

# No place like (a second) home

Second home owners are not well served by capital gains tax legislation, says **Michael Waterworth**

For capital gains tax (CGT) purposes houses are just like any other asset with the one important exemption that the gain on disposal of a person's principal private residence is not subject to CGT. This exemption applies to a dwelling-house—which might comprise more than one building—and a garden or grounds of up to half a hectare which is about one-and-a-quarter acres. Where the size and character of the house justify it, gardens or grounds in excess of that area may be exempted.

To attract the principal CGT exemption the property must have been the taxpayer's main residence and that connotes a "degree of permanence, continuity and the expectation of continuity" (see *Goodwin v Curtis* [1998] STC 475). A short stay will suffice to establish that a property is a main residence if a more permanent occupation was intended but prevented by changed circumstances but even occupation of reasonable duration will not do if the occupation was only intended as a "stop gap measure".

A husband and wife or two civil partners can only have one main residence between them for as long as they are living together and if they own separate residences when they marry or register a civil partnership they should elect which is to be their main residence within two years.

## ABSENCES AND LETTINGS

The exemption also applies where the property was the taxpayer's main residence throughout the period of ownership except for the last 36 months. This means that a sale within three years of the property ceasing to be a main residence will still be exempt.

Other absences do not prevent the exemption from applying provided the property is a main residence beforehand and afterwards. These are one or more periods of absence not exceeding three years altogether; any period when a person is employed abroad; and one

or more periods not exceeding four years altogether when the person is unable to occupy because of employment elsewhere.

There is a further and very useful exemption for residential lettings. Where a person moves out of all or a part of their main residence and lets it as residential accommodation an exemption of up to £40,000 may arise in respect of the gain attributable to the period of the letting and where there are joint owners each is entitled to this exemption on top of their individual exemptions.

## RATES AND EXEMPTIONS

For the year 2007–08 each individual has an exempt amount of £9,200 meaning that the first £9,200 of taxable gains from the disposal of all assets is exempt from CGT. In 2007–08 the rate at which CGT is paid is determined by reference to the highest rate at which a person pays income tax so a top rate taxpayer pays CGT at 40%. In the Pre Budget Report 2007 the chancellor announced a dramatic change to the rate at which CGT would be levied. Under draft legislation published on 24 January 2008 CGT will be charged at a flat rate of 18% from the year 2008–09 (except in limited cases).

## CGT AND SECOND HOMES

Where one house is used as a residence for most of the year and the other only for holidays or where one is a buy-to-let investment it will be obvious that one is the main residence but there are cases which are more difficult. For example, a person might spend every weekend in the family home in the country but sleep for three or four nights a week in a *pied-à-terre*. This can be resolved by making an election to HM Revenue & Customs within two years of the purchase of the second property.

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## IN BRIEF

- For capital gains tax (CGT) purposes houses are just like any other asset with the one important exemption that the gain on disposal of a person's principal private residence is not subject to CGT.
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tion described above only applies to a person's main residence and does not apply to a gain if the property was purchased wholly or partly for the purpose of realising a profit. A husband and wife cannot convert a second home into a second main residence by claiming one each and the lettings exemption does not apply to a property purchased solely for letting.

**"Those who are thinking of selling should consider whether it might be worthwhile waiting to do so"**

If a person's circumstances are right it is sometimes possible to juggle the exemptions by taking advantage of the rules that non-occupation during the last 36 months of ownership is discounted and that an election only needs to be made within two years of purchase. Somebody approaching retirement who buys a second home could elect to treat it as their main residence in the expectation that their former main residence will be sold within three years so that in practice the exemption applies to two properties for a short while.

The changes announced in October 2007 are also advantageous. Second home owners who would otherwise have been subject to CGT at 40% will benefit from the substantial reduction in the rate of CGT with effect from 6 April 2008 and those who are thinking of selling should also consider whether it might be worthwhile waiting to do so.

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