The Chartered Institute of Taxation

Application and Professional Skills

Taxation of Individuals

November 2021

Suggested solution

REPORT FOR JACK CLARKE AND BETH ROBERTS

1 INTRODUCTION

We understand that you wish to buy a new home together which is funded by either the sale of The Old Rectory or otherwise by Beth's former home (22 Westland Road). In the first case, 22 Westland Road will be retained; in the second case, The Old Rectory will nevertheless be sold under the terms of Jack's separation contract, with £400,000 of Jack's share of the proceeds used to buy a further buy-to-let property. The remaining £50,000 would be invested in a savings account.

This report has been prepared on the basis of current tax rates and rules and using information provided at a meeting held on 30 October 2021. It is not intended to be relied upon by any third party.

2 EXECUTIVE SUMMARY

Jack will not be liable to Capital Gains Tax (CGT) on his share of the gain from the disposal of The Old Rectory, whenever it is sold. However, there will be CGT liability on Rebecca's share of this gain, 50% of which is payable by Jack under the separation contract. If The Old Rectory is sold in September 2022, we estimate Jack's 50% share of this liability to be £16,578. If the property is sold sooner, then the CGT liability will decrease slightly.

There will be an exposure to CGT of up to £5,889 if 22 Westland Road is sold under Option 2. This is because Beth will not be eligible for private residence relief (PRR) for the period during which the property is let, other than the final nine months of ownership. However, it may be possible to avoid this by waiting to get married and making a 'no gain no loss' transfer to Jack of 50% of the property prior to sale. Delaying the sale, however, will decrease the proportion of PRR available on the gain.

Higher rates of Stamp Duty Land Tax (SDLT) are payable when an individual buys an additional residential property and they are not replacing their main residence. However, it should be possible to avoid this in most situations and with careful planning. Under Option 2, there is a greater exposure to SDLT because there will be two transactions which attract the charge instead of one.

Assuming no increase in the property's value, Rebecca's CGT exposure on The Old Rectory will increase over time as the proportion of the gain which is eligible for PRR reduces. Rebecca will also receive the cash from the sale sooner if the property is sold sooner. It should therefore be in Rebecca's interest to agree to an early sale.

Overall, Option 1 will save both CGT and SDLT when compared with Option 2 (see Appendix 1). If Rebecca agrees to an early sale (the optimum outcome), the new property should be purchased either in Jack's sole name or after the date of marriage.

From an Income Tax perspective, Beth will be liable to the High Income Child Benefit Charge from 2020/21. Going forward, there are a number of options in order to reduce exposure to the charge (and the higher rate of tax) by any or a combination of the following:

- Making pension or Gift Aid contributions
- Managing levels of taxable profits, or incorporation
- 'No gain no loss' transfers of property after getting married in order to split rental profits between Jack and Beth.

In terms of the cash savings (under Option 2), you may wish to consider investing up to £40,000 of these in an ISA as the interest would then be tax-free. There is unlikely to be any Income Tax exposure on the remainder because of the personal savings allowance.

Inheritance Tax considerations should not impact the decision, but we recommend you take further advice to ensure best use of any nil-rate bands available on death transfers.

3 GENERAL COMMENTS

3.1 CGT on sale of The Old Rectory

Under the terms of the separation contract, other than by mutual agreement between Jack and Rebecca, the sale is not possible until the earlier of you getting married or Oscar reaching 18 years old. Oscar is currently only 15 years old and you plan to get married in September 2022, therefore the earliest opportunity for sale will be after you get married unless Jack is able to reach an agreement with Rebecca to sell the property sooner.

For Jack, the disposal will qualify for full private residence relief in respect of his share of the gain because it has been his main residence throughout the entire period of his ownership.

However, Rebecca will have ceased accrual of private residence relief from the point she moved out in March 2010, other than for the nine-month final period of ownership. The property stands at a gain of £400,000. If it is sold in September 2022, there will be a CGT exposure. Based on the Rebecca's estimate of her taxable income and gains in 2022/23, we calculate the potential CGT liability for Rebecca as £33,156, 50% of which is £16,578 (see Appendix 2).

If The Old Rectory is sold sooner than September 2022 under Option 1, then the proportion of the gain which is eligible for PRR will slightly increase and the CGT payable will be reduced, though not by any significant amount.

3.2 Sale of 22 Westland Road (Option 2 only)

Because 22 Westland Road has not been Beth's main residence throughout the entire period of ownership, there is also potential exposure to CGT for Beth on the sale of this property.

The property currently stands at a gain of £150,000. For illustration purposes we will assume that the property does not increase in value between now and the point of sale. If the property is sold, say, in two months' time, then it will have been owned a total of 6 years (72 months). Beth moved in with Jack in December 2019, which means that for the first 47 months of ownership, full PRR will be applicable. The last nine months of ownership of a property which has at some point been an individual's main residence will always qualify for relief, so this leaves 16 months during which the property was let.

Therefore, 16 out of 72 months' worth of the gain (£33,333) will be chargeable to CGT. Assuming Beth makes no other chargeable disposals in the year, we can deduct the annual exemption (£12,300) and the balance will be chargeable at either 18% to the extent it falls within her basic-rate band or otherwise 28% - though based on her current income, Beth does not have any basic rate band available. The CGT liability would therefore be between £3,786 and £5,889.

This will be the case regardless of whether the property is sold before or after Jack and Beth get married; though time may affect the market value of the property which will in turn affect the amount of CGT payable.

However, if the property is not sold until after the marriage, it will be possible to take advantage of provisions which allow transfer of assets between spouses at 'no gain no loss' with a view to take advantage any unused annual exemption which Jack has. As the sale of The Old Rectory is likely to be eligible for full PRR, this will mean that Jack has his full annual exemption available to offset against any gain. However, you will need to consider whether the tax saving of such a transfer, which will not attract any SDLT, will be worth any legal and professional costs. In addition, delaying the sale will decrease the proportion of PRR available on the gain.

3.3 Further PRR considerations

It is important to note that, depending on the future market value of the property (and the CGT rules at the time), there will be a CGT liability when 22 Westland Road is sold, assuming it is sold at some point in Beth's lifetime. It may be possible to mitigate exposure to this CGT by moving back into the property at some point or even choosing to move into it instead of buying a new property together.

This is because Beth will be eligible for a period of 'deemed occupation' of up to three years for any reason if she 'bookends' the period of absence with periods of actual occupation.

If you have two properties which you use as a residence between you, you should also be aware that married couples and civil partners are only eligible for one property at any one time which is to be treated as your main residence for PRR purposes. Making an election as to which property is your main residence may be a way of manging your future exposure to CGT.

For example, if you were to use 22 Westland Road as a residence for a period and elect for it to be your main residence, you would achieve the necessary 'bookend' and potentially save the CGT which relates to the 3-year period of deemed occupation. Such an election may, however, increase the CGT payable on the residence which would otherwise have been your main residence in the absence of the election. The election must be made within two years of a change in your combination of residences.

3.4 Stamp Duty Land Tax

A surcharge of 3% on top of the normal SDLT rates applies if you are buying a residential property in addition to one you already own and you are not replacing a main residence.

As an illustration, on a property of £450,000 the difference in the SDLT payable where the surcharge does and does not apply is £13,500 (see Appendix 3).

If the property you are buying replaces a main residence which has already been sold, the additional amount is not payable. If your previous main residence has not been sold at the point the new one has been purchased, you must still pay the surcharge. But if you subsequently sell your previous main home within 36 months, you can get a refund of the additional SDLT paid.

In the case of a joint purchase, the higher rate of SDLT applies to the whole transaction if it applies to any one purchaser. Note that, if a joint purchaser is replacing a main residence, they can qualify for the standard rates if the main residence which was sold was in fact owned by their spouse or civil partner.

<u>Option 1</u>

In this case, the higher rates of SDLT would apply if the property is purchased in joint names before the date of marriage. This is because of Beth's ownership of 22 Westland Road. Beth would not be considered to be replacing a main residence.

Otherwise, SDLT will only be payable at the standard rate (that is, £12,500 – see Appendix 3) because it will qualify as a replacement of a main residence. Unlike the situation above, if it is purchased in joint names after the date of marriage then Beth will be treated as replacing a main residence because of Jack's disposal of The Old Rectory. Alternatively, the new property could be purchased by Jack before the marriage and then 50% of that property could be gifted to Beth after marriage. Such a transfer would be treated as no-gain-no-loss for CGT purposes as well as exempt for Inheritance Tax purposes. There would also be no SDLT on the transfer given the absence of any consideration.

<u>Option 2</u>

<u>Purchase of property to be used a home</u>

Beth's property is not currently her main residence. However, for SDLT purposes it is only necessary for the property to be the individual's main residence *at any time* during the three-year period ending with the date of purchase of the new property.

Beth moved in with Jack in December 2019, so this three-year period expires in December 2022. Therefore, if Beth were to sell 22 Westland Road (Option 2) and buy another property in her sole name with the proceeds prior to the date of marriage, the additional rate of SDLT would not apply.

If such a transaction were to occur after the date of marriage but before December 2022, the higher rate of SDLT could again be avoided provided The Old Rectory had also been sold at the point of purchase (if otherwise it were sold within 36 months of the purchase of the new property, then a refund of the additional SDLT could be claimed).

If the transaction were to occur *after* December 2022 (and hence after getting married), then if it is not their only property at the point of purchase, the higher rate of SDLT could be avoided by virtue of the sale of The Old Rectory, provided this had been used as a main residence in the 36 months ending with the date of purchase of the new property.

Purchase of additional buy-to-let (see Appendix 4)

The purchase of a buy-to-let property for £400,000 using the sale proceeds from The Old Rectory will not attract the higher rates of SDLT if it occurs prior to the date of marriage and in Jack's sole name while he does not own another property. Rebecca would need to agree for an early sale for this to be possible. In this event the SDLT payable at the standard rates would be £10,000.

If the purchase occurs after the date of marriage, then the ownership of either 22 Westland Road or the new home would trigger the higher rates of SDLT. In this event, the total SDLT payable on this purchase would be £22,000.

3.5 CGT and SDLT – Recommendation

We recommend that Rebecca's agreement is sought to agree an early sale of The Old Rectory and then choosing Option 1. The new property should be purchased either in Jack's sole name or after the date of marriage. In this case, the exposure to CGT is minimised and no higher rates of SDLT will be payable. Even in the event that Rebecca does not agree to an early sale, Option 1 would still be better from a tax perspective, saving both CGT and SDLT when compared with Option 2 (see Appendix 1).

3.6 High Income Child Benefit Charge (HICBC)

We understand that Jack claims child benefit in respect of Oscar, currently equivalent to £1,094.60 per year (£21.05 for 52 weeks). Child benefit is a tax-free benefit, but a tax charge applies if either the claimant or their partner has adjusted net income in excess of £50,000 for a tax year. The charge is equal to 1% of the total child benefit received (during the period for which the claimant has a partner who exceeds the annual income threshold) for each £100 over £50,000. The charge applies to the partner with the higher adjusted net income, who may not necessarily be the claimant.

A 'partner' for HICBC purposes includes not only your spouse or civil partner (unless you are permanently separated) but also another individual with whom you are living with as a spouse or civil partner. Therefore, Beth is treated as Jack's partner for HICBC purposes and has been since December 2019.

Although Jack's total income is less than the £50,000 threshold, once the rental profits are added to Beth's profits from self-employment, the threshold is exceeded for the 2020/21 tax year. However, for 2019/20, liability to the charge may have been avoided: based on the figures provided her total taxable income for 2019/20 would have been around £49,667 (£47,000 plus £8,000 * 4/12). We recommend the figures on the 2019/20 Self Assessment tax return are reviewed accordingly.

The child benefit payments from December 2019 will be used to calculate the charge using Beth's annual income. This is illustrated in Appendix 5 for 2020/21, for which year the charge is £557.

'Adjusted net income' means your total taxable income less certain deductions, including gross pension contributions and Gift Aid payments.

Therefore, Beth could choose instead to make payments to a pension scheme or to charity in order to mitigate or eliminate the charge. This would save exposure to both the HICBC and the higher rate of

tax (40%). If necessary, the £50,000 cash savings (if Option 2 were chosen) could be used to make such contributions, if Jack were to gift some or all of these to Beth.

As Beth is self-employed, she may have a limited degree of flexibility in how her profits are calculated or otherwise taxed – for example, in claiming relief for expenses, capital allowances or losses. She may also consider incorporating her business so that she can manage the extraction of profits to ensure that the HICBC and higher-rate threshold is not exceeded. However, it should be noted that the decision to incorporate a business should involve further consideration of the wider legal and cost implications.

Property income

It is also worth noting that any rental income will be taxed on the beneficial owner(s) of the property which is let. Furthermore, as it is possible to make transfers between spouses or civil partners at 'no gain no loss' for CGT purposes (such a transfer may be made free of SDLT and, incidentally, Inheritance Tax), you can thus manage which party is taxed on the rental profits.

Thus, the rental income from 22 Westland Road is currently taxable on Beth but the property may be transferred at 'no gain no loss' to Jack after the date of marriage such that the rental profits will be taxed on Jack instead. This would mean that tax would be paid at the basic rate rather than a mix of the basic rate and higher rate, and exposure to the HICBC could be avoided.

Alternatively, 22 Westland Road could be put into joint names. If this were done before the date of marriage, although there would be no SDLT if there were no consideration, CGT would apply on the transfer, so this is not advised. If it is done after the date of marriage, the rental profits would be taxed 50:50 unless an election were made to be taxed in accordance with beneficial entitlement, if this were different. Making such a transfer will not affect the analysis at 3.4. You might arrange a split of beneficial entitlement that would mean you each avoid higher-rate tax and the HICBC.

Under Option 2, similar planning could be undertaken in relation to the buy-to-let property.

3.7 Cash savings (Option 2 only)

The cash savings under Option 2 may be invested in an ISA account, interest paid on which is tax-free. However, there is an annual subscription limit of £20,000 to an ISA. It is not possible to have a joint ISA account, but each of you may open such an account so that a total amount of £40,000 can be invested in one tax year.

The balance may be invested in another savings account, which is very unlikely to generate sufficient interest to create an Income Tax liability owing to the personal savings allowance (which is a nil rate band applicable to the first £1,000 of savings income for basic-rate taxpayers, or £500 for higher-rate taxpayers).

3.8 Inheritance Tax

For IHT purposes, either Option will result in you owning a main residence and a buy-to-let property, and a combined wealth of approximately £900,000. The IHT position will therefore not impact on your decision. However, it will be beneficial to ensure the ownership structure and your Wills allow you to take advantage of the nil-rate bands available.

In general, IHT is payable at 40% on the value of the estate above the nil-rate band (NRB), currently £325,000. An additional Residence Nil Rate Band (RNRB) of up to £175,000 is potentially available where you leave your home to your children or grandchildren (or other lineal descendant) and your estate is worth less than £2 million. No IHT is payable on transfers to spouses on death and the surviving spouse can inherit any unused NRB or RNRB. A couple could therefore pass on up to £1 million tax free if their affairs are structured appropriately.

A detailed consideration of IHT is outside of scope of this report and we recommend you seek further advice on IHT, if required.

Appendix 1: CGT and SDLT summary (figures are illustrative only)

	Option 1		Option 2	
	Pre-marriage	Post-marriage	Pre-marriage	Post-marriage
CGT (on The Old Rectory, Jack's 50% share of Rebecca's liability)	£16,307*†	£16,578	£16,307*†	£16,578
CGT (on 22 Westland Road)	N/A	N/A	£3,786 to £5,889	Potentially nil
SDLT	£12,500*	£12,500	On new home: £12,500 or £26,000 On buy-to-let: £10,000* or £22,000	On new home: £12,500 or £26,000 On buy-to-let: £22,000

* if Rebecca agrees to an early sale of The Old Rectory and new home purchased in Jack's sole name
† assuming sale in March 2022

Appendix 2: Calculation of estimated CGT payable on the disposal of The Old Rectory, assuming a sale in September 2022

	£	£
Proceeds (50% share of £900,000)		450,000
Cost (50% share of £500,000)		(250,000)
Gain		200,000
PRR (69/210 months)		(65,714)
Chargeable gain		134,286
Annual Exempt Amount		(12,300)
Taxable gain		121,986
Higher-rate threshold	50,000	
Total taxable income	(40,000)	
Basic rate band available	10,000	
	10,000 at 18%	1,800
	111,986 at 28%	31,356
Total CGT liability		£33,156
50% share payable by Jack		£16,578

Appendix 3: Comparison of SDLT rates on new home purchased for £450,000

Price band	Standard rate of SDLT	Higher rate of SDLT	SDLT (at the standard rate) £	SDLT (at the higher rate) £
£0 to £125,000	0%	3%	0	3,750
£125,001 to £250,000	2%	5%	2,500	6,250
£250,001 to £450,000	5%	8%	10,000	16,000
			£12,500	£26,000
			Difference:	£13,500

Appendix 4: Calculation of SDLT for buy-to-let property purchased at £400,000 (at higher rates)

Price band	Standard rate of SDLT	Higher rate of SDLT	SDLT (at the standard rate) £	SDLT (at the higher rate) £
£0 to £125,000	0%	3%	0	3,750
£125,001 to £250,000	2%	5%	2,500	6,250
£250,001 to £400,000	5%	8%	7,500	12,000
			£10,000	£22,000

Appendix 5: Calculation of HICBC for 2020/21

	£
Taxable profits	47,000
Rental profits	8,000
Total adjusted net income	55,000
Child benefit received (£21.05 for 53 weeks)	1,115.65
Excess income above threshold	£5,000
HICBC as percentage of child benefit received	50%
HICBC (rounded down)	£557