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Owning multiple properties

Understanding the impact of Capital Gains Tax when contemplating a sale

Understanding the implications of Capital Gains Tax (CGT) is crucial for those fortunate enough to own more than one property. This becomes particularly pertinent when contemplating the sale of one of these assets.

HM Revenue & Customs (HMRC) reporting takes centre stage for individuals intending to sell a residential property in the UK that isn't their primary residence. You can strategically plan your tax affairs to reduce your exposure by staying abreast of the prevailing regulations and available reliefs.

Decoding Capital Gains Tax

So, what exactly is CGT? Essentially, it's a tax levied on the profit made from selling or gifting a chargeable asset, which has appreciated in value since its acquisition. It's HMRC's method of ensuring that individuals pay their fair share on profits realised from asset sales.

When you dispose of a chargeable asset, a CGT assessment must be conducted for that particular tax year. Typically, it's determined as the difference between the sale proceeds and the original purchase price. For further guidance on calculating this, the HMRC website offers detailed instructions.

CGT Liability: Rates and reliefs

A CGT liability will be due to HMRC if a taxable gain is recorded. The specific rate of CGT hinges on the nature of the asset sold or gifted. For instance, residential property disposals are taxed at 18% or 28%, while non-residential properties (like shares) carry a rate of 10% or 20%. You can take advantage of certain CGT reliefs to lessen this liability, especially during business sales.

Understanding Capital Gains Tax on property

When selling your residential property, one crucial factor to consider is the potential financial gain and how it can be offset by Private Residence Relief (PRR). PRR is a form of Capital Gains Tax (CGT) relief that can exempt all or part of the financial gain from selling your 'primary residence'.

To qualify for full relief upon selling a residential property, the property must have been used as your primary residence throughout the ownership period. Regardless, the final nine months of ownership are covered by relief.

Nuances of Private Residence Relief

If your property hasn't served as your primary residence during the entire ownership period, PRR is proportioned based on actual and deemed occupation periods. Actual occupation refers to your time in the property as your main home.

There's no minimum time requirement for actual occupation, but a critical test would be whether an average observer would consider this your main residence.

Deemed occupation, on the other hand, applies when you're physically absent from the property yet still meet the necessary qualifying conditions for it to be considered your primary residence.

Conditions for claiming Private Residence Relief

Provided the qualifying deemed periods are preceded and followed by actual occupation, PRR can be claimed.

Here are some instances where deemed periods qualify for relief:

- Individuals working abroad for employment can claim relief regardless of the duration abroad.
- Those employed or self-employed but required to work elsewhere in the UK can claim up to a maximum of four years for deemed occupation.
- Any period of absence from the property, regardless of the reason, can claim relief for a maximum of three years.

For more insight on these conditions, visit the HMRC website.

Last nine months of ownership and Private Residence Relief

Another critical period that qualifies for PRR is the last nine months of ownership. This period can be claimed, provided the property has been your main home at some point during ownership. However, for disabled individuals or long-term care home residents selling their main home, this period is extended to 36 months.

Scope of Private Residence Relief

PRR conditions apply to properties with gardens and grounds within half a hectare. However, HMRC will allow claims exceeding this if the area is required for the 'reasonable enjoyment' of the property. Each claim needs to be assessed on an individual basis.

For spouses and registered civil partners living together, only one residence can qualify as the main residence at any time. If they own more than one residence, they may need to confirm to HMRC which of their properties is their main home.

Determining your main residence

Without a formal declaration, HMRC will determine your main residence based on factors such as:

- Where your family resides
- Your place of work
- Voter registration location
- Correspondence address with HMRC, medical practitioners and banks

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- Car registration address
- Location of your belongings
- Council Tax billing address

Exclusions from Private Residence Relief

PRR is unavailable on buy-to-let properties, business premises such as furnished holiday lets, land and inherited property not used as your main home.

For individuals residing abroad, separate rules apply, and specialist advice should be sought.

Lettings relief and Partial Private Residence Relief

In cases where you only receive partial PRR relief, you might be entitled to another CGT relief known as 'lettings relief'. This applies when you sell a home that once qualified as your main residence, and part of it was rented out while you lived there. However, letting relief no longer applies if the entire house was rented out for a period.

Understanding Capital Gains Tax on a second property

When determining CGT on a second property, the first step involves calculating your chargeable gain. You should deduct any capital losses incurred in the current tax year from this amount. If you have any capital losses from previous years, these can also be used to reduce the gain, but only to the extent of your CGT annual exempt amount.

The impact of time on your CGT Annual Exemption

Starting 6 April 2023, every individual is entitled to a CGT annual exemption of £6,000. However, this amount will decrease to £3,000 from 6 April 2024. Once you've determined your taxable gain or loss, you can work out your CGT liability and understand the necessary reporting requirements.

Navigating CGT rates and reporting requirements

The tax rates for capital gains on residential property and carried interest typically fall into two categories: 18% and 28%. The portion of taxable gain within your basic rate tax bracket will be taxed at 18%. Any gains exceeding this bracket will attract a CGT rate of 28%. Consequently, higher rate and additional rate taxpayers will face a 28% CGT on residential disposals.

Compliance for UK residents and non-residents

If you're a UK tax resident selling a UK residential property with a CGT liability, you must submit a '60 day' CGT return. This requirement was introduced on 6 April 2020, initially requiring submission and payment of tax within 30 days from the date of completion. But this timeframe has been extended to 60 days for disposals made on or after 27 October 2021. The CGT return is separate from the self-assessment tax return, meaning you may need to make two submissions for the year.

Rules for non-residents

CGT return requirements have been in place for non-residents selling UK residential property since 6 April 2015. Like UK residents, non-residents had a 30-day timeframe to submit their returns from 6 April 2020, which was later extended to 60 days for disposals made on or after 27 October 2021. However, non-residents must submit a CGT return irrespective of whether they have a liability to pay.

Calculating gains on older properties

Non-UK residents who owned UK residential property before 6 April 2015 should calculate their gain using the market value as of 5 April 2015, instead of the actual purchase cost. From 6 April 2019, non-UK residents are also subject to CGT on capital gains from direct or indirect disposals of all types of UK land and property, including interests in UK property-rich entities. Given these rules' complexity, seeking professional advice is advisable.

Exceptions to the rule

There are certain situations where you may not need to pay CGT on a second property. For example, suppose you transfer an interest in a property to your spouse or registered civil partner (from whom you're not separated). In that case, you won't incur any CGT liability due to specific CGT rules applicable to spouses and registered civil partners.

Relief options and planning

In some rare cases, dependent relative relief may be applicable on the sale of a residential property. This relief is subject to specific conditions and complexities, so it's worth seeking advice before making a claim. Discussing your situation with your accountant before selling a property could mitigate your tax liability.

Lettings relief and Partial Private Residence Relief

If you qualify for partial PRR relief, you may be entitled to an additional CGT relief known as 'lettings relief'. This applies when you sell a home that was at some point your primary residence, and part of the home was rented out while you occupied the property. However, lettings relief no longer applies if the entire dwelling was rented out for a period. ■

Are you contemplating buying a second property?

Pondering about securing a second home mortgage? There's no need to navigate these waters alone. We're here to guide you through every step of the way! Your dream second home is just a decision away. So, what are you waiting for? For more information, please speak to us.