

Delay occupying main residence

(Lecture P1103 – 13.41 minutes)

Judgment was given on 18 July 2018 in favour of the taxpayer (M) in the First-Tier Tribunal case of *McHugh v HMRC* (2018). This decision related to the availability of principal private residence relief and the interaction of the afore-mentioned relief with ESC D49.

The essential facts were straightforward. Between November 2004 and December 2007, M and his wife built themselves a new house. They then occupied this house as their main residence until September 2010 when the property was sold for £1,350,000 (which represented a substantial gain for M and his wife).

Neither M's tax return for 2010/11 nor his wife's contained any entry relevant to CGT. HMRC argued that they subsequently made a discovery that resulted in a CGT liability arising on the transaction above. This charge related to the operation of ESC D49.

ESC D49, which deals with the problem of short delays on the part of an owner in taking up occupation of a private residence and applies where an individual:

- has land on which he has a house built which he then uses as his only or main residence; and
- purchases an existing house and, before using it as his only or main residence, arranges for alterations or redecorations or (alternatively) completes the necessary steps for disposing of his previous residence.

In these circumstances, the period before the individual uses the house as his only or main residence will be treated as a period in which he so used it for the purposes of S223(1) and (2)(a) TCGA 1992, provided that this period is not more than one year. If there are good reasons for this period exceeding one year that are outside the individual's control, it will be extended up to a maximum of two years.

Where the individual does not use the house as his only or main residence within the period allowed, no relief will be given for the period before it is so used. Where relief is given under this concession, it will not affect any relief due on another qualifying property in respect of the same period.

M took the view that his share of the gain was entirely exempt from CGT (as was his wife's). HMRC contended that, because the construction work lasted for more than three years, ESC D49 was not in point and therefore a time-apportioned gain for the period from November 2004 to December 2007 was chargeable to tax.

The First-Tier Tribunal judges challenged HMRC's stance. Such a proposition was, they said, 'startling'. Using the example of an individual who cannot identify any good reasons for extending the relief period beyond 12 months, they argued that HMRC's interpretation penalised someone who took 366 days to renovate his newly-acquired house, whereas another individual, who spent only 364 days doing exactly the same work, would be able to backdate his relief starting-point.

It is perhaps worth reminding ourselves exactly why the concession came into being. The policy behind ESC D49 is to ensure that a landowner who has held a plot of land for, say, eight years cannot relieve the whole of the gain on an eventual sale simply because, at the end of the eight-year period, he obtained planning permission to build a dwelling which he then occupied as an only or main residence. There is a material difference between that situation and the position of an individual who purchases land on which to build a house, only to find that the process takes longer than expected because of, say, a shortage of funds.

The judges' verdict was that HMRC's example in Para CG65009 of the Capital Gains Manual was simply wrong and should be replaced. Their view was that the concession could obviously not be open-ended but that, where building or renovation work stretched over a longer time-frame than the 12-month (or, sometimes, 24-month) period allowed by the concession, relief was available for that additional specified period. The words 'provided that' in the second paragraph of ESC D49 could, they felt, be given more than one meaning. In M's case, HMRC had agreed that there were good grounds for the longer period to apply and so the First-Tier Tribunal reduced the chargeable gain from a 37-month time-apportionment to a more reasonable 13-month calculation.

It will be interesting to see whether HMRC do, in due course, rewrite that example! HMRC's attitude in this case reminded the speaker all too strongly of their similarly unrealistic standpoint in *Higgins v HMRC* (2017).

Contributed by Robert Jamieson

NOTE: The Higgins case has recently been heard in the Upper Tribunal and the decision has been reversed. Our analysis of this decision is discussed in a separate article.