Capital gains tax planning

Tax changes to private residences for 2020/21.

From 6 April 2020, HMRC is proposing three significant changes which will potentially increase the capital gains tax paid on the disposal of any residential property by an individual.

These changes seek to raise extra revenue from the disposal of residential properties and to collect these taxes more quickly.

For many of the 1.2 million residential property disposals each year, there will be no liability having been occupied throughout the period of ownership as the owner's main residence.

If, however, you have a property which was once your main residence and you either let it out or have retained it for other reasons, these changes will affect you.

Working away, divorce or separation and other common issues could also see your entitlement to full private residence relief affected, meaning some of the rule changes could impact you.

If any of the above applies to you, these changes are likely to result in you having to pay significantly more capital gains tax if you sell or transfer these properties on or after 6 April 2020.

Letting relief

Since it was first introduced back in 1980, letting relief has been an extremely valuable tax break on the sale of a property that had been your main residence at some stage.

It allows any chargeable gain remaining after private residence relief to be reduced further by whichever is the lower of the amount of private residence relief already calculated, £40,000, or the chargeable gain made from letting your home (and not covered by the deemed occupation provisions).

Therefore up to an additional £40,000 of a gain is currently exempt from capital gains tax if you qualify for the relief.

This is even more valuable when you factor in that letting relief is available per owner and not just per property, so £80,000 of the proceeds from the sale of a co-owned property could potentially be exempt from capital gains tax.

For disposals made on or after 6 April 2020, HMRC is looking to limit the availability of letting relief by restricting it to those who share occupation of their house with a tenant.

Shared occupation applies where the owner lives in the same property as the tenant and the property is their only or main residence throughout the letting period.

This means that should you move out of the property and let it to a tenant, letting relief will no longer apply.

Final-period exemption

If a property has ever been your main residence, in most cases the last 18 months of ownership qualify for private residence relief and are exempt from tax – even if you live elsewhere.

From 6 April 2020, HMRC proposes to reduce this final period of exemption to nine months.

However, if you are moving into a care home or have a disability, you will still be able to claim private residence relief for the last 36 months of ownership.

30-day payment window

Capital gains tax is currently paid when you file your tax return through self-assessment, which is due on 31 January following the end of the tax year in which your property was disposed.

This could be anywhere between 10 and 22 months after the date of sale.

From 6 April 2020, anyone making a taxable gain from the sale of UK residential property will have to pay the tax owed within 30 days of the completion date.

This will be done by the submission of a 'residential property return' and the tax paid will be treated as a 'payment on account' of the capital gains tax for the tax year.

Estimates suggest that bringing the payment of capital gains tax forward on such disposals to 30 days will provide the Treasury with a one-off additional yield of between £5 billion and £8bn.

In calculating the tax due, you are able to offset capital losses already incurred at this point. You will also still need to include the disposal on your tax return.

The final capital gains tax liability will be calculated on disposal of all assets and any additional capital gains tax will be due, over and above any payments on account already made.

It is only at this point that you will be able to claim a refund for any overpayment of capital gains tax within the tax year.

Example in 2019/20

Tom bought a house for £400,000 on 5 April 2005 and wants to sell it for £700,000, potentially providing a net gain of £300,000.

He lived in the house for 10 years (120 months) and let the entire property for the remaining five years (60 months).

Private residence relief is available for the 120 months Tom lived there (two-thirds of the ownership period: 120/180 months).

This means that £200,000 of the gain will be exempt under this relief, leaving £100,000 potentially liable to capital gains tax.

If Tom sells the property on 5 April 2020, the final 18 months of ownership will be treated as deemed occupation and qualify for private residence relief, and so are exempt.

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This increases the private residence relief by £30,000 (18/180 months multiplied by £300,000) reducing the gain potentially liable to capital gains tax to £70,000.

As Tom also let the property, he will qualify for letting relief of £40,000, which is the lowest of:

- total private residence relief already calculated (£230,000)
- £40,000
- the chargeable gain made from letting your home (£70,000).

Tom's net chargeable gain remaining is £30,000.

Assuming he hasn't already used his annual capital gains tax allowance of £12,000 in 2019/20 and that he is a higher-rate taxpayer, he will pay capital gains tax at 28% on £18,000: £5,040.

This will be reported on his 2019/20 self-assessment tax return and the tax due will be payable by 31 January 2021.

Example in 2020/21

Compare this to the position if Tom were to sell the property one day later, on 6 April 2020.

Only the final nine months of ownership will be treated as deemed occupation and qualify for private residence relief.

This will halve the relief available under the previous scenario to £15,000, so the gain potentially liable to tax is £85,000.

As Tom was not in shared occupation with the tenant while he let the property, he has lost all entitlement to letting relief so the chargeable gain remains at £85,000.

With all other factors remaining, Tom will pay capital gains tax on £73,000 at 28%: £20,440. This gain will need to be reported to HMRC by 6 May 2020 and the tax paid over by that date.

The rule changes have increased Tom's tax liability by £15,400 and brought forward the payment date by nine months.

Planning opportunities

Forward planning can help mitigate the tax burden of legislative changes, even if they cannot be eliminated. Speaking to us will give you the best opportunity to utilise these opportunities.

In the coming months, things for you to consider include:

- if you are letting a property which was once your main residence, consider establishing what additional tax would be due if it were to be sold after 5 April 2020.
- if you are considering selling or gifting a property, establish which properties these changes are most likely to affect.
- consider disposing of any property or assets that may be affected by the tax changes before 5 April 2020.

- if you solely own a property and you have a spouse or civil partner, consider transferring the property to joint names prior to sale in order to utilise both annual allowances and potentially lower the rate of capital gains tax.

Contact us for capital gains tax planning advice.