A feeling of relief?

Personal tax

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Meg Saksida reviews the changes being made to main residence relief and the benefits that may be available to homeowners

Key Points

What is the issue?

Changes to capital gains tax are being made to ensure that the benefit of the main residence relief lies with the owner occupiers of homes rather than the owners.

What does it mean to me?

Changes to the ancillary reliefs of job related accommodation, final period exemption and lettings relief have refined the exemptions available to homeowners, while the introduction of two ESCs and the introduction of the 30 day deadline will also impact capital gains tax calculations.

What can I take away?

As main residence relief is a relief worth £26.7 billion (in 2018/19), it is possible that it may be subject to 'practical operation' reforms. While the scope of such reforms is still to be determined, there has been talk in the taxation community of the possibility of a lifetime cap, or a maximum main residence relief per transaction.

On 22 July this year, Chancellor of the Exchequer Rishi Sunak delivered his first budget, making several changes to the capital gains taxation (CGT) of main residences, predicted to generate £50 million in revenue in 2020/21 alone, and up to £150 million by 2023/24. The changes came into force on 6 April 2020.

Changes are being made to ensure that the benefit of the main residence relief lies with the owner occupiers of the homes rather than the owners. It was felt that in the past the benefits were more advantageous to taxpayers who were not occupying the homes these benefits derived from, particularly with reliefs such as lettings relief and the final period exemption of 18 months (36 months prior to 2014).

Changes in the ancillary reliefs

There are four ancillary reliefs for main residence relief.

1. Job related accommodation

There is ancillary relief if an individual is living in job related accommodation because: it is necessary for the proper performance of their role; it provides better performance and is customary; or it is necessary for the security of the employee. If the individual owns a home that they cannot occupy due to the job related accommodation, that home can continue to be their main residence for capital gains tax purposes for the entire period that they are in job related accommodation, as long as they intend to return to occupy the home once the employment is finished.

Under its Future Accommodation Model, the Ministry of Defence (MOD) has a pilot scheme whereby living accommodation is not provided by the MOD, but instead an armed forces ‘accommodation allowance’ is available for some employees to put towards the cost of housing provided in the open market. This allowance is now classified as job related and will also entitle the MOD employee to main residence relief (on their owned home) whilst he or she is in receipt of the allowance, as long as the payment is exempt from income tax through ITEPA 2003 s 297D.

2. Final period exemption

The current final period exemption of 18 months, which was reduced from 36 months in 2014, is being further reduced to nine months. The intention of this relief is to give taxpayers an opportunity to sell their home without having to worry about a period where they had two houses and no main residence relief for one of them; for example, if a taxpayer purchased a new home but the previous home had not yet been sold. Without a final period exemption, one of the homes may develop a charge to capital gains tax, which was deemed to be unfair.

However, the final exemption periods of 36 months and later 18 months were deemed to be too generous, resulting in the further reduction. Those living in care homes and disabled persons, however, may still rely on the 36 month final period.

3. The deemed occupation periods

The deemed occupation periods have not been changed.

4. Lettings relief

Lettings relief was introduced in 1980 as a way to allow homeowners to take in lodgers and ‘let out’ spare rooms, without losing the benefits of main residence relief. The government feels that this relief has ended up being far more generous than originally envisaged and has resulted in advantages for those who own but who do not occupy the home.

To this end, lettings relief has been restricted to those who live alongside the lodgers, rather than those who allow the tenants to have the whole home. The mechanics of the relief have not changed; it is still the lower of the following three:

- the main residence relief calculated;
- the amount of the chargeable gain related to the letting; and
- £40,000.

The change is a ‘cliff edge’ change. Any landlords with tenants in a home that had at one point been their main residence who exchanged contracts on their former home prior to 6 April 2020 would have been able to benefit from the old rules; however, those that sold after 5 April 2020 would not. If the landlord selling post 5 April 2020 is no longer able to use lettings relief, there may still be other ancillary reliefs available to them.

Don’t forget the 40 year old statement of practice ‘SP14/80’. This states that if there is only one lodger and that lodger ‘lives with the owner as a member of the family’, eating meals together, etc., the main residence relief is not restricted anyway. So presumably this new legislation is for situations where the lodger either keeps to themselves or there is more than one lodger.

Extra Statutory Concessions

Two Extra Statutory Concessions have been legislated: the ESC D21 ‘Late claims in dual residence cases’; and ESC D49 ‘Short delay by owner occupier in taking up residence’.

1. ESC D21 ‘Late claims in dual residence cases’

Usually, a taxpayer needs to let HMRC know when they have more than one main residence within two years of acquiring the second residence. In dual residence cases where the interest in one of the properties was ‘no more than a negligible capital value on the open market’ – for example, a rented property – the two year time limit was able to be extended. It was only extended, however, in cases where the individual was unaware that such a nomination needed to or could be made. The individual had to let HMRC know within a ‘reasonable time’ of them first becoming aware of being able to make a nomination.

The new legislation is similar but has removed the requirement for the individual to be unaware of the need for nomination. The new condition is that the late claim is only available if the individual has never previously given a notice under this legislation (s 5A(a)); but presumably if they had, they would prima facie have been aware.

2. ESC D49 'Short delay by owner occupier in taking up residence'

This ESC covers the situation where an individual either purchases land on which to build their main residence, or buys a completed house, but is unable to move in either due to the need to sell their previous home or the need to build, renovate, alter or redecorate the property. Previously, as long as this delay period was less than one year it could be counted as deemed occupation. In exceptional circumstances, i.e. those fully outside the taxpayer's control, 24 months would be covered.

This concession has been legislated but the new provisions appear more generous, in that they allow the period of permitted non-occupation to be 24 months from the date of acquisition in all cases.

The 30-day deadline on CGT payment

Previously, CGT was due by the 31 January in the year after the tax year of the sale. This changed in April to 30 days after the completion of the sale. If there is more than one disposal in the year, the CGT is calculated on a cumulative basis on every disposal and the previous tax paid is taken off the total due. Losses can be offset as normal; however, they may cause a cashflow disadvantage if assets pregnant with a gain are sold earlier in the tax year and then losses are realised later in the tax year. If, overall, no tax was due in the tax year, the taxpayer will need to wait until the real time system that records the gains and losses has closed in order to be able to submit their tax return and calculate any tax repayable.

This is because although returns can be amended, they can only be amended for events that occur before that gain, not after. If a capital loss occurred after a gain, the return recording the gain cannot therefore be amended.

Transfers between spouses and civil partners

Prior to April this year, if a main residence is transferred between spouses or civil partners, the history of the spouse who had previously owned the property went with the property to the new spouse or civil partner for any subsequent disposal made. Conversely, if it was property other than a main residence the history would not be transferred. The provisions have now been aligned such that the donee spouse or civil partner's period of ownership of any dwelling, main residence or not, will now be the same as that of the donor spouse.

The case of *Higgins*

The Higgins case (Higgins v HMRC [2019] EWCA Civ 1860) was very interesting as it held that the date of acquisition for main residence relief is not necessarily the same as the date of acquisition for the general capital gains tax legislation, which is the date of exchange. The facts of the case were that the taxpayer had exchanged on a property some four years before he was able to move in, due to the construction not having been finished. When he did move in, he had the quality, quantity and intention required for main residence relief, but HMRC sought to charge main residence relief for the period between the date of exchange and the date of his occupation, relying on TCGA 1992 s 28, where it is stated that 'an asset is … acquired under a contract the time … the contract is made'.

The Court of Appeal, however, appreciated that the taxpayer had no opportunity to possess, occupy or use the property in those first four years, and as there was not the requirement in the main residence legislation to determine the 'period of ownership' by reference to s 28, it was held that it would have been 'perverse' to do so. Lord Justice Newey ruled that 'Mr Higgins' "period of ownership" of the apartment for the purpose of s 223 of the TCGA did not begin until his purchase was completed'.

The future and the newly commissioned investigation by OTS

In mid-July, Rishi Sunak commissioned the independent Office of Tax Simplification (OTS) to look into capital gains tax, considering: the allowances, exemptions and reliefs available; the treatment of losses; and the interaction with other UK taxes such as inheritance tax and income tax.

Like the changes made to main residence relief, the review will consider whether the existing benefits allow tax advantages for the intended taxpayers and are not distorting behaviour or going against the intent of the original policies. Suggestions are that the rates may be adjusted to be closer to those of income tax or restructuring so that there is a flat rate for capital gain tax, rather than the four rates we currently have above the £12,300 annual exempt amount.

As main residence relief is a relief worth £26.7 billion (in 2018/19), it is possible that this too could be targeted; however, the OTS's official scoping document states that it will consider only the 'practical operation' of main residence relief. Quite how large the impact could be of such 'practical operation' reforms is yet to be established but there has been talk in the taxation community of the possibility of a lifetime cap, or a maximum main residence relief per transaction.

The definition of one's main residence, which has largely been established from past case law, could also become more precise through legislation. Finally, in combination with the OTS and the All-Party Parliamentary Group's report on inheritance tax, the capital gains tax uplift on death may also be abolished. No immediate changes are likely to take place, but the next Budget will be an interesting listen.