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24 June 2019

Capital gains tax planning for sale of residential property that was previously your Main residence

The issue:

The Government has announced changes to the period of deemed PPR relief on disposal of properties that were previously the taxpayers' main residence. The deemed period will reduce from the last18 months of ownership to only 9 months after March 2020.

In addition to this, and what is of a greater impact to many tax payers, will be the withdrawal of Lettings relief for disposals made after March 2020. Lettings relief is a very useful relief as it applies to each owner of the property separately, not per property. This could mean the capital gain on a property is reduced by £80,000 if there are two beneficial owners of the property (as each could receive up to £40k lettings relief). So, a common scenario of both spouses holding a share in the property would mean £80k of relief is achieved.

Working through an example:

To see the potential benefit to your clients, it is useful to run through a few examples – please see Box 1:

BOX 1:
Bertie and Stacey are a married couple. They purchased their first home (a 2 bedroom flat) for £250k in August 2005. They started a family in 2013, and needed to move to a bigger property. They were in a fortunate position that they were able to retain their 2 bedroom flat property as an investment property, and rented it out as soon as they moved to their new home (August 2013) and purchased a 2nd property in August 2013 which they then moved into with their newly born twins. After speaking to their tax adviser in July 2019, they realised it would be good to sell their property now and they put their property on the market with an asking price of £490k. The property eventually sold for a price of £470k with exchange of contracts taking place in November 2019. The tax analysis is as follows:

Total ownership period = 172 months

property used as main residence = 96 months

total PPR available to claim (including deemed last 18 months) = 114 months

let period = 76 months

PPR proportion = 114/172 = 66.28%

Dividing the figures by two for each of the tax payers:

disposal proceeds (each)	= £235k
less acquisition cost (each)	= £120k
capital gain (each)	= £115k
less PPR relief (66.28%)	= £76.2k
capital gain after PPR	= £38.8k
less letting relief	= £38.8k
Remaining gain	= NIL

less letting relief (see note 1 below) =

maximum letting relief available is:

the lower of:

i) £40k
ii) remaining gain after PPR = £38.8k
iii) gain arising during let period = 76m/172m * £115k = £50.8k

so the lowest of these three is £38.8k.

in this situation there is no capital gains tax arising due to the availability of both letting relief and PPR.

However, should the property not sell in time, with a sale only taking place in May 2020, then the position is very different. This then leads to the position in Box 2:

BOX 2
Total ownership period = 172 months

property used as main residence = 96 months

total PPR available to claim (including deemed last 9 months) = 105 months

let period = 76 months

PPR proportion is now 105/172 = 0.610465

Capital Gain (as per Box 1)	= £115k
less PPR (61.05%)	= £70.2k
capital gain after PPR	= £44.8k
less AE (in 2020/21)	= £12.5k (estimate)
taxable gain	= £32.3k
assuming both in HRT (28% CGT)	= £9K tax charge

so in this example it gives rise to an additional £9k of tax for each of them = £18k.

The planning:

It will be important to inform your clients about these changes now. Many clients might already be considering disposal of part of their property portfolio in order to pay off some of their mortgages that have restricted mortgage relief. In these situations, there might be a choice as to which properties to dispose of, including a property that was at one time the principal private residence of the couple. See the following example in Box 3:

BOX 3:

Sunil (a higher rate taxpayer) has two properties that he lets out. Property A was previously his PPR, but Property B was purchased as a "buy to let" investment property. Both properties have relatively high mortgage to equity ratios which means that the return on the rental income (after paying the mortgage interest – with 75% of the finance cost only receiving a basic rate tax deduction in 2019-20) is very low at 1%. The position will worsen in 2020-21 when all 100% of the finance cost will be deductible at only basic rate band of tax such that both properties will become loss making. Sunil therefore decides to sell Property A now, so that he can benefit from the availability of lettings relief and therefore pay lower capital gains tax. The sale proceeds from Property A (after paying fees and repaying the mortgage on the property) can then be used to repay some of the mortgage on Property B, thereby turning this loss-making investment into a positive return.

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The opportunity for accountants & tax advisers:

This is a great opportunity to reach out to your clients, you might wish to send a mailing to all your clients, or you might know your clients well enough to send it out to a targeted sub-set of your clients who you know are renting out a property that used to be their principal private residence in the past. A difference in timing of the sale of just one month (e.g. between March 2020, or April 2020) could have a significant impact on the capital gains tax payable.

It might take a few months to arrange the sale of the property and it might be the case that your clients will want the property to have vacant possession in order to obtain the highest possible price on the disposal. So make sure you act now as the clock is ticking on losing this valuable relief.

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