Using PPR to reduce Capital Gains Tax

By specialist property accountant Stephen Fay ACA

Many property investors have heard of 'Principal Private Residence' tax relief when selling a property – this is the relief that ensures that no capital gains tax is payable on the sale of a private home (residence). PPR is a key tax relief that investors should look to claim wherever possible, as tax bills on the sale of an investment property can be reduced hugely, or even eliminated altogether, using PPR relief.

This article looks at how PPR relief works, and provides details of recent test cases, and tax-planning tips for investors to consider.

Why is PPR important to landlords?

Most landlords 'break even' over the years in their rental accounts, assuming typical gearing levels and that all expenses, allowances, reliefs and claims are identified (and big 'if' for some landlords!). So, many property investors don't face significant tax bills until they come to sell their property – and on sale, capital gains tax can take a good chunk of the profit.

PPR is a powerful tax relief as it often allows a large portion of a capital gain to become tax-free – and unlike some CGT reliefs, this means complete avoidance rather than merely delaying the payment.

Another key point is that PPR (and PLR relief – see below) operates on a per person basis, meaning potentially double the tax saving - the significance of this point is often overlooked by investors and advisers.

How does PPR work?

Where a property is 'occupied' as a home, any capital gain will be exempt from CGT. By 'occupied', this includes:

- The actual period the property was occupied as a home
- Any non-occupation in the first 12months of ownership due to building / renovation works
- The last 3 years of ownership
- Periods spent overseas due to overseas employment
- Up to 4 years due to employment elsewhere in the UK

The total number of months 'occupied' is divided by the total number months of ownership, and that fraction is applied to the capital gain as the exempt portion of the gain.

In addition, for properties that are let, there is Private Lettings Relief (PLR) of up to £40k, per person.

Main residence elections – be careful!

Assuming that investors already have a home, a written 'election' to HMRC is necessary to designate a different property as a main residence. The election must be made within 2 years, which also allows future changes to be made to the election.

Given the power of PPR relief, HMRC inspectors are instructed not to confirm the validity of a main residence election. It is good practice, when filing the election, to enclose a duplicate election for return, requesting HMRC to acknowledge receipt by way of a date stamp. Receipt of an election does not mean acceptance by HMRC, so it is important to ensure that your accountant files the election correctly.

Proving a property was your home

A commonly-asked question by investors is 'how long do I need to live in a property for it to qualify as a private residence'? The answer is that it is all about the 'quality' of occupation i.e. about whether the property was demonstrably the taxpayer's home.

HMRC specifically refer to a case in their guides where a property was occupied for just a week, yet qualified as a PPR. However, in *Goodwin vs Curtis* (1998), the Court of Appeal held that five weeks occupation was insufficient for PPR qualification. Realistically, at least 3 months genuine occupation would be advisable.

Key evidence of occupation includes:

- Utility bills at the property – and, crucially that these reflect genuine ownership (see Dispute #1 below)
- Invoices for home insurance (on a home, not BTL, basis), phone bills, DVLA records, tax returns, credit reference agency records
- Council tax records & electoral roll details
- Non-BTL mortgage product & statements.

HMRC crackdown on abuse of PPR relief

HMRC have targeted PPR abuse by landlords as a key area to recover tax – since this is where most landlords make their main property profits. A Compliance Investigation Team has been formed to identify and challenge dodgy PPR claims, which are estimated to cost the Exchequer £120m per year.

A new computer system in the Valuation Office Agency in Worthing, East Sussex, is now able to cross-check CGT claims on tax returns against the Land Registry, bank records (showing large receipts), and Stamp Duty receipts by buyers.

Once a taxpayer has been selected for investigation, the system is then able to check credit reference agencies for mortgages held by the taxpayer, and immediate family, and can also check the NPSIS Housing Benefit database, for undisclosed rental income.

Some investors will continue to 'take their chances' with PPR claims – but with penalties of up to 100% of the tax due, plus the original tax and interest, getting caught can be painful.

Recent PPR test cases

The following test cases provide some insight into the practicalities of claiming PPR, and the level of proof required:

Dispute #1 - Short-term occupation

M Benford vs HMRC (2011) – Property sold at a £51k gain after 6 months 'occupation'. MB argued that the property was a second home due to a marriage breakdown, so PPR applied.

Result – rejected. Electric bills indicated the house was unoccupied, and MB had elected for the property to be exempt from council tax due to being empty.

Dispute #2 – Degree of permanence

A Metcalfe vs HMRC (2010) – Off-plan property sold at a profit after 'intending' to live at the property.

Result – rejected. AM did not install a fixed phone line or obtain a TV licence, gas bills showed improbably low usage over the Winter period, a credit card application had been made from another property during the 'occupation', Am could produce no bank statements or council tax bills at the address.

Dispute #3 – No intent to occupy

J Moore vs HMRC (2011) – A dilapidated property was bought and refurbished before letting and subsequent sale at a gain.

Result – rejected at appeal. HMRC were able to show that JM only lived in the property during the works, and the appeal court stated he provided 'unreliable, vague and sometimes inconsistent' evidence. What was also significant was that the case was brought by HMRC 7 years after the sale!

In summary ...

Claiming PPR requires careful planning to ensure that the facts of the case allow the claim – some investors are too cavalier about this crucial area of tax-planning. It is for the landlord to prove the PPR claim – not for HMRC to disprove it – a case of 'guilty unless proven innocent!'

The chances are that most landlords will sell their property many years after acquisition – and in the intervening years lose much of the evidence needed to claim the PPR relief. This is an area that requires multiple sources of corroborating evidence to be sure of success.

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