Is a sale taxable?

Stuart Day clarifies the principal private residence tax exemption

Agents are well placed to remind vendors that they might need to consider Capital Gains Tax (CGT) on the sale of their property. This avoids the possibility of vendors realising and consequently withdrawing after a buyer has been found.

In the majority of cases, any gain realised by a UK taxpayer on the sale of their only or main home is likely to be entirely exempt from CGT. This is because it has been their principal private residence (PPR) throughout the period of ownership. The vendor can re-invest just about the whole of the equity from the sale in a new home. The PPR exemption does not depend on that re-investment, so it also allows someone to trade down and benefit from a tax free lump sum.

Taxable gains and tax payable

If the PPR exemption is not available, any gain arising after March 1982, which is not covered by the annual CGT exemption, is usually taxed at 18% or 28%. The rate depends on the taxpayer's other income.

The legislation is complicated and there is a vast array of case law going back to 1965 when CGT was introduced. There has also been an increase recently in the number of PPR cases coming before the Courts. Possible explanations include improvements in the information available to HM Revenue & Customs (HMRC) and their ability to link it together, an initiative to raise additional taxes, desperation of some taxpayers and because fewer sales are meeting the conditions.

Trading in property?

For the PPR exemption to apply, the profit on the property's disposal must be subject to CGT rather than income tax. Those who make a business of buying and selling properties will pay income tax on their profits because they are trading.

When determining whether a trade is being conducted, HMRC look at the overall situation. They take into

account factors such as the motive, circumstances of acquisition, number of transactions, work done to improve saleability and sales price, finance arrangements, duration of ownership and the circumstances of the sale.

Anyone who buys, does up and sells a succession of properties in a short period, and claims the exemption each time may face enquiries from the tax man, especially where it can't easily be shown the property was used as the main home. Factors examined here will include where correspondence is sent, the gas and electricity usage, council tax declarations and such like. Builders and developers are often asked to demonstrate why they have not treated one or more of their developments as their own home in order to evade tax.

Substantial grounds

In addition to the dwelling house, land used for occupation and enjoyment with the residence (for example its garden or grounds) up to a permitted area can be covered by the exemption. That permitted area is half a hectare. It can be increased if a larger area is required for reasonable enjoyment of the home, taking into account its size and character. To be exempt, though, these additional grounds must normally be sold with the property. If the house is sold with part of the grounds and the remaining land is sold subsequently, the PPR exemption will not cover the later sale.

Periods of absence

If the property has not been the only or main residence throughout the period of ownership (or all but the last 36 months) the exemption may apply to only a fraction of the gain. The gain is time apportioned over the period of ownership since 1982.

Say a property increases in value over a period when it is exempt, but then holds its value whilst no longer covered by the PPR. When it is sold, part of the gain will be attributed to the period not covered by the exemption, even though the property didn't actually increase in value over that time. The self employed who let their home and rent somewhere closer to their business can be caught out by this.

Deemed occupation

Some absences can be treated as periods of occupation, provided the individual hasn't got another PPR exemption at the same time. These include:

- periods in which the individual (or their spouse/partner) holds a job outside the UK,
- up to four years where occupation was not possible because of conditions imposed by their employer (e.g. a pub landlord required to live in), and
- any periods or periods of up to three years.

Two Homes

As the PPR exemption covers the main or only residence, a second home will not normally attract the relief. When a new property is acquired, however, the owner can elect which is to be regarded as the main residence. This can present some planning opportunities. A property, which has at some point been the only or main residence (even if only relatively briefly), can be treated as the PPR for the last 36 months of ownership.

Marriage and divorce

The PPR exemption will only cover one residence owned by an individual and their spouse (or civil partner living with them), as long as they are living together. Complications often arise on marriage, separation and divorce. For example, where both spouses live in their own homes, marry and then decide to sell the property they've not been living in more than three years later.

Conclusion

In some cases, planning before a sale may mean that tax can be legally avoided. If tax is due, and the amount can be quantified, a decision whether to proceed or not can be made with the benefit of this knowledge. By being aware of some of the more common problems mentioned above, Estate Agents and vendors may be able to recognise when professional tax advice is needed. Where there is any doubt over the exemption, specific advice should be sought. ■

Stuart Dey is Business Development Director of professional business advisers Shipleys LLP. He is responsible for helping to shape the firm's business strategy and ensuring that the firm's business development and marketing activities are focused and effective. Tel: 020 7312 6528, email deys@shipleys.com