Capital Gains Tax and the Family Home

The capital gains tax (CGT) exemption for gains made on the sale of your home is one of the most valuable reliefs from which many people benefit during their lifetime. The relief is well known: CGT exemption whatever the level of the capital gain on the sale of any property that has been your main residence. In this factsheet we look at the operation of the relief and consider factors that may cause it to be restricted.

Several important basic points

Only a property occupied as a residence can qualify for the exemption. An investment property in which you have never lived would not qualify.

The term 'residence' can include outbuildings separate from the main property but this is a difficult area. Please talk to us if this is likely to be relevant to you.

'Occupying' as a residence requires a degree of permanence so that living in a property for say, just two weeks with a view to benefiting from the exemption is unlikely to work.

The exemption includes land that is for 'occupation and enjoyment with the residence as its garden or grounds up to the permitted area'. The permitted area is half a hectare including the site of the property which equates to about 1.25 acres in old money! Larger gardens and grounds may qualify but only if they are appropriate to the size and character of the property and are required for the reasonable enjoyment of it. This can be a difficult test. In a court case the exemption was not given on land of 7.5 hectares attaching to a property. The owner said he needed that land to enjoy the property because he was keen on horses and riding. The courts decided that the owner's subjective liking for horses was irrelevant and, applying an objective test, the land was not needed for the reasonable enjoyment of the property.

Selling land separately

What if you want to sell off some of your garden for someone else to build on? Will the exemption apply? In simple terms it will if you continue to own the property with the rest of the garden and the total original area was within the half a hectare limit.

Where the total area exceeds half a hectare and some is sold then you would have to show that the part sold was needed for the reasonable enjoyment of the property and this can clearly be difficult if you were prepared to sell it off.

What if on the other hand you sell your house and part of the garden and then at a later date sell the rest of the garden off separately, say for development? Then you will not get the benefit of the exemption on the second sale because the land is no longer part of your main residence at the point of sale.

More than one residence

It is increasingly common for people to own more than one residence. However an individual can only benefit from the CGT exemption on one property at a time. In the case of a married couple (or civil partnership), there can only be one main residence for both. Where an individual has two (or more) residences then an election can be made to choose which should be the one to benefit from the CGT exemption on sale. Note that the property need not be in the UK to benefit although foreign tax implications may then need to be brought into the equation.

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The election must normally be made within two years of the change in the number of residences and the potential consequences of failure to elect are shown in the case study that follows. Furthermore the case study demonstrates the beneficial rule that allows CGT exemption for the last three years of ownership of a property that has at some time been the main residence.

Case study

Wayne, a 50% taxpayer, acquired a home in 2001 in which he lived full-time. In 2005 he bought a second home and divided his time between the two properties.

- Either property may qualify for the exemption as Wayne spends time at each - ie they both count as 'residences'.
- Choosing which property should benefit is not always easy since it depends on which is the more likely to be sold and which is the more likely to show a significant gain. Some crystal ball gazing may be needed!
- The choice of property needs to be made by election to HMRC within two years of acquiring the second home. Missing this time limit means that HMRC will decide on any future sale which property was, as a question of fact, the main residence.

Wayne elects for the second home to be treated as his main residence for CGT purposes. In 2011 he sells both properties realising a gain of £100,000 on the first property and £150,000 on the second property.

The gain on the second property is CGT-free because of the election.

Part of the gain on the first property is exempt. Namely that relating to:

- the four years before the second property was acquired (when the first property was the only residence) and
- the last three years of ownership which will always qualify providing the property has been the main residence at some time.

In other words out of the ten years of ownership, a total of seven qualify for the exemption. Therefore 3/10ths of the gain - ie £30,000 will be taxable. Not bad on total gains of £250,000.

Without the election, and the first property being treated as the main residence throughout, Wayne would have found the gain on the first property wholly exempt and the gain on the second property wholly chargeable. Failure to make an election can be an expensive mistake.

Business use

More and more people work from home these days. Does working from home affect the CGT exemption on sale? The answer is simple - it may do!

Rather more helpfully the basic rule is that the exemption will be denied to the extent that part of your home is used exclusively for business purposes. In many cases of course the business use is not exclusive, your office doubling as a spare bedroom for guests for example, in which case there is not a problem.

Where there is exclusive business use then part of the gain on sale will be chargeable rather than exempt. However, it may well be that you plan to acquire a further property, also with part for business use, in which case the business use element of the gain can be deferred by 'rolling over' the gain against the cost of the new property.

Residential letting

A further relief is given if your main residence has been let as residential accommodation during the period of ownership. The case study below best demonstrates the operation of this.

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The letting exemption can be very valuable but is only available on a property that has been your main residence. It is not available on a 'buy to let' property in which you never live.

Case study

Frank bought a property in 1996 and lived in it as his main residence for eight years until 2004. Then he bought a second property which immediately became his main residence and the first property was let from then until its sale in 2011.

The gain on sale of the first property amounted to £210,000.

Exempt as main residence

1996-2004	8 years (actual occupation)
2008-2011	3 years (last 3 years of ownership)
	11 years

Gain exempt - 11/15 x £210,000 = £154,000

The balance of the gain (£56,000) relates to the period from 2004 to 2008. The property was let during this period and had previously been Frank's main residence so that the letting exemption is available. Although the gain relating to this period amounts to £56,000 the exemption for letting is limited to a maximum of £40,000.

Overall £194,000 of Frank's gain is exempt leaving £16,000 chargeable to tax and this is subject to the annual exemption so that any CGT bill will be minimal.

Periods of absence

Certain other periods of absence from your main residence may also qualify for CGT relief if say you have to leave your property to go and work elsewhere in the UK or abroad. The availability of the exemption depends on your circumstances and length of period of absence. Please talk to us if this is relevant for you. We would be happy to set out the rules as they apply to your particular situation.

Trusts

The exemption is also available where a property is owned by trustees and occupied by one of the beneficiaries as their main residence.

Until December 2003 it was possible to transfer a property you owned but which was not eligible for CGT main residence relief into a trust for say the benefit of your adult children. Any gain could be deferred using the gift relief provisions. One of your children could then live in the property as their main residence and on sale the exemption would have covered the entire gain.

HMRC decided that this technique was being used as a mechanism to avoid CGT and so blocked the possibility of combining gift relief with the main residence exemption in these circumstances.

How we can help

The main residence exemption continues to be one of the most valuable CGT reliefs. However the operation of the relief is not always straightforward nor its availability a foregone conclusion. Advance planning can help enormously in identifying potential issues and maximising the available relief. We can help with this. Please contact us if you have any questions arising from this factsheet or would like specific advice relevant to your personal circumstances.

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