cutting through complexity

Changes to Principal Private Residence relief

Principal Private Residence relief (PPR) from capital gains tax is to be restricted from April 2015 where a residence is located in a territory in which neither the taxpayer nor their spouse/civil partner (if applicable) is resident. A new day count test, which broadly requires the taxpayer (or their spouse/civil partner) to spend at least 90 nights at the residence or certain other residences in the same territory in order for it to be eligible for the relief, will be introduced.

Who should read this?

UK and non-UK resident taxpayers (including trustees and personal representatives of a deceased person) who wish to claim PPR from capital gains tax (CGT) on a residence located in a country in which they are not resident); employees and employers of assignees to and from the UK.

Summary of proposal

Changes will be made to PPR from CGT that affect both UK and non-UK resident taxpayers. Without any change to the current PPR rules, a non-UK resident with a UK residential property could nominate it as their main residence to obtain PPR and thereby avoid the extended CGT charge for non-UK residents (NRCGT charge) being introduced from 6 April 2015. This would, HMRC say, undermine the extension of the CGT rules to non-residents.

Currently, an individual (and in certain circumstances trustees and personal representatives) is entitled to relief from CGT on the sale of his only or main residence. Where an individual has lived in the property from the date of purchase to the date of sale, any gain arising on the sale is covered by PPR and fully exempt from CGT. The last 18 months of ownership of the property are covered by the relief, even where the individual has not actually lived in the property during that period.

Taxpayers with more than one residence are able to elect to choose which residence is their main residence for PPR and this will continue. However, a new rule is being introduced, from 6 April 2015, for situations where the property is located in a different 'territory' to that in which the taxpayer is resident. The new rule will restrict the availability of PPR for both non-UK residents with property in the UK and UK residents with property located in another country. The Finance Act contains the new legislation to incorporate these proposals into law from 6 April 2015.

The new restriction on PPR

From 6 April 2015 any residence owned by a UK or non-UK resident will only be capable of qualifying for PPR if it is located in a territory in which the individual, their spouse or civil partner is resident or, where it is located in a different territory, the individual meets the "day count test" in relation to the residence.

In determining the residence status of an individual, the Statutory Residence Test (SRT) will apply in the UK.

For other territories an individual will be treated as resident there in a tax year if either:

- they are liable to tax in that territory for more than half the tax year by virtue of their residence or domicile; OR
- by applying the same tests of the UK SRT but by substituting the other territory for references to the UK, albeit with some changes to the definition of work, they would be resident there

The legislation refers to "territory" rather than country. This appears to be so that it covers jurisdictions such as the Channel Islands which do not have full independent status as countries. In its application to federal states such as the USA and Switzerland, we understand from HMRC that "territory" is intended to mean the country and not an individual state.

The day count test

The day count test will be met if the individual or their spouse/civil partner spend at least 90 days in the property in the tax year (although no one day can be counted twice by virtue of both the individual and their spouse/civil partner being there at the same time). An individual will be treated as having spent a day in the property if they are present in the property at the end of the day, or if some time is spent in the property during a day and they stay in the property overnight. These alternatives are presumably given so that the day is counted if having been in the property the individual spends the night there but arrives home after midnight having worked or socialised until late in the evening.

Where the individual or their spouse/civil partner has an interest in more than one dwelling in the territory in which the property is located, days spent in those other dwellings can be aggregated with days spent in the property in question to determine whether the 90 day threshold is met.

Where the individual owns the property for a part only of a tax year, the 90 day threshold in the day count test will be reduced pro-rata.

Periods of absence

As well as the last 18 month period of ownership other periods of absence from the property (in particular the period whereby the individual cannot occupy the property because he is required by his employer to work outside the country) can also be covered by PPR provided the property is occupied as the main residence both before and after the period of absence.

In order to accommodate the new PPR rules for properties owned elsewhere than where an individual is resident:

- Where a NRCGT gain arises, any period of ownership before 6 April 2015 is excluded when considering whether the property was occupied as a residence before a period of absence, unless the taxpayer elects to specify an earlier date from which the period of absence is to be measured
- It will not be possible to claim PPR on one property and also relief for another property for the same period under the absence relief rules, save for the last 18 months
- A non-resident individual must meet the 90 days occupation test in respect of a property after a period of absence in order for the absence relief to apply to that property

Individuals who have occupied a property as a main residence for all but the last 18 months will still be able to qualify for full relief even if they dispose of the property whilst non-UK resident. For example an individual who occupied a property for 5 years whilst UK resident and then left the UK

and became non-resident would be able to sell the property within 18 months of leaving the property and not suffer any CGT due because the last 18 months qualifies for relief.

A difficulty with absence relief under the current rules is that although the property has to be re-occupied as a principal residence after the absence there is no minimum period of occupation that is specified in the legislation. It is the quality of occupation that is important not just the period of occupation although it must be more than merely temporary accommodation. For non-residents we now have a clear minimum of 90 days as being the minimum period of re-occupation.

Trustees and personal representatives

Claims for PPR in respect of properties occupied by beneficiaries and legatees can still be made. The residence and days count tests are applied in respect of the individual in respect of whom the relief is being claimed.

Claiming PPR relief in respect of NRCGT gains

PPR claimed in respect of a NRCGT gain will in default apply only in respect of periods since 6 April 2015. However, where the NRCGT gain is calculated on a retrospective basis by reference to the full period of ownership of the property, it will be possible to claim PPR back to the original date of acquisition, provided the conditions are met throughout the period.

Claims for PPR in respect of a NRCGT gain must be included in the NRCGT tax return, to be made within 30 days of disposal of the property. Such claims cannot subsequently be varied.

Individuals and their spouses/civil partners are only entitled to claim PPR in respect of one property as under the ordinary rules. Either both spouses must make the same PPR claim in their own NRCGT tax returns, or if only one is required to complete such a return, the other spouse must give written agreement to the election made. Similarly any claim to PPR by trustees or personal representatives must have written agreement from the individual it is claimed in respect of.

Timing

The new restriction on PPR will apply to disposals from 6 April 2015.

Other than for NRCGT gains where any claim for PPR must be made in the NRCGT return, any election to treat one or more properties as the main residence for PPR must be made within the existing 2 year period of acquiring a second residence. Any claim for PPR for a period in a NRCGT return will supersede any previous PPR elections made, unless the property in respect of which it was made has been disposed of.

Our view

In practice, under the new rules, UK tax residents will typically continue to obtain PPR for their UK homes as with the current rules. For individuals who retire abroad but keep their homes in the UK, they will be treated as entitled to PPR for the years they were in the UK but will be subject to the 90-day rule thereafter for each tax year from 2015/16 onwards (apart from the last 18 months of ownership). The same will apply to international assignees who become non-UK resident but keep their UK property, which was their main residence before departure.

For a UK tax resident with an overseas second home they must from 6 April 2015 satisfy the new 90 day rule (unless they are also resident in the relevant territory), even if they have already elected for the second home overseas to be their main residence for PPR.

From 6 April 2015 individuals may have to seek overseas advice to determine whether or not they are 'resident' in a territory in which they have a dwelling, unless they rely on the UK SRT tests as applied to the overseas territory.

Impact on assignees and their employers

Many assignees to and from the UK keep residential property in their home location and may sell the property while on assignment. Typically these assignees, particularly those from the UK, would expect such a sale to be free of UK CGT. However, these assignees may be caught by these new rules.

Assignees who are tax equalised (i.e. are guaranteed a net after tax salary with the employer paying the tax due) may expect the employer to pay the CGT bill on the disposal of their old pre assignment residence. This is because in broad terms the equalisation policy intends that the assignees would pay the tax that they would pay at home and if they were resident they would be able to claim PPR.

Employers will need to check their policies carefully, particularly any provisions regarding exceptions to the policy and decide whether they wish to pay the tax on the disposals of principal residences or not and include appropriate comment in their tax equalisation policies.

Employees may be more reluctant to take up overseas assignments unless they receive some assurance that any tax costs associated with the sale of their former private residence will be met. In addition employers who decide to meet these costs will face higher cost of overseas assignments.

The new 90-day rule and the Statutory Residence Test

The new 90-day rule for PPR may – in certain circumstances – have an impact on an individual's residence status under the Statutory Residence Test (SRT).

For example consider the situation of an individual who:

- has been non-UK resident in the previous three tax years;
- has not been working in the UK;
- has family resident with him overseas;
- has a home overseas; and
- has only one statutory 'tie' with the UK, that 'tie' being available accommodation.

This individual can spend up to 183 days in the UK without becoming UK tax resident under the SRT. This might enable the individual to spend 90 nights visiting the UK and benefit from PPR without becoming UK tax resident; although for individuals working outside the UK, their work obligations may make this impossible in any event.

After one tax year, that individual will acquire one more 'tie' if he spends more than 90 days in the UK in the previous year. That means that in the second year, the individual could spend up to only 120 days in the UK if he does not want to become UK tax resident.

Under the third automatic overseas test of the SRT an individual is non-resident for a tax year if:

- they work sufficient hours overseas,
- there are no significant breaks,
- the number of UK days where more than 3 hours work is performed in the UK is less than 31, and

- the number of days in the UK is less than 91.

An individual could theoretically meet the new 90 day count test for PPR and satisfy the above SRT test. However, this would be a very risky strategy as staying just one extra day would break the non-residence test and could make the individual UK tax resident for that year.

It appears that the broad intention is to prevent non-residents being able to benefit from PPR. There do in practice appear to be some, albeit limited, circumstances in which a single person can simultaneously accrue PPR and be non-resident on an ongoing basis. Employees who work abroad and have a spouse/civil partner in the UK may be able to be non UK resident and benefit from PPR in respect of the UK property on the basis of the spouse's or civil partner's occupation.

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