The place where we dwell

Personal tax | Tax voice

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John Kingsley looks at a practical problem arising from the continued failure to define technical terms to adequately meet policy objectives

Introduction

The twin criticisms of complexity and unfairness are frequently levelled at the UK's tax system. Indeed, it is said that the former inevitably leads to the latter. Complexity manifests itself in many different ways. A prime example is the lack of coherence across the definitions used (or not used in some cases) for the purposes of different taxes.

In this article we will take a closer look at the definition of a "dwelling"/"dwelling-house" for some of the major property-related taxes to illustrate the unexpected results that can arise in the absence of harmonisation and joined-up thinking.

SDLT blazes a trail

The SDLT legislation states clearly that a building used for any of the following purposes is not used as a dwelling:

a) a home or other institution providing residential accommodation for children;
b) a hall of residence for students in further or higher education;
c) a home or other institution providing residential accommodation with personal care for persons in need of personal care by reason of old age, disablement, past or present dependence on alcohol or drugs or past or present mental disorder;
d) a hospital or hospice;
e) a prison or similar establishment;
f) a hotel or inn or similar establishment (see Section 116(3) Finance Act 2003).

While this approach might be characterised as negative (it does not attempt to define a dwelling as such), it undoubtedly enables the reader to draw helpful boundaries around specific categories of buildings.

Income Tax – nature abhors a vacuum...

In stark contrast, existing Income Tax legislation generally makes no meaningful attempt to define a dwelling, either positively or negatively. The effect of this statutory "void" can be seen clearly in the context of Sections 272A and 272B of ITTOIA 2005, which were introduced with the intention of restricting the tax relief available for financing costs incurred by non-corporate residential property businesses. Section 272A is actually headed "Restricting deductions for finance costs related to residential property", although the term "residential property" is not defined and closer examination of the detail leads the reader to the concept of a "dwelling-house". Regrettably, in my view, Section 272B does not define a dwelling-house for the purposes of these new rules.

It is therefore necessary to examine HMRC's published guidance to give clients the fullest possible picture. The relevant HMRC guidance can be found in its Property

Income Manual at Para 2106, which states the following:

"*Dwelling-house has its normal dictionary meaning in this context, and can include part of a dwelling-house, as well as the land and gardens attached to the house.*"

This statement potentially raises more questions than it answers, as there is no single accepted dictionary definition of a dwelling-house.

According to Black's Law Dictionary, a dwelling is "the house in which a man (sic) lives with his family". However, the Oxford English Dictionary merely defines a dwelling as "A house, flat, or other place of residence".

The Capital Allowances Manual picks up the baton

Unsurprisingly, there are several references to the concept of a dwelling-house in The Capital Allowances Act 2001 (CAA 2001). HMRC's guidance on the definition of a dwelling-house for the purposes of CAA 2001 is set out in its Capital Allowances Manual at Para 11520, which states the following:

"*There is no definition of "dwelling house" (in the Parts of CAA 2001 in which it appears – note added by the author for clarification) and so it takes its ordinary meaning.* ***A dwelling house is a building, or a part of a building and its distinctive characteristic is its ability to afford to those who use it the facilities required for day-to-day private domestic existence.*** *In most cases there should be little difficulty in deciding whether or not particular premises comprise a dwelling house, but difficult cases may need to be decided on their particular facts. In such cases the question is essentially one of fact. A person's second or holiday home or accommodation used for holiday letting is a dwelling house. A block of flats is not a dwelling house although the individual flats within the block may be. A hospital, a prison, a nursing home or hotel (run as a trade and offering services, whether by the owner-occupier or by a tenant) are not dwelling houses. A University hall of residence may be one of the most difficult types of premises to decide because there are so many variations in student accommodation. On the one hand, an educational establishment that provides on-site accommodation purely for its own students, where, for example, the kitchen and dining facilities are physically separate from the study-bedrooms and may not always be accessible to the students, is probably an institution, rather than a "dwelling-house". But on the other hand, cluster flats or houses in multiple*

occupation, that provide the facilities necessary for day-to-day private domestic existence (such as bedrooms with en-suite facilities and a shared or communal kitchen/diner and sitting room) are dwelling-houses. Such a flat or house would be a dwelling-house if occupied by a family, a group of friends or key workers, so the fact that it may be occupied by students is, in a sense, incidental."

The difference between the HMRC's guidance on the meaning of "dwelling" in the context of the new ITTOIA rules and its commentary in the Capital Allowances Manual is quite striking but does this actually matter? While some readers might take the view that this is merely an esoteric tax discussion with no practical consequences, the following example will cast a light on the implications of not defining key terms in legislation that could affects tens of thousands of taxpayers.

Are care homes "dwelling-houses" for Income Tax purposes?

Let us consider a real-world scenario – one that involves the provision of long-term residential care to adults with learning difficulties and other challenging needs. Each resident of the eight properties concerned has his or her own bedroom and unfettered access to shared kitchen and bathroom facilities within each property. Crucially from a tax perspective, the care homes are personally owned and let to an Operating Company (Opco) (the property owners and controlling shareholders are the same people). Opco provides the care services to its end clients (Local Authorities mainly) on a fully commercial footing. The business also operates within the confines of a highly complex legal and regulatory framework, which involves ongoing monitoring and supervision by the Care Quality Commission. However, the owners were sufficiently concerned by the absence of a clear definition of a "dwelling-house" to submit a detailed non-statutory clearance application to HMRC, requesting confirmation that the Care Homes would not be treated as dwellings for these purposes.

In its response, HMRC reiterated its commitment to the "dictionary definition" approach set out in its Property Income Manual, adding that the common aspect of the dictionary definitions is that a dwelling is used as a place of residence. HMRC also emphasised the importance of the guidance set out in its Capital Allowances Manual, highlighting the provision of the facilities required for day-to-day private domestic existence as being central to the concept of a dwelling. The application of these principles undoubtedly brings the personally owned Care Homes in this case within the scope of the new ITTOIA rules, an outcome that appears to be entirely

outside the government's stated policy of levelling the playing field between BTL investors and homeowner-occupiers.

As far as care homes are concerned more generally, HMRC expressed the view that they will sit on a spectrum, where the level of care provided and oversight at the properties will mean that some will be dwellings and some will not. Of course these comments are made subject to the usual caveat about reliance on the specific facts. HMRC also added that the status of a care home (i.e. dwelling or not) could vary over the course of a tax year if the nature of the services or level of the care provided altered, which raises some interesting challenges from a self-assessment perspective.

Conclusion

The absence of a harmonised definition of a dwelling leads to obvious anomalies between the major taxes. At the very least such anomalies add to the incoherence of the UK's tax system and have the potential to undermine its integrity, which is undesirable for all stakeholders.

In the context of the care home sector, many operators will be surprised to hear that financing costs on personally owned properties might be caught by the new ITTOIA rules. The denial of tax relief to some operators will put further strain on a socially important business sector that is already facing strong headwinds, potentially leading to further contraction. From a tax reporting perspective, HMRC's guidance in this area will inevitably lead to care home providers with an Opco structure taking different views of the same or very similar fact patterns when it comes to filing their own personal tax returns. Unfortunately, others might be unaware of HMRC's views. Either way, the end result would appear to be manifestly unfair and it is suggested that the ITTOIA rules should be revisited at the earliest opportunity to ensure that they are targeted in accordance with the government's stated policy objectives.