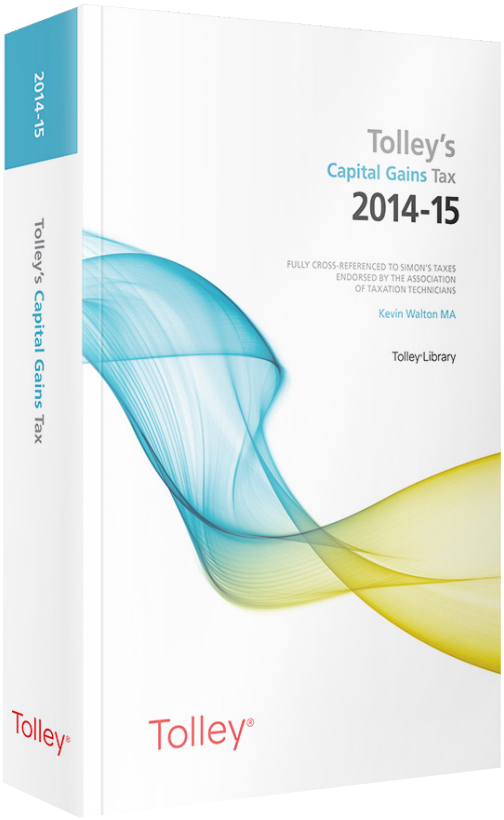
TOLLEY'S CAPITAL GAINS TAX 2014-15

Excerpt from Chapter 51: Private Residences



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EXEMPTION GENERALLY

[51.2]

Where a gain accrues to an individual so far as attributable to the disposal of, or of an interest in:

(a) a dwelling-house or part of a dwelling-house (see 51.3 below) which is, or has at any time in his period of ownership been, his only or main residence (see 51.4 below), or

(b) land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the 'permitted area' (see 51.5 below),

then either the whole or a fraction of the gain is exempt as below. [*TCGA 1992, s 222(1)*].

Any loss accruing is similarly treated as being wholly or partly a non-allowable loss. [*TCGA 1992, s 16(2)*].

Note that the exemption is *not* restricted to dwelling-houses situated in the UK.

In *Harte and another v HMRC* FTT, [2012] UKFTT 258 (TC); 2012 STI 2219, the taxpayer's occupation of a house for short periods of time whilst deciding whether to live in it permanently or to sell it was held not to amount to 'residence' for these purposes, so that the exemption could not be claimed. In *Moore v HMRC* FTT, [2013] UKFTT 433 (TC); 2013 STI 3371 the taxpayer's occupation of a house for several months after separating from his wife and before purchasing a house with his new partner, 'did not have any degree of permanence or expectation of continuity'. The taxpayer had never envisaged the house as a long-term home, so that his occupation of it did not constitute 'residence' for the purposes of the exemption. In *Gibson v HMRC* FTT, [2013] UKFTT 636 (TC) the taxpayer's camping on a site on which his previous dwelling-house had been situated during the building of a replacement house which he planned to sell was held not to be residence for the purposes of the exemption.

Spouses and civil partners

There can only be one main residence in the case of an individual and his spouse or civil partner living with him, so long as they are 'living together' (see 44.4 married persons and civil partners). [*TCGA 1992, s 222(6)*]. As regards separation or divorce, see 51.7 below.

Total exemption

Total exemption (under *TCGA 1992, s 223(1)*) applies to a gain within *TCGA 1992, s 222(1)* above if the dwelling-house or part of a dwelling-house has been the individual's only or main residence throughout the period of ownership, or throughout the period of ownership except for all or any part of the last 18 months of that period (36 months for disposals before 6 April 2014). A 36-month final period continues to apply to certain disposals by disabled persons and long-term residents in a care home (see further below).

Fractional exemption

Fractional exemption (under *TCGA 1992, s 223(2)*) applies where total exemption does not apply to a gain within *TCGA 1992, s 222(1)*. The fraction of the gain that is exempt is given by:

(i) the length of the part or parts of the period of ownership during which the dwelling-house (or part) was the individual's only or main residence, but inclusive of the last 18 months of the period of ownership in any event (36 months for certain disposals by disabled persons and long-term residents in a care home (see below) and for all disposals before 6 April 2014), divided by;

(ii) the length of the period of ownership.

Disposals by disabled persons or persons in care homes

For disposals by an individual on or after 6 April 2014, the final period of ownership that qualifies for exemption even where the dwelling-house was not then the only or main residence is extended from 18 months to 36 months where, at the time of the disposal:

(1) the individual is a 'disabled person' or a 'long-term resident' in a 'care home' and does not have any other right in a private residence (see below); or

(2) the individual's spouse or civil partner is a disabled person or a long-term resident in a care home and neither the individual nor the spouse or civil partner has any other right in a private residence.

'*Disabled person*' is defined for this purpose at *FA 2005, Sch 1A*. An individual is a '*long-term resident*' in a care home at the time of a disposal if at that time he is resident there and has been resident, or can reasonably be expected to be resident there, for at least three months. A '*care home*' is an establishment providing accommodation together with nursing or personal care.

An individual has any other right in a private residence at the time of a disposal if:

- at that time either he owns or holds an interest in a dwelling-house, or part of one, other than that on which the gain in question arises or the trustees of a settlement own or hold such an interest and the individual is entitled to occupy that dwelling-house or part under the settlement's terms; and
- a gain on the disposal of that dwelling-house or interest (or of part of it) at that time would have qualified for exemption, or would have qualified if an election under 51.9 below had been made.

Period of ownership

In considering 'period of ownership' for the purposes of the total or fractional exemption (but *not* for determining for the purposes of *TCGA 1992, s 222(1)* above whether the dwelling-house (or part) has at any time in the period of ownership been the only or main residence), any period before 31 March 1982 (6 April 1965 for disposals before 6 April 1988) is ignored.

See 51.7 below for certain periods of ownership that additionally qualify for the purposes of total and fractional exemption.

[TCGA 1992, s 223(1)(2)(5)–(7), s 225E; FA 2014, s 58].

Change in interest

Where the individual has had different interests at different times, the period of ownership is taken for the purposes of *TCGA 1992, ss 222–226* generally (i.e. all the provisions contained in this chapter) to begin from the first acquisition taken into account in arriving at the amount of the allowable expenditure deductible in the computation of the gain to which *TCGA 1992, s 222(1)* above applies. In the case of an individual living with his spouse or civil partner:

(A) if one disposes of, or of his interest in, the dwelling-house (or part) which is their only or main residence to the other, and in particular if it passes on death to the other as legatee, the other's period of ownership is treated as beginning with the beginning of the period of ownership of the one making the disposal, and

(B) if (A) above applies, but the dwelling-house (or part) was not the only or main residence of both throughout the period of ownership of the one making the disposal, account is taken of any part of that period during which it was his only or main residence as if it was also that of the other.

[*TCGA 1992, s 222(7)*].

Apportionments

For the purposes of *TCGA 1992, ss 222–226*, apportionments of consideration are to be made wherever required, and, in particular, where a person disposes of a dwelling-house only part of which is his only or main residence. [*TCGA 1992, s 222(10)*].

See 51.8 to 51.13 below for provisions supplementary to the above.

TCGA 1992, s 222(10) seems to override *TCGA 1992, s 52(4)* (apportionments to be on just and reasonable basis; see 16.5 computation of gains and losses) so that, because of the absence of the 'just and reasonable' criterion, there may be an argument that a different basis of apportionment may apply, e.g. where the residence and the permitted area of land block access to other land outside the permitted area but sold together with the residence etc. it may fall that the value of the other land should reflect the situation as if the two areas were in separate ownership (*Taxation* 7 December 1995 p 256).

Dwelling-house

[51.3]

An immobilised caravan with main services installed has been held to be a dwelling-house (*Makins v Elson* Ch D 1976, 51 TC 437) but one still on wheels and with no services installed was not so held (*Moore v Thompson* Ch D 1986, 61 TC 15).

A houseboat will often be an exempt asset in its own right (see 24.4 exemptions and reliefs regarding tangible movable wasting assets). If this is not the case, it may qualify as a dwelling-house if it is permanently located on a site and connected to all mains services. Such a houseboat *will* be regarded as a dwelling-house if it has been used as an immobile residence for a period of six months or more and has had its engines removed. Other cases will be considered on their merits. (HMRC Capital Gains Manual CG64328).

Green v CIR CS 1982, 56 TC 10 involved the disposal of a mansion (occupied by the taxpayer) and its two wings. The Commissioners' finding that the wings were not part of his dwelling-house was upheld.

In *Gibson v HMRC* FTT, [2013] UKFTT 636 (TC) the taxpayer knocked down an existing house and built a new house because it was cheaper than extending the house. The tribunal held that the two dwelling-houses could not be treated as the same dwelling-house for the purposes of the exemption.

Main residence

[51.4]

Where a taxpayer has more than one residence, the question as to which is the main residence is a question of fact, subject to the making of an election as in 51.9 below.

See *Frost v Feltham* Ch D 1980, 55 TC 10 (which concerned mortgage interest relief for income tax purposes). See also HMRC Capital Gains Manual CG64545 for factors which HMRC will consider in deciding if a residence is a main residence in the absence of an election.

In *Regan and anor v Revenue and Customs Comrs (No 2)* TC 2247 [2012] UKFTT 570 (TC) the First Tier Tribunal held that when considering the facts of what constitutes a main residence it should be determined based on the quality of the occupation not the quantity of the occupation.

The permitted area

[51.5]

The '*permitted area*' in 51.2(b) above means an area (inclusive of the house itself) of 0.5 hectares (i.e. 5,980 sq. yards or 5,000 sq. metres) or larger area if required for the reasonable enjoyment of the whole or part of the dwelling-house as a residence having regards to its size and character.

Where part of the land occupied with a residence is and part is not within 51.2(b) above, then (up to the permitted area) the part that is to be taken within 51.2(b) is that part which would be most suitable for occupation and enjoyment with the residence if the remainder were separately occupied.

[*TCGA 1992, s 222(2)–(4)*].

In *Varty v Lynes* Ch D 1976, 51 TC 419, the taxpayer owned and occupied a house and garden (together comprising an area less than one acre, the latter being the then 'maximum' permitted area subject to an appeal Commissioners' determination). He sold the house and part of the garden in June 1971. In May 1972, he sold at a substantial profit the rest of the garden for which he had meanwhile obtained planning permission. An assessment on the gain accruing on the disposal of the remainder of the garden was upheld. The exemption provided by 51.2(b) above related only to the actual moment of disposal of the land, and in relation to land formerly used as garden and grounds did not apply to a disposal subsequent to the disposal of the residence. HMRC apply this decision so that no relief is due on any sale of a garden taking place after a prior sale of the dwelling-house (Revenue Tax Bulletin August 1994 pp 148, 149 and see HMRC Capital Gains Manual CG64377–64385).

For a useful summary of the considerations made by HMRC in arriving at the 'permitted area' (and whether a subsidiary building forms part of the residence as a whole — see 51.6 below), see Revenue Tax Bulletin, February 1992, p 10. The Revenue made the point that land, other than that taken by the site of the dwelling-house, must be 'garden or grounds' at the time of sale if it is to be within the permitted area. In deciding whether an area of garden or grounds larger than 0.5 hectares is 'required for the reasonable enjoyment' of the dwelling-house as a residence, it considers the following words of Du Parcq J in the compulsory purchase case of *In Re Newhill Compulsory Purchase Order 1937, Payne's Application* KB 1937, [1938] 2 All ER 163 to be useful guidance:

> ' "Required", I think, in this Section does not mean merely that the occupiers of the house would like to have it, or that they would miss it if they lost it, or that anyone proposing to buy the house would think less of the house without it than he would if it was preserved to it. "Required" means, I suppose that without it there will be such a substantial deprivation of amenities or convenience that a real injury would be done to the property owner.'

In *Longson v Baker* Ch D 2000, 73 TC 415, in which a permitted area of 7.56 hectares was unsuccessfully claimed and in which the taxpayer stressed the equestrian aspect of the property, it was held that the reasonable enjoyment test is an objective one. It was not objectively *required*, in other words necessary, to keep horses at a house to enjoy it *as a residence*. An individual taxpayer may subjectively wish to do so but that was not the same thing.

It should be noted that HMRC considers that a separate disposal of part of the garden or grounds of a residence may be prima facie evidence that the part disposed of was not required for the reasonable enjoyment of the dwelling-house as a residence although this only becomes of relevance where the area of the garden or grounds exceeds 0.5 hectares. However, it accepts that there are two common circumstances where this inference may be incorrect. The first is where the owner of the land makes a disposal to a member of his family where he may be prepared to tolerate some curtailment of the reasonable enjoyment of the residence. The second is where financial necessity may force the owner to sell land which would be regarded as part of the most suitable area of garden or grounds to be included in the permitted area (HMRC Capital Gains Manual CG64832).

There is no requirement that the land occupied and used with the residence as garden or grounds at the time of disposal has to adjoin the land on which the dwelling-house stands. See *Wakeling v Pearce* (Sp C 32), [1995] SSCD 96 where the distance between the garden (which was disposed of) and the land including the dwelling-house (which was retained) was less than 10 metres. However, HMRC consider the facts of the case and the decision do not affect its interpretation of the underlying provisions and that it will be rare for exemption to be given to land (even if used as a garden) separated from the residence by other land which is not in the same ownership as the residence (see Revenue Tax Bulletin August 1995 p 239).

See *Taxation 5 January 1989, p 311* for a case where the Ombudsman considered the District Valuer to have been wrong in taking the view that the presence of a tennis court and swimming pool must be regarded as irrelevant in deciding what was the permitted area.

Subsidiary buildings

[51.6]

The courts have considered whether a building which is separate from the main dwelling-house building can fall within the exemption a number of times.

A lodge built for occupation rent-free by a caretaker/gardener and his wife, the housekeeper, and separated from the main house by the width of a tennis court (around nine yards) with the total area of land involved being around 1.1 acres, was held to be within the exemption (*Batey v Wakefield* CA 1981, 55 TC 550). A residence for exemption purposes was declared to be a dwelling-house and all of those buildings which are part and parcel of the whole, where each part is appurtenant to and occupied for the purposes of the building occupied by the taxpayer. However, this is a question of fact and degree.

In *Markey v Sanders* Ch D 1987, 60 TC 245, a finding by Commissioners that a staff bungalow situated 130 metres away from the main dwelling-house and screened from it by a belt of trees, formed part of the taxpayer's residence was not accepted by the Court. It was held that *Batey v Wakefield* laid down two tests:

(1) the occupation of the building must increase the taxpayer's enjoyment of the main dwelling-house; and

(2) the building must be 'very closely adjacent to' the main dwelling-house.

Each of these was held to be a necessary, but not by itself sufficient, test and in the present case the first test was satisfied but not the second. The total area of land involved was around twelve acres.

However, *Markey v Sanders* was expressly not followed in *Williams v Merrylees* Ch D 1987, 60 TC 297, so that a finding by Commissioners that a lodge situated 200 metres from the main dwelling-house formed part of the taxpayer's residence during his occupation of the latter was upheld. The total area of the property was around four acres. In the latter case doubt was expressed whether the *Batey v Wakefield* decision did require the satisfaction of two distinct conditions and it was concluded that all the circumstances should be looked at to see whether there is 'an entity which could sensibly be described as being a dwelling-house though split up into different buildings performing different functions'.

The *Williams v Merrylees* decision was itself disapproved by the Court of Appeal in *Lewis v Rook* CA 1992, 64 TC 567. A finding by Commissioners that a gardener's cottage some 170 metres from the main dwelling-house formed part of the taxpayer's residence was initially upheld in the High Court, but was rejected in the Court of Appeal. The true test was declared to be whether the cottage was 'within the

curtilage of, and appurtenant to [the main house], so as to be part of the entity which, together with [the main house], constituted the dwelling-house occupied by the taxpayer as her residence'.

The curtilage concept was derived from a non-tax case, *Methuen-Campbell v Walters* CA, [1979] QB 525 (and see also *Dyer v Dorset County Council* CA, [1989] QB 346), in which Buckley LJ stated that 'for one corporeal hereditament to fall within the curtilage of another, the former must be so intimately associated with the latter as to lead to the conclusion that the former in truth forms part and parcel of the latter'. The cottage in *Lewis v Rook* was not 'intimately associated' with the main house as it was some way off and separated from it by a large garden. The total area of land involved was around 10.5 acres and Balcombe LJ remarked that as

> 'the "permitted area" of garden and grounds which is exempt from capital gains tax is limited to one acre [now 0.5 hectares] or such larger area as the [Appeal] Commissioners may determine as required for the reasonable enjoyment of the dwelling-house as a residence, it does seem to me to be remarkable that a separate lodge or cottage which by any reasonable measurement must be outside the permitted area can nevertheless be part of the entity of the dwelling-house'.

HMRC consider that whether or not a particular building is within the curtilage of the main house is a matter of fact and degree. The building must be geographically close to the main house and be an integral part of it. However, as the necessary proximity required will vary in each case HMRC do not attempt to set a generally acceptable limit. Buildings within the curtilage of the main house will of necessity be 'appurtenant' to it. See HMRC Capital Gains Manual CG64245, 64255 for further discussion.

In *Honour v Norris* Ch D 1992, 64 TC 599, the taxpayer owned four separate, self-contained flats in a London square. Two of these were adjacent and were converted to form a single property, the other two being some way off and not adjacent to each other. Although the taxpayer and his wife had occasionally used the non-adjacent flats themselves, their main function was to provide sleeping accommodation for guests and a nanny. The Commissioners upheld the taxpayer's contention that one of the distant flats, which had been sold, was part of his main residence. However, the Revenue's appeal was upheld in the High Court, Vinelott J remarking that the proposition that the flat which had been sold formed part of the taxpayer's main residence was 'an affront to common sense'.