Draft Finance Bill 2019-20—changes to Principal Private Residence relief and lettings relief

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Private Client analysis: Courtney Halifax, tax manager at Mercer & Hole, examines the potential impact of the forthcoming changes to capital gains tax (CGT) Principal Private Residence (PPR) relief and lettings relief for divorcing or separating couples under the draft Finance Bill 2019-20.

What is the background to these changes?

Currently, PPR relief provides a time apportioned exemption from CGT for any periods during which a property was occupied as the seller's main home, as well as the final 18 months of ownership.

Any part of a property which is used exclusively for business or is let out (except under the rent-a-room scheme), will not be covered by PPR relief. In the latter circumstances, provided the property has at some time been the seller's main home, lettings relief exempts any chargeable gains relating to the let period on a time apportionment basis. This is subject to a maximum available relief of £40,000 (or the value of PPR relief available if lower).

Originally lettings relief was introduced to encourage people to rent out unused spaces in their homes; while the original intention of the final period PPR exemption was to ensure taxpayers did not incur a tax liability when selling their former home if there was a short overlap period in buying a new home.

Since introduction, the legislation has also provided individuals the opportunity to accrue CGT relief on multiple properties. As a result, the relief has been used by some individuals who occupy multiple properties for short periods of time in a bid to minimise their CGT liabilities on future sales. It appears that these unintended tax advantages provided to landlords as a result of these reliefs has resulted in the introduction of measures aimed to 'better target the ancillary reliefs…at owner occupiers'.

What is the current position relating to the availability of PPR relief and lettings relief where a married couple or civil partners separate?

For CGT purposes, a married couple cease to be treated as such with effect from the end of the tax year in which separation takes place. This means that from 6 April 2020, following the couple's separation, they are unable to benefit from CGT-free spousal transfers. From this date, any transfers between separated spouses will be deemed to take place at open market value until the divorce is finalised and decree absolute is issued.

Therefore, if transfers take place outside the tax year of separation, couples can be reliant solely on the final 18-month PPR exemption to ensure that no CGT liability arises on a sale or transfer of the former family home.

PPR relief can be extended beyond 18 months in the situation where one party disposes of their share in the property to the other party under a court order, or agreement made in contemplation of a permanent separation. In this situation, provided the transferee has continued to occupy the property as their main residence throughout the period since the transferor left the property, PPR relief will be extended from the date the transferor moved out of the property up until the date of the transfer. Although this additional PPR relief is available to mitigate the CGT on transferring the main home between parties in the course of divorce proceedings, this relief does not apply if the property is being sold to a third party.

If the separating couple also own investment properties which have at any time been occupied as their main homes, then it is currently possible for each individual to obtain a £40,000 reduction against the capital gain arising on transfer alongside PPR relief.

What are the proposed changes to PPR relief and lettings relief in the draft Finance Bill 2019-20?

The final period exemption for PPR relief is being reduced from 18 months to 9 months. The only exception to this will be if the owner has had to move out of the property into a residential care facility, in which case a 36-month exemption period will apply.

For lettings relief, an additional condition is being implemented which means that owners will only qualify for relief if they have occupied the property at the same time as their tenants, which will not be the case in the majority of circumstances. In many circumstances, this will result in a potential CGT increase of £11,200 per person (being the maximum lettings relief of £40,000 at 28%).

How could these changes affect separating couples?

The government advised in the draft Finance Bill 2019-20 consultation that despite the complications which come alongside divorce and relationship breakdown, they consider that the existing rules are appropriate to provide relief from CGT in most cases.

Where the family home is sold during the year of separation, the couple have continued to reside in a property together, or the property is transferred between spouses, this may well be the case. A common situation will however remain where one party has moved out of the family home more than nine months before a settlement agreement is reached and the property is sold to a third party after the tax year of separation. In this situation, a CGT liability is likely to arise for the non-occupying party.

In reaching a settlement agreement, the availability of PPR relief on the family home should not be assumed and it is important that consideration is given to any inherent CGT liabilities when determining asset divisions. The tax advantages of transferring the family home to the residing spouse before any sale should also be taken into account in determining the best asset split.

Further, it will no longer be possible for a transferor who has moved out of the family home following separation to claim PPR lettings relief under the new rules as they will not be occupying the property at the same time as their tenant.

When do the changes take effect and is there anything else separating couples should be made aware of?

The new rules are due to come into effect from 6 April 2020, with no grandfathering provisions for those property owners who are currently able to take advantage of PPR and lettings relief in its current form. Although draft legislation has been issued for review and comment, this has not yet made it into the statute and so there is a chance that things may change before the set implementation date of 6 April 2020.

It is also worth noting that with effect from 6 April 2020, a new 30-day payment and reporting limit is being introduced for the sale of UK residential property by UK resident individuals where full PPR relief does not apply, in line with the existing requirements for non-resident individuals.

Interviewed by Devon Marshall.

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