PRIVATE RESIDENCE RELIEF BASICS

One of the most often asked questions we receive is how to mitigate capital gains tax (CGT) on second homes. The following is a brief synopsis of our understanding of PPRR and how it can help clients to save tax. We have more detailed notes from outside experts for those who want additional detail.

1. WHAT IS PPRR

Your principle private residence is the property which you designate will qualify for relief from Capital Gains Tax (CGT).

A married couple and civil partners can have only one main residence exemption – unmarried couples who are not in a civil partnership can have one each.

2. MULTIPLE RESIDENCES

Where you have more than one residence you are entitled to elect which one of them is to be treated as your main residence for the main residence exemption to apply.

The property ***must be available to live in*** thus property that is rented and which you as the owner are excluded from occupying, will not qualify as a main residence.

On the acquisition of a new property you will be able to elect between the residences (including those which you own already) as to which one should be your principal private residence.

Once you have moved or changed your property (or bought a second property) you have 2 years to decide upon which of your properties is to be your PPRR (see 3.1). After you have done this you can change the PPRR again at any time (backdated up to 2 years), so the aim should be to maximise this relief to your most likely property to sell and the biggest gains which are likely from each residence.

3. CONCESSIONS

3.1 When Buying

A delay in taking up occupation of a dwelling-house as a residence at the start of a period of ownership is permitted. Basically, this gives relief of up to 12 months of ownership even if the taxpayer has not resided in the dwelling-house. The allowable 12 month period may be extended for another 12 months to two years provided there is a good reason for so doing.

3.2 When Selling

If declared a PPRR when selling you can claim relief for the last 18 months of ownership even if you did not reside in the property.

If the property has been owned prior to March 1982 you can ignore non PPRR periods prior to this time.

3.3 When Working Away From Home

Any period throughout which you were employed and worked outside the United Kingdom; and any period or periods not exceeding in total four years throughout which you could not reside in the property in consequence either of the situation of your place of work or of any condition imposed by your employer requiring you to reside elsewhere (being a condition).

3.4 Rented Property

Rented property is not eligible for relief from CGT, however ***if at some stage you have lived in the property*** up to £40,000 of any gain not qualifying for principal private residence relief can be relieved through "letting relief". This is £40,000 per owner, £80,000 for husband and wife.

The capital gain throughout the period of ownership is treated as accruing evenly during that period and the amount of letting relief available is the ***smaller of*** £40,000 and the amount of the gain relieved under the PPRR provisions.

For example:

Cost of Property	£200,000	
Net sale value	£280,000	
Taxable Gain	£80,000	
Period of ownership	10	years
Period of PPRR	4	years
Period of Letting	6	years
Gain Covered by PPRR	£32,000	
Gain During Letting	£48,000	
So PPRR exemption is:	£32,000	
Letting Exemption is:	£32,000	
Total Exemptions	£64,000	
Leaving a taxable gain of:	£16,000	

3.5 Trusts And Individuals Moving Into Residential Care

There are still concessions allowing certain disabled individuals, beneficiaries of trusts and those moving into residential care to sell their home and get 36 months PPRR relief.

3.6 Tax Planning

The tax planning really applies to individuals with more than one property (although there are some interesting rules applicable to those who get married).

3.7 Live In The Property

If you have lived in the property as your only, or main, residence at any time the gain referable to the last 18 months of ownership is free from CGT. If the property was owned for a total of five years but you lived there for the first year only then only 50% of the gain would be taxable.

As can be seen from the letting relief in section (4) by living in the property you can double your PPRR up to £80,000 subject to how long the periods of ownership and letting have been.

3.8 Transfer Part Of The Property To A Spouse To Use Their Annual Allowance

This will allow them to use their annual exemption, as well as your own.

So in the example in (4) above the £16,000 gain would be fully relieved by two exemptions (£12,300 per person in 2020/21) but would give rise to a taxable liability of £3,700 gain times the then CGT rate if owned by only one person.

3.9 Transfer Part Of The Property To A Spouse To Use Their Tax Bands

The rate of CGT is 18% for a basic tax payer and 28% for a higher rate tax payer. To ascertain the rate the gain is added to your taxable income. Let us assume there is a £50,000 taxable gain on a property (or indeed any taxable asset). Currently the asset is owned by one spouse who earns £25,000 pa gross. The tax will be as follows:

Gross income	£25,000	
Less allowances	(£12,500)	
Gives Taxable income of:	£12,500	
Combined Income and Gains above	£37,500	is subject to 28% CGT
The Gain is	£50,000	
Less annual allowance	(£12,300)	
Taxable Gain	£37,700	
The first element of gain	£25,000	
Is subject to 18% tax	(£4,500)	
The remaining gain of	£12,700	
is subject to 28% tax	(£3,556)	
So total tax bill is:	(£8,056)	

Let us assume the spouse of this individual earns £60,000 pa. By gifting a significant proportion of the property to them the tax bill can be significantly reduced:

	Spouse	Partner	Totals
Gross income	£60,000	£25,000	£85,000
Less allowances	(£12,500)	(£12,500)	(£25,000)
Gives Taxable income of:	£47,500	£12,500	£60,000
Higher rate threshold	£37,500	£37,500	£75,000
So tax rate is	28.00%	18.00%	
Ownership is split	22.00%	78.00%	
Gain is	£11,000	£39,000	£50,000
Less annual allowance (2020/21)	(£12,300)	(£12,300)	(£24,600)
Taxable Gain @ 18%		£25,000	£25,000
Taxable Gain @ 28%	-	£1,700	£1,700
Tax @ 18%	-	(£4,500)	(£4,500)
Tax @ 28%	-	(£476)	(£476)
Total Tax Due	-	(£4,976)	(£4,976)

So a split before sale reduces the tax by £3,000. Much more if the property was originally held by the higher rate tax payer.

3.10 Consider Which Property You Will Sell First

If you know you are likely to sell your holiday home years before your main residence then it makes sense to make that your PPRR to get the benefit of the tax relief, only to return the PPRR to your home when the holiday property is sold.

3.11 Consider Which Property Will Appreciate Quicker

In recent years it would have been a disaster to move your PPRR from your main home in London to a holiday home in Suffolk since London property has risen by perhaps 40% whilst Suffolk (and many other rural locations) has seen very little gains at all.

4. RESTRICTIONS

PPRR is restricted to your house and gardens. Typically the land should be its garden or grounds up to a permitted area of 0.5 of a hectare. The key is that at the date of disposal if the garden or grounds do not exceed the permitted area and are, as a matter of fact, used as garden or grounds they will automatically qualify for relief. However, even if the ground exceeds this permitted area relief may still be available if the land can be said to be needed for the reasonable enjoyment of the dwelling-house as a residence.

Since as a British tax payer you are liable to capital gains on your worldwide assets there is no reason why your property should be in the UK. We have seen in the past clients successfully claim foreign holiday homes as their PPRR.

Since the MP's debacle there has been a tightening up for PPRR declarations and HMRC will look for proof that the property is your main living home and has been (ideally) for a minimum of 3 months.

5. EXAMPLE LETTER

A typical declaration letter might look like this:

YOUR CURRENT ADDRESS

Date

HM Revenue & Customs
Address of your HMRC

Dear Sirs

RE: TAXPAYERS' NAMES AND UNIQUE TAXPAYERS' ID

In accordance with Section 222(5) TCGA 1992 we hereby elect for (PROPERTY YOU WANT TO BE TREATED AS YOUR PPRR INCLUDING POST CODE) to be treated as our main residence with effect from (DATE WHICH CAN BE UP TO 2 YEARS PREVIOUSLY), being the date of purchase of (THE ADDRESS OF THE PROPERTY WHICH HAS BEEN BOUGHT INCLUDING POST CODE).

Yours faithfully

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TAXPAYER'S NAME TAXPAYER'S NAME