To flip or not to flip?

A guide for clients

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The pros and cons of changing your main residence.

With property being one of the most reliable investments around in a period of historic low-interest, many money-savvy people these days end up owning additional properties.

They might rent them out, live in them or simply sit on them to sell on when the time is right.

Whatever your reason for owning multiple residential properties, it's important to think hard about which you define as your main home for legal and tax purposes.

That's because if you decide to sell your 'main residence' or 'principal private residence', as HMRC calls it, you'll usually be exempt from capital gains tax on the sale through private residence relief. If you sell an additional property, on the other hand, you could face a hefty tax bill.

That's why some people practice what is known as 'flipping' – ascribing main residence status to a property they're planning to sell in the near future.

Confusingly, 'flipping' is also sometimes used to describe the practice of buying, renovating and quickly selling on a property, or series of property. That's not what we're talking about here although – even more confusingly – there is sometimes an overlap in the two practices.

Main residence flipping was a very popular strategy for reducing tax a few years ago when the terms of the available tax relief were more generous.

It gained bad publicity at the height of the parliamentary expenses scandal in 2009. It was revealed that more than 50 MPs had flipped their main residence status with the suggestion that some had done so to gain a tax advantage.

At around the same time, it became clear that some people were acting as so-called 'serial sellers', changing their main residence status many times in quick succession as they bought, improved and sold properties.

Inevitably, as a result, the Government has made moves to reduce the incentive to flip properties. In particular, changes introduced from April 2020 have, in the minds of some, made flipping essentially pointless.

It is, however, more complicated than that, as always.

The meaning of main residence

Before we get into pros and cons of flipping main residence status, let's pin down some of the terminology.

Firstly, this might seem obvious but 'main' can only apply to one property. Some people might argue that if they split their time more-or-less equally between two properties, and regard both as 'home', then both have a claim on 'main' status. The law says otherwise, however, and you can only have one main residence at any one time.

Secondly, to count as a 'residence' it has to be a building fit for habitation, that you have actually lived in. Unfurnished commercial units, a room with a blow-up bed in the back of a retail premises or a boat with a tarpaulin over it are unlikely to qualify.

If you spend time living in more than one property – a flat in London during the week and a cottage on Dartmoor most weekends, for example – it's up to you to inform HMRC which you consider to be your main residence. You've got two years from the date the combination of properties changed to notify HMRC which of your properties is your main residence, so in this straightforward example, two years from the date the second property was acquired.

And you and your spouse or civil partner must share the same designated main residence – you can't choose one each with the intention of hedging your bets on any future tax relief claim.

If you don't notify HMRC and there is any debate over which is your main residence down the line, they'll base their judgement on matters of fact.

Where do you spend the most time? Where do your children live? Did you cook, eat, sleep and spend leisure time on the premises?

It can also help if you use the address to sign up for services such as broadband internet or mobile phone contracts; routinely give the address for correspondence; or register that address as your primary point of contact with banks, HMRC and other institutions.

But those measures only underline your residential status, they aren't enough on their own to prove the point if HMRC should challenge your claim.

Capital gains tax

The reason defining your main residence is important is because you may be entitled to capital gains tax relief on it.

Capital gains tax is charged on the disposal of an asset, such as a property. It applies specifically to the increase in value since you purchased it, not to the total amount you receive. At present, in 2020/21, there's a tax-free allowance of £12,300.

Higher and additional-rate taxpayers pay an extra 28% in capital gains tax on disposal of residential property while for basic-rate taxpayers, it's either 18% or 28%, depending on the amount of the gain and various other factors.

Here's an example of capital gains tax in practice: let's say you inherited a £520,000 property on the death of a relative and sold it after a couple of years, during which time its value had increased by £80,000. With various fees taken into account and after deducting the tax free allowance, the taxable gain is about £64,000, so your capital gains tax bill would be about £18,000. That's a hefty chunk of money which makes planning well worthwhile.

Relief and its limits

Principal private residence relief, or main residence relief as it is often called, applies to any property you have lived in during the time you owned it.

You can claim relief on the period during which you were living there – including a break or period of absence in certain circumstances – and for a period after you moved out. That extra time included in the relief, known as the final period exemption, is supposed to allow for delays in selling your home after you have already moved to another property.

From April 2020, the final period exemption has been reduced to nine months, in the majority of cases. It was previously 18 months, having previously decreased from 36 months in 2014.

Let's look again at the example given above. If when you inherited the house you'd moved into it for a time, you could designate it as your main residence. Then, as long as you sold it within a set time after moving out, you'd be eligible for principal private residence relief on potentially all or an element of the gain.

It's also worth being aware, however, that if the purpose of moving into the property was to oversee renovation work with a view to substantially increasing its value prior to its eventual sale, you wouldn't be eligible for private residence relief.

Is flipping still worth it?

The days when flipping could be the basis of an entire property business model are largely behind us.

If you do own more than one house or flat, however, it is certainly still worth taking some time to decide which is your main residence with a view to your overall tax position.

You should also review that regularly, considering the relative value of each property and how likely it is you will want to sell one of those properties in the next year or so.

As with many aspects of tax today, as HMRC seeks to close what it regards as loopholes, it's about marginal gains.

That's why, more than ever, it's best to get professional advice so that we can identify every available opportunity as part of an overarching tax strategy.

Get in touch for tax planning advice*.*

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