

Spouses with houses

(Lectures P1051/ P1052/ P1053 – 14.11/ 18.35/ 13.43 minutes)

This article will look at principal private residence (PPR) relief and specifically at how the relief works in the context of a husband and wife. The article will review some general principles in relation to PPR relief and then look specifically at the following scenarios;

- Couples getting married and the impact it has for PPR relief in relation to their respective houses;
- Spouses “inheriting” PPR periods from each other on the transfer of a residence during lifetime and on death; and
- The effect of separation and divorce on PPR relief.

Statutory references in this article are to the Taxation of Chargeable Gains Act (TCGA) 1992.

References to married couples, husbands and wives and spouses also apply to civil partnerships and civil partners. References to marriage include the registration of a civil partnership. References to divorce include the dissolution of a civil partnership.

Some background rules...

Gains made on the disposal of a dwelling house (and its garden and grounds) that at some point had been occupied by the taxpayer as his only or main residence are eligible for PPR relief. Without delving too deeply into the intricacies of the rules, the relief is a percentage of the gain with the percentage determined by the ratio of occupation to ownership. “Occupation” can include some periods during which the taxpayer was absent from the property and will always include the final 18 months of ownership as long as the property has been occupied by the owner as a residence at some stage.

A taxpayer can normally have only one property at any given time which qualifies for PPR relief. Whilst the “final 18 months” rule means that two properties can be simultaneously exempt from CGT in this period, in general if an individual has two residences, gains accruing on one of them will be chargeable to CGT.

If a person has more than one property concurrently used as a residence, relief is given on the “main” residence determined as a question of fact. [S.222(1)(a)]. This is commonly (but not always) the property in which the taxpayer spends the majority of his time although the facts and circumstances of each case must be considered.

An individual can override this by nominating which of his dwelling houses is to be treated as the main residence for PPR purposes. [S.222(5)]. The nomination therefore allows a property which is not in fact being used as the main residence of the taxpayer to be the one which is eligible for PPR relief. Typically this is advantageous where the “second” home is standing at the largest gain or is most likely to appreciate in value. A dwelling house can only be validly nominated if it is, as a question of fact, being used by the taxpayer as a residence for at least some of the time. So a let property, for example, cannot be the subject of a nomination.

The nomination must be made within two years of acquiring a second residence. Each time there is a change in the individual's combination of residences, a new 2-year period begins thereby creating a new opportunity to make a nomination.

No return is required if a gain is fully covered by PPR relief (in this case the CG supplementary pages do not need to be completed). However in complex cases, taxpayers might consider it prudent to make at the very least a "white space" disclosure even where full PPR relief is considered to be available. This might offer protection against the possibility of a discovery assessment further down the line. If partial relief is available, the taxpayer should disclose the address of the property together with a computation of the gain or loss.

The effect of marriage on PPR relief

A married couple who are living together is treated as a single person for PPR relief and is only allowed one qualifying residence between them. [S.222(6)]. It is not possible for (say) a wife (W) to own the main home and for her husband (H) to own their second home and for both W and H to each then claim PPR relief on the disposal of their respective properties. For the period during which the couple were married, only one of the dwelling houses will be a qualifying property.

This puts spouses at a CGT disadvantage compared to unmarried couples who can each have their own qualifying residence. An unmarried couple can have two residences simultaneously qualifying for PPR if those properties are concurrently used as residences (even on a part-time basis). In this instance it is advisable for each party to make a S.222(5) nomination in respect of the property they own as this avoids any argument that the other property – ie, the one owned by their partner which they could be said to occupy under gratuitous licence – is in fact their main residence.

If, at the date of marriage, the two parties each own a residence and the couple thereafter continues to use both properties as residences, they can jointly nominate which of the properties is to be treated as their qualifying residence for PPR purposes. The two year period for making the nomination commences on the date of marriage.

The effect of marriage is therefore that one property ceases to qualify for PPR relief and becomes exposed to CGT. The final 18 months of ownership of the now exposed property will be eligible for PPR relief. A disposal of that property within 18 months of marriage will normally ensure that no chargeable gain will accrue.

Illustration 1

Andrew and Beth married on 1 December 2014. Andrew owned a house in Dorset (cost £500,000 on 1 May 1992) and a flat in London (cost £400,000 on 1 June 2012). He typically used the flat in London on 2 or 3 occasions during the week (depending on his work commitments). Andrew had made a valid nomination in September 2012 for the flat in London to be his main residence for PPR purposes (as this was considered the more likely property to yield a substantial gain). The election was stated to take effect from 1 June 2012.

Beth owns a house in Surrey in which she has always lived. After marriage the couple lived in Beth's house in Surrey. Andrew thereafter commuted from Surrey to London for work and ceased to use the London flat. The flat was redecorated then let to tenants from 1 June 2015. The couple continued to use the house in Dorset as a weekend retreat. Andrew sold the London flat on 1 December 2017 for £840,000 (net of selling costs).

Andrew's chargeable gain in 2017/18 is:

	£
Sale proceeds	840,000
Less: Base cost	<u>(400,000)</u>
Gain	440,000
Less: PPR relief £440,000 x 48/66	(320,000)
Less: Lettings relief £440,000 x 12/66 (capped at £40,000)	<u>(40,000)</u>
Chargeable gain	<u>80,000</u>

PPR relief:

	Qualifying	Non-Qualifying	Let
1 June 2012 – 1 December 2014	30		
1 December 2014 – 1 June 2016		18	12
1 June 2016 - 1 December 2017 (18m)	<u>18</u>	—	—
	48	18	12

The London flat ceased to be eligible for PPR relief from the date of the marriage. As it was not sold within 18 months of becoming a non-qualifying property, a chargeable gain accrued. This is partially alleviated by lettings relief that gives additional PPR relief if a property is let during a non-qualifying period. The chargeable gain may then be reduced by Andrew's annual exempt amount.

If Andrew has other chargeable gains in the year, it is advisable to use the annual exempt amount against the gain on the sale of the flat as this gain, being on a disposal of residential property, will be charged at the upper CGT rate of 28% (or 18% if Andrew does not pay income tax at the higher rate).

Transfers between spouses

Where a husband and wife are living together for any part of a tax year, transfers between them of chargeable assets in that year automatically take place at no-gain-no-loss. [S.58]. The effect of this provision is that the donee spouse inherits the historical CGT base cost of the donor spouse for the purposes of calculating a gain on a future disposal. The value of the asset at the date of the transfer is irrelevant and no formal valuation exercise is necessary.

A husband and wife are "living together" until they are separated in such circumstances that the separation is likely to be permanent. The no-gain-no-loss rule therefore applies until the end of the tax year in which the couple separates. A transfer of an asset after the end of the tax year in which separation occurs will generally take place at market value.

PPR relief on inter-spouse transfers

Even though the transferee spouse (H) takes over the historic base cost of the transferor spouse (W), it does not automatically follow that H also inherits W's PPR history. This depends on whether the provisions of S.222(7) are satisfied.

Under S.222(7)(a), if the husband and wife are living together and the property subject to the transfer is their only or main residence at the date of the transfer, for PPR purposes the donee spouse (H) is deemed to have acquired the part transferred at the date when it was acquired by the donor spouse (W). In addition, any periods during which W had occupied the property as her PPR are similarly deemed to be PPR periods for H. [S.222(7)(b).]

This is the case even if W had acquired the property before the date of the marriage. This means that if one party had a PPR prior to marriage and transferred all or part of that property to their spouse after marriage at a time when they were occupying the property as their main residence, the receiving spouse will inherit the PPR history of the transferor.

However, care must be taken as this rule only applies if the property transferred is the couple's only or main residence at the date of the transfer (note the use of the present tense). If this is not the case – for example, if the transfer is made between the spouses during a period in which they are living elsewhere - the donee spouse is deemed to have acquired his/her interest in the property at the date of the transfer. Any PPR entitlement for the donee from that point would then be based on his/her own occupation and the PPR history of the donor spouse falls away.

Note also that even if a donee spouse (H) inherits the PPR history of the donor spouse (W) by virtue of S.222(7), this does not automatically give H an entitlement to lettings relief for a period when the property was previously let by W. This is because S.223(4) permits lettings relief where a dwelling house "has at any time in his period of ownership been wholly or partly let BY HIM as residential accommodation" (author's capitalisation). In this instance, the property would not have been let by H, so even though H inherits W's PPR history, lettings relief would be denied.

This provision prevents spouses from potentially "doubling-up" lettings relief from £40,000 to £80,000 by means of an inter-spouse transfer immediately prior to the sale of the property. Transferring the property immediately prior to a period of letting would however give access to lettings relief for both spouses on a future disposal. Achieving £80,000 of residential lettings relief is therefore possible with careful planning.

Illustration 2

Kate bought a house in Leeds for £60,000 in June 2008. In June 2010 Kate married Luke and they lived together in the property owned by Kate. In June 2013 the couple moved to a rented house in Newcastle so that Luke could be nearer to his mother who was sick. After some repair and redecoration work, the house in Leeds was let to tenants from June 2014. In December 2014 Kate transferred a 50% interest in the house in Leeds to Luke. The house was worth £180,000 at that date.

Luke's mother has recently died and Kate and Luke are now considering their next move. The house in Leeds is still let but the current tenants have offered to buy the house for £250,000. Kate and Luke wish to know their CGT position assuming the offer is accepted and the sale is completed in December 2017. They have also asked if there is anything they can do to mitigate any liability.

Kate's chargeable gain will be as follows:

		£
Proceeds (50%)		125,000
Less: Cost (50%)		<u>(30,000)</u>
Gain		95,000
Less: PPR relief	£95,000 x 78/114	<u>(65,000)</u>
Less: Lettings relief	£95,000 x 24/114	<u>(20,000)</u>
Chargeable gain		<u>10,000</u>

PPR relief:

	Qualifying	Non-Qualifying	Let
June 2008 - June 2013	60		
June 2013 - June 2016		36	24
June 2016 - December 2017 (18m)	<u>18</u>	<u>—</u>	<u>—</u>
	78	36	24

The transfer of a 50% interest in December 2014 is a no-gain-no-loss transfer. Lettings relief is limited to the gain arising in the non-qualifying period during which the property was let (in this case June 2014 to June 2016 being 24 months). Luke's chargeable gain will be as follows:

	£
Proceeds (50%)	125,000
Less: Cost (50%)	<u>(30,000)</u>
Gain	95,000
Less: PPR relief	(Nil)

The house in Leeds was not the couple's main residence at the transfer date as they were then living in Newcastle. S.222(7) does not apply and does not therefore impute Kate's ownership period and PPR history to Luke's half share of the property. Luke is therefore deemed to have acquired his 50% share of the property in December 2014 for the purposes of calculating PPR relief. As there have been no actual periods of occupation of the Leeds house by Luke since he acquired an interest in the property in December 2014, there is no PPR relief in relation to his own gain. Note that even though Luke did actually occupy the property between June 2010 and June 2013, as he did not have an interest in the property before December 2014, this period of occupation will not have any bearing.

This problem can be partially alleviated if the couple reoccupies the house in Leeds as their main residence before a sale is completed. Whether residence is established is a question of fact. A minimum period of occupation is not specified and neither HMRC nor the Courts attempt to impose one. The term "residence" implies a degree of permanence, so as a question of fact the property must actually become their home.

It is the quality of occupation rather than length of occupation that determines whether a dwelling-house is the owner's residence.

If the Leeds property is in fact occupied as a home for (say) 6 months and the house is then sold in June 2018 (again for proceeds of £250,000 for comparative purposes), the chargeable gains would be as follows:

	Kate	Luke
	£	£
Proceeds	125,000	125,000
Less: Cost	<u>(30,000)</u>	<u>(30,000)</u>
Gain (as before)	95,000	95,000
Less: PPR relief (Kate) £95,000 x 114/120	(90,250)	
Less: Lettings relief (Kate) £95,000 x 6/120	(4,750)	
Less: PPR relief (Luke) £95,000 x 18/42		(40,714)
Less: Lettings relief (Luke) £95,000 x 24/42 (capped)	—	<u>(40,000)</u>
Chargeable gain	<u>Nil</u>	<u>14,286</u>

PPR relief (Kate):

	Qualifying	Non- Qualifying	Let
June 2008 - June 2013	60		
June 2013 - June 2016 (deemed occupation)	36		
June 2016 - December 2016		6	6
December 2016 - June 2018 (18m)	<u>18</u>	—	—
	114	6	6

The 3 year period of absence between June 2013 and June 2016 will qualify as deemed occupation for Kate under S.223(3)(a) because Kate had lived in the house before the absence and subsequently reoccupied the property as her main residence. The combination of PPR relief and lettings relief exempts the whole of her gain from CGT.

PPR relief (Luke):

	Qualifying	Non- Qualifying	Let
December 2014 - December 2016		24	24
December 2016 - June 2018 (18m)	<u>18</u>	—	—
	18	24	24

For PPR purposes, Luke is deemed to have acquired his share of the property in December 2014. As Luke does eventually occupy the property as his main residence, the final 18 months of ownership will qualify for PPR relief. This in turn triggers eligibility for lettings relief as the property had been let by Luke in the period since he acquired an interest in the property in December 2014. Lettings relief in this instance is capped at £40,000.

Kate and Luke's reoccupation of the house (even for a relatively short period) will therefore reduce their joint chargeable gains from £105,000 to £14,286. The CGT saving (potentially over £25,000) is possibly enough to justify the personal upheaval and inconvenience of moving into the house for a short period and the probable loss of a willing purchaser (giving that the tenants who have made the offer to buy would now be moving out).

Planning to avoid inheriting PPR periods

It can be advantageous for spouses to deliberately fail to satisfy the conditions of S.222(7) such that the donee spouse does not inherit the PPR history of the donor. If the inter-spouse transfer takes place just before the spouses reoccupy the property as their main residence, S.222(7)(a) would not then be satisfied as the property subject to the transfer was not at that time the couple's main residence. The donee spouse would therefore start to accrue PPR relief from the first day he/she occupies the property as their main residence and the previous unfavourable PPR history of the donor spouse would be permanently washed-out.

Illustration 3

Wendy bought a house in south Wales in March 1985 that she used as her main residence. In March 1986 she moved out of the house and into rented accommodation. The house in Wales was subsequently let as residential accommodation. In September 2017 Wendy married Harry. Harry is soon to start a job in Cardiff so the couple intends to return to live in Wendy's house in south Wales when the current tenancy expires in June 2018.

If Wendy retains the property, the period from March 1986 to March 2018 (32 years) will be a period of absence for PPR relief. It is possible for 3 years of this period to be treated as a period of deemed occupation, but 29 years would still be non-qualifying. Wendy will be entitled to lettings relief although this will be restricted to the PPR relief or £40,000 (whichever is lower).

If Wendy transfers the property to Harry after June 2018 – i.e. at a time when it is being used as the couple's main residence – Harry will inherit Wendy's PPR history (being 29 non-qualifying years). In addition Harry will not be entitled to lettings relief as the property was not let by him during this period (it was let by Wendy).

If Wendy transfers the house to Harry before June 2018 – ideally just before the couple occupies the house – Harry will not inherit Wendy's PPR history as the property would not be transferred at a time when it is the couple's main residence. Instead Harry's ownership period for PPR relief purposes starts at the date of the inter-spouse transfer and his PPR relief entitlement will be determined solely by his occupation of the property during his ownership. This acts to wash-out Wendy's long non-qualifying period for PPR and means that if the couple thereafter remains in occupation of the house until the date of sale (or until 18 months beforehand), no chargeable gain will arise.

PPR relief on non-spousal transfers

If an interest in a PPR is transferred between non-spouses – for example where the transfer takes place before marriage – the CGT implications are as follows.

The transfer does not take place at no-gain-no-loss. Instead, as this is not an arm's length transaction, the disposal will take place at market value. [S.17]. This is despite the parties not being "connected persons" for CGT purposes. "Market value" in this instance will be the discounted value of a part share in a property (as opposed to being a percentage of the whole). Discounts for part-shares can be substantial reflecting the difficulty in being able to sell a part of a house on the open market. While this reduces the chargeable gain for the transferor, it will in turn leave the transferee with a low CGT base cost.

No taxable gain is likely to arise for the transferor as PPR relief will apply (assuming full occupation until the date of the transfer).

The transferee acquires his/her share of the property at market value (as computed for the transferor).

The transferee's PPR period will begin from the date of the transfer and cannot be backdated (S.222(7) does not apply to non-spousal transfers).

Inter-spouse transfers on death

The principle of the transferee spouse taking-over the PPR history of the transferor spouse also applies if a residence passes from one to the other on death. The couple must have been living together and the residence must have been their only or main residence before the death of the transferring spouse.

The only difference is that the transfer on death does not take place at no-gain-no-loss. Instead the transferee spouse will inherit the property with a base cost equal to its probate value. [S.62].

Illustration 4

Eric bought a house in June 1984 for £95,000 that he used as his residence. In March 1986 he married Freda and they lived in the house until Eric died in August 2015.

The house was valued at £850,000 for probate. Freda soon realised that the house was too big for her to manage on her own, so in September 2015 she moved in with her daughter. The house remained empty until it was sold in September 2017 for £950,000.

Freda's chargeable gain is:

	£
Sale proceeds	950,000
Less: Probate value	<u>(850,000)</u>
Gain	100,000
Less: PPR relief £100,000 x 393/399	<u>(98,496)</u>
Chargeable gain	<u>1,504</u>

PPR relief:

	Qualifying	Non- Qualifying
June 1984 - August 2015	374	
August 2015 - September 2015	1	
September 2015 - March 2016		6
March 2016 - September 2017 (last 18m)	<u>18</u>	-
	393	6

Note that even though the gain is calculated by reference to the probate value in August 2015, Freda is deemed to have acquired it in June 1984 for the purposes of calculating her PPR relief.

In some circumstances the application of this rule will not be to the advantage of the transferee. For example, assume a house passes from a wife (W) to her husband (H) on her death. Before W died the house was only used as the couple's only or main residence for part of her period of ownership. Following W's death, H occupies the house as his only residence. He sells it several years later.

The gain on the property is calculated by reference to the probate value and will be eligible for PPR relief. If we looked only at the use of the house during H's period of ownership, there would be full PPR relief and the gain arising would be fully exempt. However, when calculating H's PPR relief we must look back at the PPR history of W which H now inherits (whether he wants to or not!). In this case H will inherit a non-qualifying period which will restrict the PPR relief on the sale of the property. This rule cannot be disapplied.

Separation & divorce – effect on PPR relief

A husband and wife who are separated are no longer treated as a "single person" for PPR purposes (the "spousal unit" for PPR is typically broken when one spouse leaves the family home as this causes a separation likely to be permanent). Each party is thereafter entitled to PPR relief on their own main residences.

A previously non-qualifying property that is then occupied by one of the spouses (H) after the date of separation will duly become a qualifying property. If H only owns one property and uses that property as his main residence, no nomination is necessary as the property now being occupied by H becomes his PPR as a question of fact. However if, after the date of separation, H has more than one property available for him to use as a residence (and he concurrently resides in both) he is entitled to make a nomination. The 2 year time limit for nominating runs from the date of separation.

Separation (or more likely divorce) will often bring about the sale or transfer or all or part of a property which had at some point been the main residence of the divorcing parties. This will constitute a disposal by the party (or parties) giving up their interest(s).

In the event of a third-party disposal of a jointly-held property, the capital gain on each owner's share of the property should be computed and reported separately. The sale proceeds, costs of sale, costs of acquisition (including enhancement costs) and incidental expenses of acquisition should be divided between the parties in the ratio of their respective "equitable interests". This ratio is applied irrespective of which spouse actually received the proceeds or incurred the expenditure.

It is important to note that a person can have an "equitable interest" in a property even though he or she may not be the legal and/or registered owner. Case law has determined that if one person contributes towards the costs of acquiring the property or towards the mortgage payments without being a registered owner, he/she acquires an equitable interest in the home proportional to those contributions.

Therefore where a couple become permanently separated or divorced, it is important for them to establish what equitable interest each of them has in the matrimonial home as this will influence the CGT computations. This may be done by mutual agreement or it will be determined by the Courts. Where such an agreement is reached, both parties will be considered to have held their equitable interests in the home from the outset.

After one spouse has moved out of the matrimonial home, there may subsequently be a transfer of an interest in that residence as part of a settlement. The transfer may be ordered by the Court or may be voluntary. The transfer is a disposal for CGT purposes. The CGT treatment of the transfer depends on when the transfer takes place.

If the transfer takes place in the year of separation, the disposal takes place at no-gain-no-loss (as already discussed). If the transfer takes place between separation and divorce, the consideration for the disposal is deemed to be the market value of the interest transferred at the date of transfer (the parties still being connected persons for CGT by virtue of their legal marital relationship).

If the transfer takes place on or after the divorce (the decree absolute), the parties are no longer connected persons. HMRC normally then accepts that a subsequent sale of a property by one party to the other is a transaction at arm's length.

No deemed market value is therefore imputed and the disposal consideration is accepted as being the money (or money worth) changing hands.

However if the disposal between them is in pursuance of a Court Order, HMRC practice is to deem the disposal consideration to be equal to the market value of the asset at the date of disposal. This is because an order of the Court is not a "bargain" between the parties as it is the Court which decides the terms of the agreement, not the parties themselves. As such, the transaction cannot be a "bargain at arms' length" and S.17 therefore applies to impute market value. However, it should be borne in mind that the open market value of an interest in the matrimonial home is normally heavily discounted to take account of the rights of occupation of the spouse residing in the home under the Matrimonial Homes Act 1967 (so very often a substantial discount may be in order to reflect these rights). The basis of the valuation should be disclosed in the tax return and might thereafter be referred to the HMRC Valuation office.

Illustration 5

Gareth and Helen married in July 2002. In October 2002 they bought a house in Bristol, in joint names, for £162,000. The house was occupied as their main residence from October 2002 until they separated in April 2014 at which point Gareth left the marital home.

Helen continued to reside in the house after the separation. The couple divorced in June 2017. In September 2017 the Court ordered Gareth to transfer his half share in the matrimonial home to Helen. The interest was conveyed to her in October 2017.

The house was valued at £850,000 in October 2017 with a 50% interest in the property valued at £350,000 with vacant possession. HMRC Valuation Office accepted that the value of a 50% interest subject to Helen's rights of occupation would be £225,000.

Gareth's chargeable gain in October 2017 is as follows:

	£
Proceeds	225,000
Less: Cost	$1/2 \times £162,000$
	(81,000)
Gain	144,000
Less: PPR relief	$£144,000 \times 156/180$
	(125,800)
Chargeable gain	19,200

PPR relief:

	Qualifying	Non-Qualifying
October 2002 – April 2014	138	
April 2014 – April 2016		24
April 2016 - October 2017 (18m)	<u>18</u>	—
	156	24

Note here that there can be no argument put forward that during the 24 month non-qualifying period Gareth is letting his share of the house to Helen and is therefore entitled to residential lettings relief. Letting means granting the temporary possession and use of a property in consideration of rent or hire. Helen could not be said to be renting or hiring Gareth's share of the property and no consideration is paid.

The CGT charge can be mitigated in appropriate cases by S.225B (formerly ESC D6). S.225B allows the former matrimonial home to be treated as the only or main residence of the transferring spouse (Gareth) from the date his occupation ceased (April 2014) until the earlier of a) the date of transfer and b) the date on which the property ceased to be the only or main residence of the spouse to whom the property is transferred (Helen). The effect of a S.225B claim in this instance would be to treat the period from April 2014 to the date of the transfer to be a period of deemed occupation for Gareth thereby extinguishing his chargeable gain.

A S.225B claim can only be made if the departing spouse (Gareth) has not made an election for a different property to be his qualifying residence.

A S.225B claim may not therefore be beneficial if Gareth had acquired a property after the date of separation and that property is appreciating in value. Gareth may therefore choose to bear a small CGT liability in respect of his former matrimonial home in order to preserve full PPR relief on his new property.

S.225B claims are only possible if a transfer is made from one former spouse to another. The election is not available if the property is instead sold to a third party, even if sales proceeds are divided between the former spouses. The election is not available on transfers between unmarried couples.