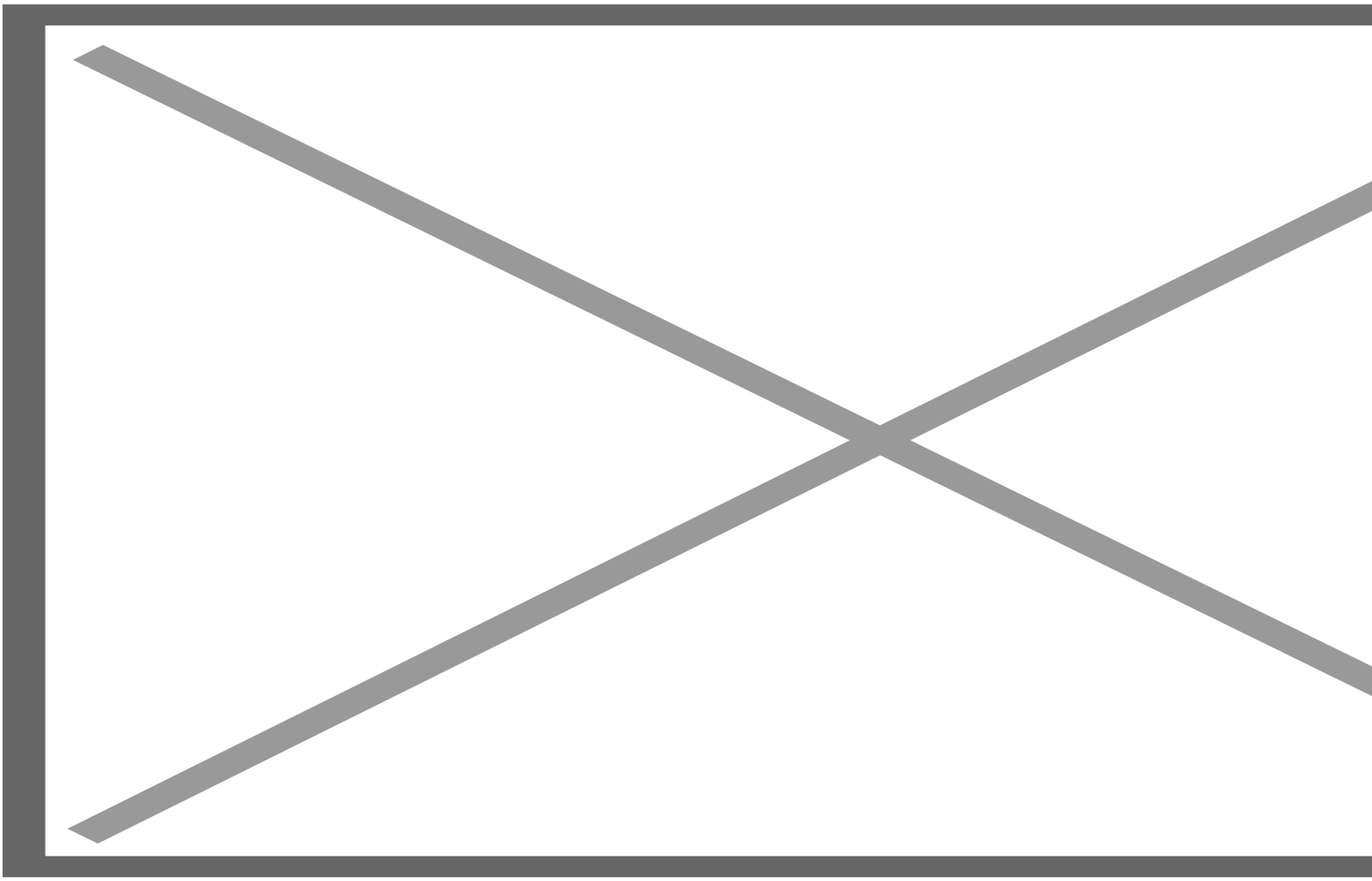
The evolution of main residence relief

Personal tax



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Ximena Montes Manzano reviews recent cases in the First-tier Tribunal dealing with appeals against CGT assessments/amendments denying the main residence exemption

Key Points

What is the issue?

The last few years have brought a fair number of appeals against closure notices or discovery assessments issued by the Revenue assessing gains realised on the disposal of residential property.

What does it mean to me?

Occupation as a main residence becomes harder to discern when there are unusual circumstances like relationship breakdowns, periods of absence or financial difficulties.

What can I take away?

Although each case will turn on its own facts, it is often helpful to recognise the factors which are most likely to persuade a tribunal that the exemption is applicable.

The last few years have brought a fair number of appeals against closure notices or discovery assessments issued by the Revenue assessing gains realised on the disposal of residential property. Whether the statutory test for the main residence exemption applies to such a disposal is ultimately a question of fact and degree. Although each case will turn on its own facts, it is often helpful to recognise the factors which are most likely to persuade a tribunal that the exemption is applicable.

The majority of cases in this area include some kind of occupation of a dwelling but the issue (or one of the issues) for the Tribunal to consider is whether such occupation had the sufficient intention and expectation of permanence and continuity so as to amount to occupation as a residence. Occupation as a main residence becomes harder to discern when there are unusual circumstances like relationship breakdowns, periods of absence or financial difficulties.

Andrew Oliver [2016] UKFTT 0796 (TC): True intention

This case involved a relationship breakdown which had allegedly led the taxpayer to move to a second property for a limited period. This case had starker facts than its predecessors in that the taxpayer ran a property letting business trading under two separate names and at the relevant time had between 10 and 20 properties in his portfolio.

The Tribunal decision notes that despite the fact that he was undergoing a trial separation from his long-term partner in the spring of 2006, he did not see it fit to move into any of his existing properties on a short-term basis.

Instead, Mr Oliver decided to buy a property that had been recommended by an acquaintance but that had a very short lease and could not be sold as it was not well presented.

The taxpayer alleged that negotiating a lease extension had taken longer and had cost more than planned. As a result the flat had been bought with a seven-year buy to let mortgage in both his name and his partner’s. In the interim, Mr Oliver stayed in a spare bedroom in the matrimonial home, with friends, or in his boat. On 21 February 2007, the purchase of the new property was completed and on the same date three different estate agents were engaged to market the property.

The marketing pictures showed an unfurnished flat which Mr Oliver tried to explain by stating that he had moved all the furniture out of each frame for better effect. A contract for sale was agreed in March 2007 and the sale was completed in April 2007. The flat had been bought and resold in a period of 97 days.

Notwithstanding, Mr Oliver presented the Tribunal with an extensive bundle of correspondence addressed to him at the relevant property including utility bills, electoral registration application, DVLA certificate and statements for two bank accounts.

He also exhibited a diary and a photograph of his daughter at the property as well as affidavits signed by him, his partner and his business acquaintance.
The Tribunal held, following *Morgan* ([2013] UKFTT 181(TC)), that the intention of the occupier affects the quality of the occupation and that in this particular case the intention of the taxpayer had not been to occupy it as his main residence. The use of the flat was at best uncertain. The Tribunal expressed concern about the evidence presented and agreed with HMRC 'that the creation of certain pieces of evidence does not reflect "behaviour which takes place in the normal course of events" and is more in the nature of the creation of a paper trail.'

This case is a helpful reminder that a document trail is not proof in itself. The Tribunal will examine all surrounding circumstances and will look at the overall picture in order to determine whether there was a true intention to reside permanently and continuously.

See *Bailey* ([2017] UKFTT 0658 (TC)), *Munford* ([2017] UKFTT 019 (TC)) and *Lam* ([2018] UKFTT 0310 (TC)) for other instances where the Tribunal had to consider intention and nature of occupation.

Desmond Higgins [2017] UKFTT 0236 (TC): the 'period of ownership'

In this appeal, the Tribunal had to interpret the phrase 'period of ownership' in a case where the taxpayer, Mr Higgins, purchased an apartment off plan in London King's Cross six years before disposal.

The taxpayer had paid a small deposit in 2004 to mark his interest in the property and in 2006 entered into a contract for a leasehold of a new built apartment from a developer. The building project encountered delays due to the financial crisis in 2008 and construction commenced in late 2009. Under the terms of the contract, the taxpayer had no right to enter or occupy the apartment until legal completion took place in January 2010.

After completion, the apartment was occupied as the taxpayer's only residence until its disposal in January 2012. The Revenue argued that the 'period of ownership' commenced on the date of the contract to acquire the lease of the apartment (2006) and ended on the date of the agreement to sell (December 2011).
Since Mr Higgins' could not access the apartment during its construction, HMRC argued he could not relieve the part of the gain related to the construction phase.

The Tribunal rejected HMRC's contention holding that the phrase 'period of ownership' naturally and ordinarily began on the date the taxpayer was legally entitled to physical possession (or the date of legal completion).

The Tribunal dismissed HMRC's attempt to invoke TCGA 1992, s 28 to determine the period of ownership for the purposes of main residence relief. It held that s 28 is not a provision which determines liability but is a deeming provision which identifies the time of acquisition and disposal of a chargeable asset. Further, applying s 28 to main residence relief would lead to perverse and absurd results and would be contrary to the purpose of the legislation (to exempt from tax gains realised on the disposal of an individual's home).

This entirely sensible decision was appealed by HMRC to the Upper Tribunal and was heard in late June 2018. [Editorial comment: On 26 September, the Upper Tribunal allowed HMRC's appeal in Higgins, holding that the period of ownership started on exchange of contract.]

Ritchie & Ritchie [2017] UKFTT 0449 (TC): a new apportionment principle?

Mr and Mrs Ritchie purchased 0.669 hectares of land in 1987. The land included two buildings, a large shed and a small 'potting' shed. The taxpayers used the large shed (or garage) to store their car and various other household items including tools and toys. The taxpayers decided to develop the land and during construction

stayed in adjacent rented accommodation and laid a path for access to their shed which was 85 metres away.

They built a substantial three-storey house together with front and back gardens and moved in 1995. In 2007 the land including the dwelling-house and sheds were sold to developers for £2m. There was, therefore, a pre-occupation period of seven years before any dwelling-house was constructed on the site.

The Tribunal had to consider *inter alia*

- whether or not the shed was part of the dwelling house, and
- whether the gain should be time apportioned because – as HMRC contended – the asset had changed substantially due to the construction of the house.

The taxpayers argued that the large shed had been part of the dwelling rented by them throughout the pre-occupation period because of their close proximity and combined use.

The Tribunal rejected the taxpayers' argument that the shed was part and parcel of their main residence which happened to be located on somebody else's land.

The Tribunal held that this contention was inconsistent with the lack of an election treating the shed as their main residence at any stage.

Notwithstanding this, the Tribunal found it difficult to time apportion the gain as per *Henke* ((2006) SpC 550) (an authority well established but not binding). If a time apportionment had been made, 35% of an approximate gain of £1.8m would have to be disallowed.

The FTT held that 'by no yardstick' could the land go up in value by £630,000 in a seven-year period. Instead, the FTT proceeded to apportion according to the principles in TCGA 1992, s 224(2): a change in what is occupied on account of '*any other reason*'.

Applying this principle, the gains reflected the value of the dwelling-house in early 1995 (£200,000) less the agreed cost of construction of £179,900 and the cost of the land of £11,000. The total taxable gain was therefore £9,100. The Tribunal's novel apportionment approach saved the taxpayers hundreds of thousands of pounds in tax. Unsurprisingly, HMRC have appealed this decision and the Upper Tribunal will hear the full appeal on 6 and 7 November 2018.

Recent cases demonstrate that while the principles of main residence relief have been established for a number of decades, the tax tribunal is willing to revisit those principles in light of changing times (higher divorce rates, single person households, new-built development). See for instance *McHugh* ([2018] UKFTT 0403 (TC)) for the FTT's latest application of ESC D49.

It is also clear that some of those principles may need to be clarified further in order to cater for modern life whilst still preserving the purpose of the legislation.