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Capital gains tax: relief on disposal of private residence

Finance Bill 2019-20

Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 The CIOT comments on Clause 1 Capital gains tax: relief on disposal of private residence [published for consultation on 11 July 2019](#).
- 1.2 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2 Legislating ESC D21: Clause 1(2) (a) inserting TCGA 1992 section 222(5A)

- 2.1 New subsection (5A) applies where an individual has failed to make a nomination stating which of two or more residences is their main residence within the statutory time limit of two years, and is intended to legislate ESC D21.
- 2.2 New (5A) provides:

‘(5A) A notice under subsection 5(a) determining which of 2 or more residences is an individual’s main residence for any period (‘the period concerned’) may be given more than 2 years from the beginning of the period concerned if -

‘(a) the individual has not at any time previously given a notice under subsection (5)(a) (whether in respect of the period concerned or any other period), and

(b) the individual has not at any time during the period concerned held an interest of more than negligible market value in more than one of the residences’
- 2.3 Condition (a) precludes a ‘late’ notice being given if the taxpayer has previously made an election within the statutory time limit at any time in respect of an entirely different set of properties and circumstances, possibly many decades ago. This condition goes beyond the terms of ESC D21 that required only that the individual

was unaware that a nomination could be made. A previous timely election may have been on the advice of an agent and in different circumstances (for example, where two properties were owned rather than one being of negligible capital value).

- 2.4 A further example of a situation where ESC D21 applies currently but new subsection (5A), as drafted may not, is where an overseas assignee owns a main residence in the UK and rents more than one property abroad while on assignment. The assignee is unaware that a nomination should be made. On becoming aware, the assignee wishes to make a late nomination. For example, assume that the assignee rents property A for two years and then rents property B for six years before returning home and moving back into his old home. At present, under D21, the assignee could submit two late nominations under ESC D21, one for the first two years and one for the subsequent six years (separate combinations of residences, therefore separate nominations required). Currently the timing and order does not matter provided that both are done in a reasonable time. However, as drafted, new section 222(5A) allows for only one late election. Would HMRC accept a simultaneous nomination for both properties A and B in these circumstances?

Although it may be reasonable to expect a late nomination to be required only once as once made, awareness of the need for it might be reasonably assumed, this example illustrates a fairly commonplace scenario that would have been within ESC D21 but may be precluded under section 222(5A).

- 2.5 In the context of overseas assignees, the nature of employer-provided accommodation for the purposes of section 222 is an area of current uncertainty. However, at present the position can be resolved by ESC D21. It is fairly common for an employer to provide accommodation to an overseas employee for the first couple of years of an assignment. The employee may then move into privately rented accommodation. Members report cases of misunderstandings over the nature of the interest held by the assignee in the employer-provided accommodation. In some cases, that interest may fall outside section 222 as a mere licence to occupy. In other cases, the assignee may hold a tenancy and therefore a late nomination may be required. Currently misunderstandings on the nature of employer-provided accommodation, resulting in missed timely nominations, are easily remedied using ESC D21 currently even if a late nomination for a later period in a privately rented accommodation had been made in the interim. These practical difficulties, currently mitigated by ESC D21, will not be addressed by the draft legislation.
- 2.6 A further area of uncertainty in relation to overseas assignees that is currently pragmatically resolved by ESC D21, is the quality of permanence where an assignee takes on a short term tenancy. In such circumstances, although the assignee has an interest, it is not necessarily a residence as that requires permanence and expectation of continuity. If an assignee took the view that a short-term let was not sufficiently permanent to constitute a residence, the assignee may conclude that there is no need for a nomination for that period of occupation. However, if this view is subsequently challenged, ESC D21 potentially provides a remedy via a late nomination. However, under the draft legislation it would not be possible to make a late nomination if a previous nomination had been made for another period in respect of a property that was clearly a second residence (rented or otherwise).
- 2.7 Paragraph 6.8 of the consultation stated that the intention was to legislate the concession in its present form. The framing of new sub-section (5A) does not appear to be wholly consistent with this intention and will not address common practical situations that were previously resolved under ESC D21.
- 2.8 Instead of legislating D21 in the form of the draft, our preferred approach, as set out in our consultation response, is to address the underlying practical issues by excluding the need to consider interests that have

no capital value (and therefore potential for a gain) when deciding which of two properties is a main residence for PRR.

- 2.9 An alternative that might be considered is to abolish the two-year time limit for a PRR nomination, and simply enable PRR nominations to be made following a disposal. This approach would have the advantages of aligning the position of UK residents with that of non-UK residents, who are not subject to the two-year time limit, removing the bear-traps for internationally mobile individuals who become/recommence UK residence after the time limit for making nominations has passed and, additionally, remove the various quirks around determining whether or not a nomination needs to be made and/or is in time.
- 2.10 To the extent that D21 is legislated, many of the practical issues identified above would be removed if the draft legislation followed the wording of the ESC more closely in providing for a late nomination ‘where the individual was unaware that such a nomination could be made’.

3 Clause 1(4) inserting new section 223ZA Amount of relief: individual’s residency delayed by certain events.

- 3.1 New section 223ZA is intended to legislate the terms of ESC D49. It is disappointing to note that section 223ZA(2) legislates the cliff-edge that we hoped would be avoided.

Paragraph 7.8 of our consultation response is reproduced below:

*Where there has been a delay in taking up residence due to the owner undertaking repairs or redecoration ESC D49 provides relief provided that the period of delay does not exceed twelve months (or a longer period of twenty-four months if there are good reasons for the delay). In the First-tier Tribunal decision of *McHugh v HMRC*, the tribunal judge rejected a strict application of the time limits that created a cliff edge such that ‘...a man who bought a plot of land and built a house upon it and moved into it after 364 days should be able to discount that period of time for capital gains tax purposes, whereas the man who took two days longer to build his house, loses the right to discount that entire 366-day period for capital gains tax purposes.’*

- 3.2 We note that section 223ZA(3) provides that:

‘(3) For the purposes of subsections (1) and (2) of section 223, as they have effect in relation to the gain, the dwelling-house or the part of the dwelling-house is to be treated as having been the individual’s only or main residence from the beginning of the individual’s period of ownership until the moving-in time.’

On the basis that the new sub-section refers only to section 223, it is purely a computational measure and the actual main residence for section 222 purposes should be unaffected. Therefore, the actual main residence that the person is living in while the renovation is taking place and the residence under renovation etc. may both qualify as the main residence at the same time (in the same way that the final period exemption does not interfere with relief on another property that happens to be the actual main residence at the time). However, ESC D49 was explicit on that point; ESC D49 concludes by saying that relief under the concession. ‘..will not affect any relief due on another qualifying property in respect of the same period’.

We suggest that it would add welcome clarity and avoid misunderstandings if that final sentence of ESC D49 is replicated in the legislation.

3.3 Are the qualifying events specified (completion of construction, renovation etc) and disposal of any other dwelling house intended to be alternatives? ESC D49 refers to arranging for alterations or redecorations or completing the necessary steps for disposing of a previous residence.

4 Clause 1(5) inserting new section 224A Part of private residence let out during period of ownership

4.1 New section 224A provides for the reformed letting relief replacing TCGA 1992 section 223(4) such that lettings relief only applies to those circumstances where the owner of the property shares occupancy.

4.2 Section 224A(2) sets out the conditions for the relief to apply:

‘(2) The condition is that –

(a) part of the dwelling house is the individual’s only or main residence, and

(b) another part of the dwelling house is being let out by the individual as residential accommodation otherwise than in the course of a trade or business.’

4.3 Paragraph 9 of the Explanatory Notes indicates that it is intended to apply where the owner shares occupancy **with a tenant**. (*Our emphasis*). This indication is consistent with the consultation. However, paragraph 10 of the Notes refers to shared occupation with another individual ‘who has no interest in the residence’. It is not entirely clear therefore whether or not the intention is that the new relief would be available for a tenant who would in fact have an interest (by virtue of the lease) in the residence.

4.4 The consultation made no reference to the qualification in (2)(b) that the letting out as residential accommodation must be ‘otherwise in the course of a trade or business’. Similarly, the Explanatory Notes do not consider this qualification.

4.5 To the extent that TCGA 1992 section 224 applies where there is exclusive use of the dwelling house or part for the purposes of a trade or business, the shared occupation restriction is otiose. The restriction would appear to apply only where there is business use of a room not used exclusively for the purposes of a trade or business.

4.6 We consider that the shared occupation restriction to non-business lettings will give rise to potentially difficult questions of fact as to what type of letting may constitute a business for these purposes and therefore lead to a denial of the relief. A trade is likely to be much easier to determine. We note that the Upper Tribunal case of *Elisabeth Moyne Ramsay v HMRC*¹ [2013] UKUT 0226 (TCC) considered the question of whether a residential property letting was a business for the purposes of TCGA 1992 section 162. The decision considers the meaning of business carried on by an individual in the capital gains tax context more generally. Mere passive receipt of rent would not normally be regarded as the carrying on of a business. The decision indicates that regard should be had to the factors referred to in *Customs and Excise Commissioners v Lord Fisher*² together with the degree of activity undertaken (in the sense that in order to constitute a business, the degree of activity must outweigh what might normally be expected to be carried out by a mere passive investor.) As the test depends largely on questions of fact, we are concerned it may be difficult to provide definitive guidance to assist ordinary taxpayers who need to apply the test to their particular circumstances.

¹ https://assets.publishing.service.gov.uk/media/5764f7cf40f0b652dd000060/Elisabeth_Moyne_Ramsay_v_HMRC.pdf

² [1981] STC 238

- 4.7 CG64702 indicates HMRC's view that, in relation to SP14/80, more than one lodger will lead to a restriction of private residence relief on the basis that 'A distinction was intended by the Statement of Practice between a person who takes a single lodger into their home and a person who is running a lodging house as a business. The relief available to the latter should be restricted.' HMRC have adopted the approach of treating more than one lodger as a business. Will this distinction be maintained by HMRC in the application of section 224A? If so, it would be helpful to set out the rationale clearly in guidance for the distinction so that taxpayers may apply it in other circumstances, for example, what would be HMRC's view on a couple being lodgers? It is not unusual where a room is being let to students or apprentices for there to be more than one lodger at the same time. Indeed, with overseas school pupils coming to the UK, this is often encouraged – is it intended that this would restrict the relief?

5 Acknowledgement of submission

- 5.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

6 The Chartered Institute of Taxation

- 6.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,700 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

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