



WING TIPS

Pay Less Capital Gains Tax When You Sell Your Second Home

Introduction

Most people know that they do not pay Capital Gains Tax ("CGT") when they sell their home. This is because of something known as Principal Private Residence ("PPR") relief. But what if you have more than one home? There are now significant numbers of people who have their main family home and also have a cottage by the sea or in the country or perhaps a villa in the sun or at a ski resort.

Not surprisingly, the tax rules allow for only one home to qualify for PPR relief and thus be exempt from CGT. In the absence of a claim to the contrary (which is discussed below), where there is more than one home it is the "main" home which qualifies for this exemption. It is a question of fact which is the main home and, for most people with two homes, there would be a fairly obvious family home at which they spent most of their time together with the holiday home in which they spent much less of their time. In these circumstances the main family home would qualify for PPR relief and there would be no relief available in respect of the holiday home. Furthermore, a husband and wife are allowed only one main residence between them for the purposes of the relief.

In a tax case many years ago, a publican in London who owned a holiday home in North Wales ended up with no tax relief at all. This is because the home in London was his main residence, but was not owned by him, whereas the home in North Wales was not his "main" residence and therefore attracted no relief. The publican should have taken advantage of an opportunity that is available to all individuals who have more than one home - to make an election for any one of several homes to be treated as though it were the main home. He could have elected for the home in North Wales to be treated as his main home (even though, as a matter of fact, he spent more time in London) whereupon any gain made on the sale of the home in North Wales would have qualified for PPR relief.

This same rule allowing an election to be made can be very useful for people who own more than one home. It becomes valuable when it is combined with another relief relating to private residences - what is known as the "three year rule".

Many years ago, the government recognised that people often had difficulty selling their home and might end up moving into a new home when the old one is still unsold.

There are very specific reliefs to deal with this situation where the move is made necessary as a result of a change in the circumstances of employment. However, there is also a general rule that, where a house has at some time been an individual's only or main residence, it will be treated for the purposes of PPR relief as if it had been the main residence throughout the last three years of ownership. Crucially, this general rule applies even where there is some other house which, in fact, has been the main residence over that three year period and thus qualifies for the PPR relief.

In summary, it is possible for two houses to qualify for PPR relief over the same period of time. This will be the case during a period when one of them is, in fact, the main residence and the other is in the last three years of ownership. So let's look at a case study which illustrates how this opportunity for tax saving actually works.

We will imagine Mr Wyse and Mr Knott, both of whom have lived in large family homes in different parts of Surrey for over twenty years. Each of them has a nice little holiday home in the Cotswolds, where they are next door neighbours at No. 1 and No. 2 Cherry Cottages. They bought the cottages at the same time in September 2001 and paid £100,000 each. Over the years they have both spent about the same amount of money on improvements to their holiday homes and they have a total cost price for tax purposes of £120,000. As a result of improvements to the road network, enhancements to local shops and restaurants and a general increase in property values these cottages are now worth £275,000 each. Both Mr Wyse and Mr Knott decide to sell up at the end of the summer in 2006 and use the net sale proceeds, after tax, for their daughters, both of whom are getting married in the autumn.

Mr Wyse spoke to his accountant at the time he bought No. 1 Cherry Cottages and he was advised to buy in the joint names of himself and his wife and to make an election jointly with his wife for the cottage to be treated as their main residence for four months in late 2001. He also spoke to his accountant when he started the process of selling in August 2006 and was advised to delay the sale for a couple of weeks so that he would have five full years of ownership.

When he had sold the cottage his accountant calculated his CGT liability at just under £7,500 (see below). His accountant added that, if the rules remain much the same, the effect on PPR for his Surrey home of making the election relating to the cottage would be zero, unless he and his wife make a gain of well over £2 million when they sell in a few years time on his retirement. After expenses of sale of £5,000 and CGT of £7,500 Mr Wyse has about £262,500 left. He uses all this money to buy his daughter a nice two-bedroom flat in London where he and his wife can stay overnight when they visit their daughter and son-in-law.

Mr Knott did not take any advice at any time. He bought the cottage in his own name, made no election, and sold it a few days before the fifth anniversary of his purchase. After the sale, he decided to ask his accountant to calculate his tax liability and was told he would have to pay just over £50,000 in CGT (see below). After allowing for this tax and the expenses of sale of £5,000 Mr Knott has about £220,000 left. He uses all the money to buy his daughter a nice flat in London, but he and his wife always have to drive home after a visit to their daughter and son-in-law because they could only afford to buy them a one-bedroom flat!

Mr Wyse	£	Mr Knott	£
Sale price	275,000	Sale price	275,000
Expenses of sale	<u>5,000</u>	Expenses of sale	<u>5,000</u>
Net proceeds	270,000	Net proceeds	270,000
Cost price	<u>120,000</u>	Cost price	<u>120,000</u>
Gain before PPR	150,000	Gain before PPR	150,000
PPR for 40 months out of a total of 60 months (2/3)	<u>100,000</u>	No PPR	-
Gain after PPR but before Taper	50,000	Gain after PPR but before taper	150,000
Taper relief after 5 full years is 15%	<u>7,500</u>	Taper relief after 4 full years is 10%	<u>15,000</u>
Chargeable gain before annual exemptions	42,500	Chargeable gain before annual exemption	135,000

	£		£
Mr Wyse	21,250	Mr Knott	135,000
Less annual exemption	<u>8,800</u>	Less annual exemption	<u>8,800</u>
Taxable	12,450	Taxable	<u>126,200</u>
Tax at 40%	4,980	Tax at 40%	<u>£50,480</u>

	£
Mrs Wyse	21,250
Less annual exemption	<u>8,800</u>
Taxable	12,450
Tax at 20%	2,490

Total tax **£7,470**

For further information on Pay Less Capital Gains Tax When You Sell Your Second Home , please contact Brian Williams at Vantis Tax plc on: +44 (0)20 7549 8053 visit www.vantisplc.com