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CAPITAL GAINS TAX: PRIVATE RESIDENCE RELIEF: CHANGES TO THE ANCILLARY RELIEFS

Response by Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the HMT and HMRC consultation document *Capital Gains Tax: Private Residence Relief: Changes to the ancillary reliefs* ('the Consultation') issued on 1 April 2019[1].

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 We have concerns about the reduction of the final period exemption and the approach to the changes for letting relief which we have set out further below. The proposed changes, which will increase both the probability of an individual being required to pay Capital Gains Tax (CGT) and the amount that they will pay, also coincide with significant changes to the timing of the reporting and payment of CGT with the introduction of the 30-day reporting requirement for UK residential property in April 2020. Sufficient early publicity and clear guidance setting out the full impact of the package of changes will be required to ensure that taxpayers can appreciate and comply with all the new rules in this area.

1.4 Our response is set out as follows:

Section 2 – Final period exemption

Section 3 – Lettings relief

Section 4 - Ministry of Defence Future Accommodation Model and Job Related Accommodation

Section 5 – Extra Statutory Concessions

Section 6 - Married persons and civil partners transfers

Section 7 – Timing of the changes

[1] https://www.gov.uk/government/consultations/capital-gains-tax-private-residence-relief-changes-to-the-ancillary-reliefs

1.5 We would be pleased to discuss any aspect of this response further. Relevant contact details can be found in Section 8.

2 Final period exemption

2.1 **Question 1: Do you have any comments about the reduction of the final period exemption?**

2.2 When Capital Gains Tax (CGT) was introduced by Finance Act 1965, provision was made for Private Residence Relief (PRR) to apply for the last 12 months of ownership, even if the property had not been the individual's main residence during that time:

"The gain shall not be a chargeable gain if the dwelling-house or part of a dwelling-house has been the individual's only or main residence throughout the period of ownership, or throughout the period of ownership ***except for all or any part of the last twelve months of that period****."*

Since then, the duration of this *final exemption period* has varied, most recently dropping from 36 months to 18 months with effect from 6 April 2014. We are asked to comment on the proposal to reduce the period again to nine months from 6 April 2020. (A 36-month final exemption period is retained in certain circumstances when the individual is a disabled person or a long-term resident in a care home.)

2.3 When considering the final exemption period proposals, there are three elements to consider:

- What is the purpose of the final exemption period?
- What is a reasonable period which would achieve that purpose?
- Are there unintended consequences from the proposed period?

What is the purpose of the final exemption period?

2.4 We consider that the purpose of the final period exemption is to allow individuals a period of grace in which to sell their main home without incurring CGT even if they have to leave the property before exchanging on a sale.

2.5 While in the majority of cases, people are only able to purchase their next home when their current property has been sold, there are a number of circumstances where individuals may move out of their home before they are able to exchange on a sale. These might include:

- Separation or divorce.
- The requirement to relocate to take up a new job or accompany a spouse or partner moving for a new job.
- The requirement to relocate nearer family.
- Sickness or ill health rendering the current home unsuitable so that the individual is forced or would prefer to relocate either nearer to family or to a different property or into care.

In the final case, there may be some relief if the extended 36-month period is available but this extension is narrowly drawn and limited in scope. It is only available if the individual is disabled or a long-term resident of a care home at the time of disposal. The relief is not available if the individual moves to live with a family member who provides care and is lost, for example, if the individual moves from care to the residence of a family member.

2.6 It seems reasonable in all these circumstances to allow individuals a period of grace before they begin to lose the full benefit of PRR. In many of these circumstances, a CGT liability could impact on the household's ability to afford the next property or meet care costs.

What is a reasonable period which would achieve that purpose?

2.7 The proposed period of final exemption is nine months, and the next question is whether this is a reasonable period that achieves the purpose of allowing people sufficient time to sell.

2.8 The time that a property takes to sell will depend on a number of factors, including the general strength of market conditions. The weaker the housing market, the longer it takes to sell, and the greater the chance that an individual may be forced by other factors to consider relocating in advance of sale. In the past, the final exemption period has been increased to 36 months to reflect the difficulties of selling in challenging market conditions.

2.9 At the present time, given the uncertainty in respect of Brexit and the potential negative impact on the economy, there is a possibility of a slowdown in the property market. The reduction to nine months could adversely affect taxpayers who have no option but to relocate and face an increased wait to sell their original home.

2.10 On that basis, it is difficult to see that a nine-month period is sufficient, or that April 2020 is an appropriate time to impose any reduction.

2.11 *Average selling times*

2.12 We understand that HMRC have reported that, on average, properties sell within 19 weeks. (We do not know to what period of time this statistic relates to and it may be out of date.) On this basis, a nine-month final exemption period was argued as reasonable as this is twice this period. We do not think that an average figure alone is sufficient justification for the proposed nine-month period.

2.13 When considering an appropriate period to allow, it is necessary to review not just the average period of time that a property takes to sell, but the distribution of sale periods. This data would allow HMRC to conclude, say, that x% of all sales occurred by y weeks. A significant amount of detail is lost by looking purely at the average figure.

2.14 Equally, we presume that the average length of sale time will be open to regional variations and other factors such as seasonal variations and the price bracket of the property. It is often reported that some London property can sell in very short space of time. If this is the case, then such transactions could distort the average time to achieve a sale and may not reflect the position elsewhere in the country. In order to judge whether the nine-month window is a reasonable time to allow people to sell across the country, it is important to review a broader range of data and establish how the time to sell varies with a range of different factors.

2.15 *Additional comments on separation and divorce*

2.16 For divorcing/separating couples, it should be noted that there is additional provision under s225B TCGA 1992 where the final period of exemption is not enough. Provided that the spouse who has moved out is transferring the property under an agreement or court order to the other spouse for whom the property remains their only or main residence, then the disposing spouse can elect to claim PRR for the period

between moving out and disposal. However, making this election will prevent the disposing spouse claiming PRR on any other property that they acquire during this period.

2.17 S225B is a useful provision, although limited. It does not apply when the couple are separating but were not married or in a civil partnership, and it also requires the individual to make a judgement over whether or not to claim PRR on the disposal of the home they have moved out of as it comes at the cost of losing full PRR on any new property acquired during that period. Accordingly, it cannot be relied on in all circumstances.

2.18 ***Are there unintended consequences from the proposed period?***

2.19 The final question is whether or not the policy of allowing a final exemption period in the current manner results in unintended consequences.

2.20 In the first instance, the proposed shorter period will impact on those are unable to sell their main residence within nine months, which could be for a range of factors outside their control (the wrong area, the wrong time of year, etc).

2.21 In our view, the proposed period is too short to allow individuals time to sell their property in the face of potentially challenging conditions.

2.22 ***Individuals with two or more properties benefiting from the final exemption period***

2.23 We understand that HMRC's concern is that individuals who occupy two or more properties are able to move the main residence election between the properties to ensure that, while only one property can be the main residence at any one time, careful elections can ensure that on sale, all properties will benefit from PRR equal to at least the final exemption period. This is arguably an unintended benefit for some individuals resulting from a longer final exemption period. At 3.3 the Consultation notes the intention of the proposed restriction is to "better target the exemption at owner-occupiers".

2.24 We appreciate that obtaining relief for the final exemption period on multiple properties is a genuine concern and that reducing the final period of exemption would reduce the loss of tax due to what is commonly known as 'flipping' elections. However, there does need to be a balance between restricting the ability of those with two or more properties to benefit from extra periods of relief while still ensuring that those who are unable to sell their home receive an appropriate final exemption period and that they are not unfairly treated.

2.25 Rather than penalising those struggling to sell their home by shortening the final exemption period, we think that consideration should be given to restricting the availability of the relief to make it harder to flip between properties. Whilst this might not resolve all of the issues, it would help to reduce the benefit of the final exemption period to an individual with two or more properties at the same time as preserving entitlement to the relief for those who need it.

2.26 In a two-property situation, individuals may typically 'flip' their PRR between two properties 'A' and 'B' as follows:

An individual acquires and lives in property A. On the purchase of a second property B, they will elect for A to be their main residence. (An election is unlikely to have been made prior to the acquisition of the second property as it is not required.) At a later date, having made the initial election, they can vary it and elect for B to be main the main residence for a short period – from as little as a day to (more conservatively) one or more months – before varying the election again to re-elect A as their main residence. The result is that a

final exemption period of 18 months is obtained on both properties at the negligible cost of the loss of PRR on A for an extremely short period. Hence the term 'flipping' as the election has been moved from one property to another and back.

2.27 One approach to tackle this would be to prevent a change in election until a minimum period had elapsed. This would increase the loss of PRR on A and thus, when considered together, reduce the benefit of the final exemption period on B. A general restriction is required as otherwise the individual could start by electing for B on purchase, and then move the election to A within a short period. The minimum duration period of an election could match the final exemption period thereby ensuring that the acquisition of relief on B was at the expense of a matching period of loss on A.

2.28 Consideration would need to be given to the situation where B was sold within the minimum period in which the election cannot be moved. Either the PRR would automatically default back to A without the need for election if no other property was acquired (so that sale of B overrode the minimum period, which may allow for some manipulation) or PRR could be denied on A until the minimum period had elapsed on B, regardless of the sale of B during that period.

2.29 We appreciate that this will require some planning/monitoring, but would allow the final exemption period to be set to benefit those who need it – who have separated, moved for career or family, and who are struggling to sell their property – without individuals with multiple properties receiving a 'double dip' on the benefits of PRR.

3 Lettings relief

3.1 **Question 2: Do you have any other comments about the reform of lettings relief?**

3.2 We are surprised that the Consultation refers at in paragraph 4.2 to the structure of the relief, which was introduced in 1980, as extending much further than the original policy intent. Letting relief has been permitted when the property owner is not in occupation from its inception. Statement of Practice 14/80[2] (SP 14/80) is clear that letting relief can apply where the dwelling-house has "at any time in his period of ownership **been wholly or partly let** by him as residential accommodation" **[our emphasis]**. An example to that effect is included within SP 14/80. The relief was initially given statutory form as section 80, Finance Act 1980[3] and is currently incorporated into the current legislation at s223(4) TCGA 1992 without any substantive change in the wording. The wording of that section is unambiguous. It appears to have taken some time to notice this apparently unintended extension of the original policy intent.

3.3 Under the new proposals, lettings relief will only be available where the property owner shares occupation of their house with a tenant. We have concerns over the definition of sharing accommodation and whether or not the changes could be to the detriment of those already letting to lodgers and benefitting from PRR instead.

3.4 ***SP14/80 and PRR for lodgers***

3.5 At the present time, SP14/80 allows an individual who is letting rooms to a lodger, sharing their living accommodation and taking meals with them, to continue to claim PRR. The extension is further clarified in HMRC's manuals at CG64702[4] confirming that in these situations no part of the accommodation should be

[2] https://www.gov.uk/government/publications/statement-of-practice-14-1980/statement-of-practice-14-1980
[3] https://www.legislation.gov.uk/ukpga/1980/48/section/80/enacted
[4] https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg64702

treated as having ceased to be the owner's main residence, and encouraging the operation of the statutory code flexibly.

3.6 At present therefore, an individual with a lodger will benefit from PRR and would only need to have recourse to letting relief if they run a lodging house.

3.7 It is unclear what impact the proposed changes would have on those who share with lodgers as presently defined in SP14/80. Will they now lose the benefit of PRR and be required to claim letting relief instead? PRR is more beneficial to an individual as it is not subject to the various limits imposed on letting relief.

3.8 Given that the Government has in previous consultations on rent-a-room relief expressed a desire to encourage people to let their rooms to lodgers, any withdrawal of the ability to claim unrestricted PRR in these circumstances would be a counter-productive measure.

3.9 There appears to be some confusion in the Consultation about the 'exclusive' use of rooms by lodgers as set out in example 3 of the Consultation. Where the lodger is an *excluded occupier* they will not generally have exclusive use of any part of the property, not even the bedroom they use. If the distinction between lodgers and shared occupation is retained it is not clear how, practically, a homeowner would be able to distinguish between *a lodger* where PRR still applies under SP14/80 and where they would only be entitled to letting relief under *shared occupation*.

3.10 As an aside, one of the weaknesses of SP14/80 is that PRR is not available where there is more than one lodger. Members have reported to us instances where the lodger has asked for a spouse or partner to be able to join them and share their room. While this has been acceptable to the homeowner, they have declined on the grounds that, if SP14/80 is strictly construed with the term 'a lodger' (singular) they could risk the loss of PRR and have to rely on letting relief instead. It would be beneficial if PRR could be allowed where the lodger and their partner are sharing a room.

3.11 ***Other comments on letting relief***

3.12 The impact of the change is potentially significant. Although the relief is restricted to £40,000, the potential tax increase could be as much as 28% x £40,000 = £11,200 for an individual seller who has not been in occupation. This is on top of the loss of relief in the final exemption period.

3.13 Members have expressed concerns that the change will be made on a cliff-edge basis. An owner who is not able to sell on or before 5 April 2020 will have significantly more tax to pay on a sale from 6 April 2020. It is not straightforward, especially if a tenant is in place, to accelerate the pace of sale. Furthermore, some individuals will have planned sales within a timeframe which will result in no gain and it may not be possible to amend these plans within the time.

3.14 One approach which would ameliorate the cliff-edge effect would be to allow the exemption for periods up until 5 April 2020 (doing so by reference to the pre-April 2020 qualifying conditions) but not allow any further letting relief to accrue (unless there was joint occupation) from that date. This would prevent the change having retroactive effect.

3.15 Members have also expressed concerns that a rush to sell properties before the change in order to 'lock in' the letting relief may reduce the number of properties available to rent. Since it is harder to sell with a sitting tenant, it may also encourage some landlords to ask their tenant to move out before the property is sold. (On the other hand it might increase the pool of properties for first-time owner-occupiers. It will depend on the nature of the properties sold.)

3.16 ***Practical aspects of the changes***

3.17 In order to claim letting relief, or if a claim is tested, it will be necessary to be able to prove to HMRC that occupation is shared. Guidance will be needed to define shared occupation – how much sharing is required, for how long and on what basis. Presumably shared occupation from April 2020 will be defined very differently from how it is set out in SP14/80 which requires the lodger to take meals as a family member? As times have changed, we suspect that this is less common that it was, and in situations that members have reported to us, lodgers will often cook their meals separately using shared kitchen facilities.

3.18 We have some concerns about Example 3 included in the Consultation as it is based on the position where the tenant has exclusive use of one or more rooms. In most circumstances where the lodger is an excluded occupier, occupying under licence, there is no possibility of them having exclusive use of any part of the property. We consider this example is unhelpful, and instead more consideration needs to be given to the shared occupation that the government envisages should still qualify for letting relief.

3.19 An individual may for example have a lodger and choose to work away during part of the week or for periods of time during the year. Is there an intention to restrict the relief in this case? If an individual takes on a lodger, then goes on an extended holiday of some months, at what point would an individual be no longer considered to be in shared occupation? We presume a pragmatic approach will be taken where the owner is on extended holiday or in hospital.

3.20 Guidance will also be required on how owners can evidence that they were in shared occupation. We assume that this might include keeping possessions in the property, potentially shared bills, electoral registration, the absence of other residences etc. Given that this requirement is new and that evidence may not have been retained for claims relating to periods prior to 6 April 2020, will a pragmatic approach be taken by HMRC?

3.21 Finally, many members also noted that the relief as it stands is poorly understood by the general public and that it is an area where many owners seek advice. Whatever changes are made, clear guidance needs to be provided as soon as possible.

4 Ministry of Defence Future Accommodation Model and Job Related Accommodation

4.1 **Question 3: Do you believe there is a case for legislating to ensure that the benefits of job related accommodation will continue to apply to personnel who organise accommodation through the Future Accommodation Model?**

4.2 We agree that the benefit should be extended to ensure that military personnel are not disadvantaged by arranging accommodation through the Future Accommodation Model.

5 Extra Statutory Concessions

5.1 **Question 4: Do you have any comments on legislating these ESCs in their present form?**

5.2 ***ESC D21: Private residence exemption: late claims in dual residence cases***

5.3 In the current circumstances this is a very useful concession and members report that the use of this ESC has been extremely helpful in a number of situations in preventing unfair outcomes. Clients taking advantage of this relief have often not previously taken advice and find themselves potentially losing PRR because they have chosen to rent a property nearer work or family. Accordingly, we support legislating for this concession.

5.4 ***ESC D49: Short delay by owner-occupier in taking up residence***

5.5 In principle, we agree that this concession is useful and should be legislated. However, there are a number of aspects of the concession which could be improved as part of this process.

5.6 In its present form, the relief has a cliff-edge effect. If the delay is under one year, then relief is allowed in full. If the delay is more than one year (unless for good reasons outside of the individual's control) there is no relief. We suggest that the relief could be more nuanced and allow relief of up to one year regardless of whether or not the delay is longer. At the present time, if the delay is 53 weeks, all relief for the period is lost, whereas if the delay is only 51 weeks the relief is granted. Under our suggestion, a delay of 70 weeks would attract 52 weeks of relief leaving 18 weeks unrelieved.

5.7 There are also circumstances which ESC D49 does not cover where a similar relief would be appropriate:

- When an individual *inherits*, rather than purchases an existing home but arranges for alterations or redecorations before moving in. (ESC D49 only provides for relief where an individual has *purchased* a property whereas it is perhaps more likely that an inherited property would need work before it could be occupied.) It would be preferable if the legislation could use a broader term such as *acquire*.
- When an individual purchases off-plan and is unable to occupy for some period of time while the property is constructed. (ESC D49 does not deal with situations where there is a delay between exchange and completion of the contract.)

5.8 The issue in the final point is illustrated in the recent Upper Tribunal case of *HMRC v Desmond Higgins*[5]. Here, Mr Higgins bought a flat 'off plan' which was not in existence at the time of exchange of contracts. Despite Mr Higgins occupying the flat for the entire period that it was in existence and physically possible for him to occupy it as a residence, his claim to full PRR failed and a CGT liability arose because of the long period of time between exchange and completion of purchase due to delays in the construction of the flat. It was held by the Upper Tribunal that PRR could not apply to this period and thus, on the basis of time apportionment, a proportion of the gain was chargeable. D49 was of no assistance in this situation as the delay in occupation was caused by the gap between exchange and the completion point.

6 Married persons and civil partners transfers

6.1 **Question 5: Should the receiving spouse always inherit the ownership period and the use to which the property had been put in the past regardless of whether it is a main residence at the time of transfer?**

6.2 Under the current rules, when a residential property is transferred between spouses or civil partners, the transfer occurs on a no-gain, no-loss basis. However, for the purposes of any PRR claim, the period of ownership which has to be considered depends on whether or not the property was the donor's main

[5] https://assets.publishing.service.gov.uk/media/5bab515ae5274a54d2ef7bc2/HMRC_v_Desmond_Higgins.pdf

residence at the time of transfer. If it was, then the donee is deemed to have acquired the property when the donor did and inherits their subsequent use. If it was not, then they are deemed to acquire it at the date of transfer.

6.3 The proposal is that when *any* residential property is transferred on a no-gain, no-loss basis between spouses or civil partners, the donee will always inherit the donor's acquisition date and use. It will no longer be relevant whether or not the property was the main residence of the donor at the time of transfer.

6.4 While this is inconsistent with the approach in other reliefs (for example in Entrepreneurs' Relief where the recipient spouse has to build up their own period of entitlement) the proposed amendment would help to remove two situations (illustrated in the Consultation) where PRR is either unreasonably denied or granted to the donee. Accordingly, removing the test of whether or not the property is a main residence appears to be a reasonable approach when residential properties are transferred between spouses or civil partners.

6.5 Consideration will need to be given to the position where a property was commercial for a period, then converted to residential property before being transferred between spouses. We presume that in this case the solution will be to continue to transfer the full history of the property and deem the recipient spouse to have acquired the property at the original acquisition date, before it became residential.

7 Timing of the changes

7.1 The proposed changes are due to take effect from 6 April 2020. This means that measures which will both increase the probability of an individual paying Capital Gains Tax (CGT) on residential property disposals and increase the amount of the tax for these already expecting a CGT liability, will be introduced at the same time as new accelerated reporting and payment on account requirements.

7.2 From April 2020, UK residents disposing of UK residential property where CGT arises will be required to both report the disposal and make a payment on account of the tax due within 30 days of completion. This 'in-year' payment system for UK residents is a major change to the UK tax system. Similar measures introduced in 2015 for non-UK residents have resulted in the issue of many late filing penalties where individuals were not aware of the changes and had continued to report the disposal of UK property and pay tax via their SA return after the tax year end. Many individuals opted to challenge these penalties and we now have a position where, at First Tier tribunal, some late-filing penalties have been struck out, and others upheld, based on very similar fact patterns.

7.3 Our concern therefore is that any changes, together with the 30–day reporting requirements, need to be well publicised by HMRC to prevent individuals becoming accidentally subject to penalties.

7.4 We think that a light touch approach to penalties would be appropriate in the early years of the new measures. Many non-resident individuals did not appreciate that an in-year return was required until they came to report the disposal on their tax returns, by which time the initial return was well overdue. UK-resident taxpayers could be in a similar position in relation to disposals of UK residential property from April 2020. That could arise if they calculated that they had no CGT liability on the property disposal (thereby relieving them of any 30-day reporting and payment obligations) but had in that calculation ignored the evaporation of letting relief and/or the shortening of the final period with the result that they did not appreciate that they had a reportable CGT liability.

8 Contact details

8.1 We would be pleased to join in any discussion relating to this Consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Helen Thornley on 07773 087125 or hthornley@att.org.uk.

The Association of Taxation Technicians

9 Note

9.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,000 members and Fellows together with over 5,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.