CUBE PARTNERS

CHANGES TO CAPITAL GAINS TAX PRIVATE RESIDENCE AND LETTING RELIEFS

For many, owning and selling their own home is thought to be tax-free but, as always, tax is never quite as simple as that.

Principal Private Residence Relief (PPRR) is a set of tax rules which are designed to ensure that the sale of a person's home is exempt under certain conditions. Generally, if you own one home, live in it and sell it, any gain will be tax-free but suppose you lived elsewhere due to a work secondment and let your old home out, then what?

The existing rules can be complex but allow PPRR for a number of specific absences from the property, including periods of letting. The government is making a number of changes to the PPRR rules and we thought that we should make you aware of the more important ones below.

Broadly, all of the above changes apply to transactions undertaken from 6 April 2020.

Change 1 – transfers between married couples

The general rule for capital gains tax (CGT) is that transfers of assets between married couples and civil partners takes place at no-gain/no-loss. In addition, the PPRR rules provide that where one spouse makes a transfer of their only or main residence to the other, the receiving spouse inherits the other spouse's period of ownership of the dwelling even if that period started before marriage. This rule does not however apply to a dwelling which is not their main residence at the time of the transfer. There may be positive or negative effects of a transfer depending on the relevant circumstances.

To make the tax rules consistent, the new rules provide that when a spouse or civil partner transfers an interest in a dwelling to their spouse or civil partner (whether or not the dwelling is their only or main residence at the time), the receiving spouse or civil partner will inherit the transferring spouse or civil partner's ownership history, including their previous use of the property.

Change 2 – the final period of ownership

Generally, the final period of ownership of a person's home will be tax-free, irrelevant of whether it is actually occupied as such. The final period exemption will be reduced from 18 months to nine months. The rules which give 36 months relief to those with a disability, and those in or moving into care, will not change.

Change 3 – lettings relief

Lettings relief was introduced to ensure that people could let out spare rooms within their property on a casual basis without losing the benefit of PPRR. The government considers lettings relief extends much further than the original policy intention and also benefits those who let out a whole dwelling that has at some stage been their main residence.

The new rules state that where a gain arises on a person's home and, at any time in the individual's period of ownership:

- part of the dwelling-house is the individual's only or main residence; and
- another part of the dwelling-house is being let out by the individual as residential accommodation otherwise than in the course of a trade or business

then lettings relief may be due.

Effectively, this means that lettings relief will not be available for those periods where an owner has moved out of the property and therefore no longer shares occupation with a tenant or tenants.

Example of where the letting changes have effect

Eric purchased a house for £200,000 on 1 January 2000. He sold it for £350,000 on 31 December 2020. During Eric's 20 year (240 months) ownership he:

- lived in the house as his only residence for 17 years (204 months)
- let the entire property for three years (36 months) before selling it.

The net gain is £150,000 and PPRR will be available for the period Eric occupied the house as his main home which is 204/240 months. This means that of the gain £127,500 is eligible for relief, leaving a potential gain liable to CGT of £22,500.

Eric also qualifies for 9 months of final period exemption which is £5,625. This reduces the potential taxable gain to £16,875 (£22,500 - £5,625).

As Eric was not in shared occupancy with his tenants, lettings relief does not apply for the three years that he let the property. (If the sale had been before 6 April 2020, this gain would have been eligible for letting relief.)

If Eric has not used his annual exempt amount for the year (which for the year 2019/20 is £12,000) he can further reduce the taxable amount to £4,875 (£16,875 - £12,000). If Eric is a higher rate tax payer he will pay CGT of £1,365 (£4,875 x 28%).

Change 4 – need to report and pay tax

In addition to the changes to PPRR, the government is also introducing a reporting requirement on the sale of all UK residential properties. This would include residential investment property and also situations in which the sale of a person's home is not fully covered by PPRR.

In such situations a special return must be completed within 30 days of completion. In addition, if a person is required to make such a return and, as at the filing date for the return, an amount of tax is notionally chargeable, the person is liable to pay that amount on account on the filing date for the return.

Currently the need to report a capital gain and pay tax on the gain is 31 January following the tax year in which the disposal is made so the new requirements are a significant reduction in timescales.

What to do next?

As can be seen, the above changes may be both complex and financially significant, particularly the changes to lettings relief which are effectively retrospective. However, there is time to plan ahead. If you think that any of the changes may apply to you, please get in touch as soon as possible to discuss possible planning opportunities.

Example of the potential impact of this change

Mr A bought a house in March 2010 for £100k. He lived in the property for 6 years, before moving into a new home and renting out the property for 4 years before selling the property in March 2020 for £200k.

Pre 5 April 2020 Gain

Proceeds -	£200,000
Less: Cost -	(£100,000)
Gain before PPRR -	£100,000
Less: PPRR	(£75,000)
Gain after PPRR -	£25,000
Less: Letting Relief -	(£25,000)
Chargeable Gain -	£NIL

Post 5 April 2020 Gain

Using the same example as above but property is sold in March 2021.

Proceeds -	£200,000
Less: Cost -	(£100,000)
Gain before PPRR -	£100,000
Less: PPRR	(£61,363)
Gain after PPRR -	£38,637
No Letting Relief -	-
Chargeable Gain -	£38,637

Thus for just selling the property 12 months later the taxable gain (ignoring the CGT annual exemption of £12.5k) has gone from NIL to £38k. The CGT payable on this will be at 18% or 28% depending upon your income for that year.

Summary

If you have a property that you previously lived in and you are now renting this property then these rules will impact you. Losing 9 months of PPRR relief will result in higher capital gains. Lettings relief is also potentially worth up to £40,000 so for property owners letting out a second home you will lose this relief entirely. In the future under these rules the capital gains due on the sale of properties will be significantly increased. You may wish to consider selling the property pre 5 April 2020 so you are not caught out by these rules.

If you own a second property that you are unable to claim either PPRR or lettings relief then you will only be impacted by the need to report this to HMRC within 30 days and also make a payment to HMRC for the projected tax due.

If you wish to discuss this article please do not hesitate to contact us.

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