5)(a) the taxpayer is given the right to conclude the question of determining which of two or more residences is his main residence for any period by notice given to the inspector within two years from the beginning of the period. This is subject to a right to vary the notice by a further notice to the inspector as respects any period beginning not earlier than two years before the giving of the further notice.

The election is conclusive (as against the position for mortgage interest relief purposes, where an objective test is applied to determine which is the main residence if more than one exists). Accordingly, so long as for the period concerned each of the two or more dwelling-houses in point has in fact been a residence, it does not matter that the property in respect of which the election is made is manifestly not the main residence.

Obviously, an exclusive lease or licence agreement to a third party will preclude the property from being a residence. More difficult perhaps may be the case noted above where, although a property was available for use by the owner, his actual use of it was so sporadic or intermittent that it may be hard to say that he did in fact occupy it as his residence. In practice this may be a point not taken too strictly by the Revenue, especially if the other residence is not even owned, but the point needs to be appreciated. Certainly, if there are no reasonable grounds for believing that there are in fact two or more residences for a particular period it is not even open to the individual to make an election (see *Moore v Thompson* [1986] STC 170).

On the face of it the effective date of an election can be back-dated by up to two years, with no provision for extension. Suppose that Jim bought a flat on 1st January 1989 and a house on 1st January 1990. He would have had to give notice before 1st January 1992 to treat one of the two as his main residence for the period 1st January 1990 to 1st January 1992. If he did not in fact give notice until 1st

January 1993, then the period 1st January 1990 to 1st January 1991 would under s.222(5)(b) be open to determination by the inspector on the basis of which was as a matter of fact the main residence during that period.

However, this is subject to the Inland Revenue view that the period within which an election can be made starts to run from the time when the taxpayer first owns more than one residence (it being irrelevant that one of the residences may not give rise to a gain when sold). In particular, on page 5 of Inland Revenue leaflet CGT 4 it is said that "when you acquire a further home you normally have up to two years in which to tell the tax office which one you have chosen to have the exemption. You can alter your choice but this cannot affect the period more than two years before you make the new choice."

On this basis in the above example the period would start to run at 1st January 1990 and on the footing of the reported Revenue view a notice given on 1st January 1992 or later could presumably have no effect at all. Extra-Statutory Concession D21 extends the two year period if the interest in the second property used as a residence was of negligible value and the taxpayer was unaware of the need to elect, though the taxpayer's nomination (while effective from the date on which he first had more than one residence) must be made within "a reasonable time" of his first becoming aware of the possibility of electing.

However, many commentators, including the writer, question whether the reported view is correct. It appears that the Revenue have recently lost a case before the Special Commissioners on this point and that they are appealing to the High Court. S.222(5) simply refers to "any period" and there is no restriction in the terms of the legislation that that period should begin at any particular point in time. Certainly if the taxpayer is late in making an election, especially where the election is made in favour of the property which is not manifestly the main residence, the notice should clearly state the period in respect of which the relief is claimed, in the recognition that this may be contested by the Revenue but on the expectation of having fair grounds for argument. Nonetheless, given knowledge of a Revenue practice it is always wise to proceed on that basis and therefore to submit the election as soon as possible. Certainly, if the Revenue view were right it might appear that once the two year period had expired it would no longer be possible to make an election at all while those two residences were maintained (unless and until a third residence were acquired); the question would therefore be reduced to one of fact.

Note that in a job-related case it will still usually be sensible to put in an election. S.222(8) merely provides that the dwelling-house owned by the taxpayer will be treated as a residence during the period of job-related occupation elsewhere, provided that he intends to occupy the dwelling-house as his residence in the future. It would always be open to the Revenue (though perhaps rather harshly) to contend that the job-related property, if not some other dwelling, was (in the absence of an election) the main residence during the relevant period.

As a practical point the two year period under s.222(5) runs from the date on which the notice in writing is given to the inspector. To ensure that receipt is acknowledged, a copy of the notice should be enclosed with the original with the request that it be returned marked with the appropriate date stamp.

So far as a married couple is concerned, any notice given under s.222(5)(a) must be given by both and any notice given by the inspector which affects residences owned by husband and wife respectively must be given to each and either spouse may appeal (s.222(6)). Although the legislation refers to "a residence owned by the husband and a residence owned by the wife" this should not be taken too literally. Supposing both husband and wife jointly were to own two or more properties the terms of s.222(6)(b) would not strictly apply, since there is not one residence owned by each spouse, but realistically it must do so.

The spousal election procedure will take effect only if each spouse has (or has an interest in) one or more residences and at least one of them has (or has an interest in) more than one residence. It would be possible (though perhaps unusual) for a particular property to be a residence of one but not the other spouse, even if they were not separated for tax purposes. This rule of course underlines the fiscal significance of spouses living together. In particular the no gain/no loss provisions on transfers between husband and wife under s.58 apply only and rather curiously in the case of a woman disponor if in that year of assessment she is living with her husband.

When two people get married and each owns one or more residences careful thought is needed to maximise the available Capital Gains Tax exemptions, in particular in respect of the last 36 months of ownership of any property before sale. (This is a particular application of a more general planning point.) While notices of election can be changed, the change can only cover a period going back two years. It is not clear whether an election necessarily ceases to have effect on marriage (unless, say, one of the spouses brings no residence to the marriage) or on separation or divorce. However, the safest course is obviously to submit new elections.

It is worth noting also as a further point that the Revenue apparently maintain that once one of the houses has been sold an election cannot be submitted, since at the date of the notice the taxpayer will not have more than one residence. If correct this would mean that the question for the final two years of ownership of the sold house and before would fall to be determined by the inspector.

Note that an election may have beneficial consequences in the context of s.776 Income and Corporation Taxes Act 1988 (transactions in land: taxation of capital gains). Main residence relief under s.223 is denied by s.224(3) where the dwelling was bought with a view to realising a gain from the disposal of it. The danger of s.776 applying income tax treatment under Case VI of Schedule D is obviated by s.776(9) in a case where the dwelling would qualify for main residence relief or

would qualify apart from s.224(3). Accordingly, a person buying a house which will certainly fall foul of s.224(3) and which could also be caught by s.776 can obviate the s.776 risk simply by electing for it to be the main residence. This would have the effect of giving rise to a capital gain which may be of consequence if capital losses are available to reduce the gain.

This s.776 point would not apply to non-garden or grounds land which would not qualify for the main residence exemption, in which case an apportionment would be required. Nor, indeed, if the Revenue could reasonably allege trading; while they have been traditionally unsuccessful with Case I assessments on disposals of private residences, bear in mind that they continue to try!