PPR AND LETTING RELIEF

Julie Butler considers tax planning around residential property

Most family farms and landed estates contain a number of houses, cottages and converted farm buildings. It is normal for members of the family to move from property to property, to be forced to sell residences to help with farm finances, or to pass property to the next generation to help with the potential inheritance tax (IHT) burden.

Such transfers and disposals can give rise to capital gains tax (CGT) liabilities. Many farming families turn to 'principal private residence' relief (PPR) to help mitigate the CGT liability. It is tempting for those trying to use PPR to wash clean any potential CGT liability to stretch the rules with regard to permanence and evidence of occupation. Two recent cases – *Moore* v *HMRC* [2010] UKFTT 445 (TC) and *Metcalfe* v *HMRC* [2010] UKFTT 495 (TC) – have highlighted the need to be careful regarding the need to keep within the PPR legislation and guidance where there is a genuine change of residence, to ensure that this is evidenced. With the three-year (or 36-month) rule and letting relief, there can be important planning around short stays.

DEGREE OF PERMANENCE: QUALITY OF CONTEMPORANEOUS EVIDENCE

It might seem obvious to many that to achieve a PPR qualification there must be both intent to occupy and a degree of permanence, but these principles were recently tested in the courts. The cases are of particular relevance to the farming community, who move residence around the farming estate, and also at a generic level to all taxpayers who own more than one property.

Many in the tax industry report that the number of tax enquiries has reduced, but HMRC seems to have a huge appetite for detecting and debating apparent PPR abuse.

MOORE: THE NEED FOR QUALITY EVIDENCE

Mr Moore and his partner Miss A (now Mrs Moore) bought a house in 1999 with the intention of renovating and living in it.

Mr Moore was a plasterer and decorator and his father was a builder. Soon after finishing the works, Mr Moore and Miss A found that the neighbours were impossible to live near. As a result of these conditions, Miss A changed her mind and refused to consider moving to live in the property. They then decided jointly to let it out. The property was let until its disposal in 2004.

Mr Moore argued that only he was living at the property as his residence during the period from the completion of the works for about three months, and that as a result the property was his PPR and qualified for PPR relief for three years and three months of the ownership period, i.e. the three months' occupation and the three years after leaving the property that is allowed under the *Taxation of Chargeable Gains Act* (TCGA) 1992, with 'letting relief' covering the remainder of any gain. Mr Moore accepted that he had no documents to use as evidence. Mr Moore said that had he not been advised to keep any such documents and had not done so, and stressed that seven years had elapsed before HMRC opened its enquiry in 2007, and ten years had elapsed before the hearing took place. This clearly highlights the need to retain documentary evidence and to update important records relating to residence in a timely manner.

'HMRC SEEMS TO HAVE A HUGE APPETITE FOR DETECTING AND DEBATING APPARENT PPR ABUSE'

The decision of the Tribunal was that Mr Moore could not produce any supporting evidence for his claims that he planned to live in the property as his PPR. The conclusion from the evidence was that he occupied the property only to renovate it to a condition suitable for rental. Evidence was presented by HMRC that Mr Moore had repeated the scenario in another property three years later. The Tribunal agreed with HMRC that Mr Moore's occupation of the property 'did not have the quality that turned mere occupation of it into its being his residence'.

The Tribunal stated that Mr Moore's evidence was 'unreliable, vague and

sometimes inconsistent'. Mr Moore's appeal was dismissed. The case highlights the need for evidence to claim PPR and the need to prepare for a first-tier Tribunal in a strong manner on the part of both the client and the advisor. Farmers planning to claim PPR on farm property they reside in for a short while must retain quality evidence. Obviously, the strongest argument is the true facts of residence.

METCALFE: ESTABLISH PLACE OF RESIDENCE

Mr Metcalfe claimed to have moved into an apartment around November 2002, having acquired it 'off-plan' the previous month. The property came with carpets, fridge/freezer, cooker and washing machine, and Mr Metcalfe had purchased a bed. Mr Metcalfe did not install a landline telephone at the property as he had the use of the telephone at his place of work and used a personal mobile phone. A credit-card application in December 2002 was made from another address. An electricity bill had been provided by Mr Metcalfe, which showed a low level of electricity use over the winter months; Mr Metcalfe argued that the apartment was very warm and had double glazing, and he worked long shifts.

Mr Metcalfe stated that his partner had moved in with him, but after a short amount of time had moved out as she did not enjoy living in York, and the distance from her family was too far to travel. Mr Metcalfe sold the property in March 2003. He insisted that he had bought the apartment with the intention of living there permanently. However, after his partner left the property and he returned to work in Leeds, he changed his mind. Mr Metcalfe explained that he had made a number of 'technical errors' by failing to notify his bank and the Council of a change of address and stated that he had mistakenly assumed he would receive a council tax bill for his new premises in due course.

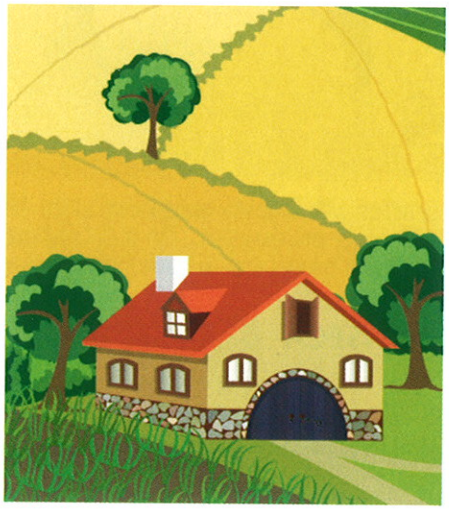
Without any other documentary evidence provided by Mr Metcalfe, HMRC argued that he had not established the property as his place of residence.

The Tribunal judges assessed the understanding of residence with regard to the quality of Mr Metcalfe's occupation of the apartment, balancing the degree of permanence, continuity and expectation of continuity of that occupation. The Tribunal found as a fact that Mr Metcalfe's written and oral evidence fell short of establishing that he had, in fact, ever resided at the apartment. The Tribunal was satisfied that Mr Metcalfe had, for a time, occupied the apartment as his dwelling house. The Tribunal did not accept that Mr Metcalfe had provided any evidence to show that the occupation had any degree of permanence and that it amounted to residence. The taxpayer's appeal was dismissed.

'*MOORE* V *HMRC* HIGHLIGHTS THE NEED FOR EVIDENCE TO CLAIM PPR'

LETTING RELIEF

Where a property has only been a principal private residence for part of the period of



ownership, and for another part has been let out, 'letting relief' is available. Letting relief is mentioned in *Moore* and helps with complex farm property CGT calculations where there are different PPR periods.

An example is where a taxpayer moves out of a property that has been their only or main residence for a number of years and lets the property before disposing of it at some time in the future. This may be longer than the three years allowed under the 36-month rule mentioned in *Moore*, so an apportionment would be needed to arrive at the taxable gain. Section 223(4) TCGA 1992 offers relief to the taxpayer. To qualify, the property (or part of the property) must have been occupied as the owner's only or main residence at some point during the period of ownership, and must be let as residential accommodation.

The amount of the relief is the lowest of:

- the amount of private residence relief given by s223(1)-(3) TCGA 1992
- (for disposals from 19 March 1991) GBP40,000, and
- the amount of the chargeable gain arising because of the letting.

The maximum relief is applied to each disposal that attracts private residence relief. For a couple, this could mean relief of two times GBP40,000, i.e. GBP80,000.

TWO RESIDENCES: THE IMPORTANCE OF THE NOMINATION/ELECTION

Where an individual owns more than one home, they may, within two years of acquiring a second, elect which is to be their main residence and hence be covered by PPR for CGT. Once made, the election may be varied at any time from a date that may be up to two years before the date of the second nomination. If such a nomination has not been made, then the question of which home is the main residence will be decided on the facts. In any event, once a nomination has been made, the final three years of ownership will qualify under the 36-month rule, and there are CGT-planning opportunities around this. HMRC has a large amount of guidance on the subject in its manuals.

PROOF OF RESIDENCE: MEETING HMRC REQUIREMENTS

The following are points HMRC has been known to look at with regard to proof of residence:

- At which residence is the individual registered to vote and how is it furnished?
- Where does the family (if any) spend its time?
- If the individual has children, where do they go to school?
- Where is the individual's place of work and where are they registered with a doctor and/or dentist?
- Which address is used for correspondence (e.g. for banks and building societies, credit cards, HMRC and car registration)?
- Which address is the main residence for council tax?

ACTION POINTS

PPR is a very effective tax relief to help mitigate CGT liabilities, especially with the current rate of 28 per cent, combined with letting relief, the 36-month rule and the second property election. It is important for farming families and taxpayers with more than one residence to plan who lives where and for how long in a tax-efficient way.

As these recent Tribunal cases show, HMRC does not take kindly to any form of apparent abuse of the relief, and it is experienced at asking the right questions in its desire to test the degree of permanence. Keep documents to make sure the answers to these questions are available.

Julie Butler is the author of *Tax Planning for Farm and Land Diversification* and *Equine Tax Planning*