



HOME SWEET HOME - EXEMPT FROM CGT?

Everyone knows that a gain they make when selling their home is exempt from capital gains tax (CGT), but everyone is not always correct in this assumption. There are several ways in which CGT can be payable on the sale of your home, and this article concentrates on the way the exemption is withdrawn in cases where money has been spent “wholly or partly” with the motive of making a profit from the sale of your home.

When first read, the legislation seems to deny exemption to anyone who tries to improve their home – all the adverts for home improvements in the magazines emphasise that you will increase the value of your property, and when we buy a house, somewhere in the back of our minds there is the thought that one day we can sell it at a profit. If we lose the exemption for spending money on our home “partly” to make a gain on it, then who would ever be exempt?

Fortunately, HMRC do not see it that way. Their Capital Gains Manual says:

Anyone who buys a dwelling house is likely to hope that, in the fullness of time, they will make a gain on its disposal. One house may be chosen over another because its value is more likely to appreciate over time. These cases could be said to fall within the words of the statute but relief should not be restricted.

It would be unreasonable and restrictive to apply the legislation in this way. The subsection should only be taken to apply when the primary purpose of the acquisition, or of the expenditure, was an early disposal at a profit.

The legislation is generally invoked in one of three types of situation:

Pseudo Property Development

When I was an inspector of taxes, I came across a builder who was moving into run-down houses, doing them up, and selling them on, before moving into another derelict property, and so on. Because he only owned one property at a time, and genuinely lived in it while doing it up, he could not be taxed as a property developer, but we could and did refuse the CGT exemption even though the properties were clearly his main residences.

Enfranchisement

This refers to a leasehold tenant buying the freehold of his property from his landlord. Clearly, this greatly increases the value if his ownership, especially if the lease did not have long to run, and if he then sells the freehold shortly thereafter, HMRC may well question whether he has lost the exemption for a main residence.

Note that not all the gain will be taxable. Only the increase in value caused by the enfranchisement will be taxed, and from this can be deducted the cost of buying the freehold.

Partitions and Conversions

As a general rule, if you divide a large house up into flats, the sale proceeds from those flats will be greater than you could have got for the house as one unit. Some people manage to finance acquiring their property by converting part of it into a separate dwelling and selling this.

In these cases, the CGT exemption may well be lost, or rather restricted to the gain that would have occurred if the house had been sold as one unit.

But that's no reason....

Just because you may be liable to CGT is not a reason not to engage in any of the above activities. Even if you do pay some CGT, it will only be on the additional gain you make, and after paying CGT at 28% you will still have 72% of that gain in your pocket!

This article by James Bailey first appeared in Tax Insider magazine (www.taxinsider.co.uk)