Cox Manning
Accountants & Tax Advisers

32 Dragon Street, Petersfield
Hampshire GU31 4JJ
(T) 01730 266816
(F) 01730 263337
(E) info@coxmanning.com
(W) www.coxmanning.com

Furnished Holiday Lettings

Past, present and future

The UK tax treatment of Furnished Holiday Lettings (FHL) has been advantageous for many years. FHL are treated as a trade for certain purposes, provided certain conditions are met. The regime can often be preferable when compared to the tax position for normal property lettings, in particular for an individual's income tax and capital gains tax purposes as explained below. Further, as profits from FHL count as earnings on which pension contributions can be based, this can be a useful addition to a buy to let property portfolio which otherwise only generates investment income. This briefing is mainly written from the perspective of an individual and tax years but the developments are of equal relevance where a company runs a FHL business.

All change

Changes were made in 2009 so that this preferential treatment was made available to a qualifying property located in the European Economic Area (EEA) as well as in the UK to avoid discrimination within the EEA. Letting outside the EEA does not qualify as FHL. Such changes were due to have a short life as HMRC also announced their intention to completely abolish the FHL rules for all properties, whether in the UK or EEA, with effect from 6 April 2010, but these changes did not become law.

Instead, the Coalition Government consulted upon a series of changes to the rules which are now law.

Losses past

One of the key tax advantages in the past was that if an FHL made a loss then it could be relieved in a number of flexible ways. An ordinary property business loss has only ever been capable of relief by carry forward against the same income source. The FHL loss on the other hand was relieved as though it was a trading loss. In particular this enabled the loss to be used against general income or even gains in the same tax year or in an earlier tax year (current or previous accounting period for companies) depending on the precise circumstances of the business. This had therefore the potential to save tax at for example the 40% higher rate, often securing the taxpayer a repayment of tax.

Losses present

For 2011/12 (accounting periods commencing on or after 1 April 2011 for companies) there are two types of FHL business:

- a UK FHL business consisting of properties in the UK and
- an EEA FHL business consisting of properties in one or more EEA states.

Profits and losses are now to be calculated for each category as a separate trade. Loss relief will then be restricted for all FHL businesses as losses will only be available to carry forward against profits from the same type of trade (i.e. UK or EEA). There will no longer be any flexibility to relieve losses against other types of income or gains.

Further, it will also not be possible, to set any UK FHL losses against the EEA FHL profits or vice versa.

Example 1

Andrew has a number of properties in Cornwall which qualify as FHL. These properties occasionally incur losses and Andrew is always pleased that his accountant claims these losses to be set against his other income. This normally means that he receives a tax repayment as all his other income is employment income and his tax is paid via PAYE.

Any losses that are incurred for 2011/12 and onwards cannot be set against Andrew's other income. Instead, the losses will be carried forward and set against any subsequent profits from his UK FHL business.

Example 2

Phil owns a number of properties in France, Spain and the UK. All properties qualify as FHL and whist historically the UK properties are profitable the others incur losses.

Following the change in 2009, Phil has been able to set the losses on the EEA properties against his general income and therefore reduce his tax liability.

However, from 2011/12 any losses incurred on the EEA FHL will not be available to relieve against his general income and he will therefore face an increased tax liability in the future.

Instead, the losses on the EEA FHL can only be carried forward and set against any eventual profits on EEA FHL (if indeed there are ever any).

Conditions past and present

For 2010/11 and earlier years in order to qualify as an FHL the property had to be let on a commercial basis with a view to making a profit and meet certain letting conditions. Generally these stipulated that the property had to be available for letting to the public for a minimum period of 140 days in a year and the property had to actually be let for a minimum period of 70 days. Additionally, the FHL must not be let for periods of longer term occupation (more than 30 consecutive days to the same person) for more than 155 days during the year.

Where two or more properties are owned and let then an election exists to 'average' the days of occupancy. This facility continues in 2011/12 and onwards (accounting periods commencing on or after 1 April 2011 for companies) but there will have to be a separate averaging calculation for UK and EEA lettings.

Future conditions

For 2012/13 (accounting periods commencing on or after 1 April 2012 for companies):

- the minimum period over which any property must be available for commercial letting to the public will be increased by 50% from 140 days to 210 days in a year and
- the minimum period over which a qualifying property is actually let will be increased again by 50% from 70 days to 105 days in a year.

A new relaxation

Due to the significant increase in the actual days letting required, it was decided that there should be some relaxation to allow those who wish to remain qualified for FHL purposes for 2012/13 onwards an opportunity to adjust to the stricter conditions. The new relaxation is also likely to be useful for those who may have started an FHL business since 2009/10.

Under the arrangements a property can continue to qualify as an FHL if it qualifies in one tax year then loses its status in either the next or the next two tax years and an election to that effect is made. The rules apply for 2010/11 and onwards. Critical to this election is the requirement that there is a genuine intention to meet the relevant letting condition of 70 days currently rising to 105 days for the relevant tax year(s).

If a person makes the election, the accommodation is to be treated as a qualifying FHL for that tax year. However, if an election is not made for the first of the relevant tax years, then one cannot be made for the second. It is also worth pointing out that it will not be possible to claim both this election and the averaging relief in the same tax year for the same business.

Example

Christina, an accountant, owns Pink Place, a property in Greece, which she lets out and which qualified as a FHL in 2010/11. However, despite her having a genuine intention to meet the letting day requirements, because of circumstances beyond her control Pink Place did not meet the 70 day actual let requirement in 2011/12 and she believes Pink Palace is unlikely to meet the increased 105 day requirement in 2012/13.

Christina can make an election for 2011/12 and 2012/13 for Pink Place to be treated as a FHL.

If Christina did not make the election for 2011/12 she could not make the election for 2012/13.

Please do contact us for more details of how and when to make such elections.

Capital allowances

One of the potential advantages of a property letting qualifying as an FHL is the facility to claim capital allowances on qualifying 'plant and machinery' expenditure which would cover various fixtures, furnishings and equipment. Where dwellings are let as ordinary property letting businesses, this is not permitted.

If a property fails to qualify as a FHL, whether or not the property continues to be owned by the taxpayer, then normal capital allowance rules treat the event as a deemed disposal at the market value of the assets qualifying for plant allowances. In many instances recent plant expenditure will have enjoyed 100% capital allowance relief when purchased due to the Annual Investment Allowance. This means that the practical effect of the deemed disposal is that an extra profit will be chargeable.

If the property continues to be let as a dwelling, then whilst there are generally no further capital allowances, an alternative allowance for fixtures, known as a 'wear and tear allowance' (broadly 10% of rental income received) is available. In addition there are further rules to accommodate the situation where a property letting requalifies as a FHL in a future period. These are not considered further here but please do contact us if these matters are relevant to you.

Entrepreneurs' Relief (ER)

If a FHL is disposed of and a gain is made on the sale then it is possible that the gain could qualify for ER. ER enables qualifying gains to be taxed at a 10% rate of tax as opposed to the normal 18% or 28% that can apply to capital gains. There is currently a lifetime limit of £10 million per person of gains that can qualify for ER.

The business will have to have been operated for a period of 12 months and would have had to qualify as either a UK FHL or an EEA FHL.

If the FHL ceases to trade then as long as the FHL is disposed of within three years of cessation the gain would still qualify for ER.

If a FHL ceases to qualify and is let as a dwelling then in order to preserve entitlement to ER the property would need to be disposed of within three years of the cessation of the FHL business.

Even where a property ceases to be a qualifying FHL, the owner may continue to let the dwelling as an ordinary property rental business for a number of years. If at a later stage the letting does subsequently requalify as a FHL, it could also once more become eligible for ER. To qualify for ER status there must be a qualifying period of at least twelve months prior to the disposal of the property.

Business Property Relief (BPR)

Unlike other reliefs considered in this briefing there is no explicit tax law provision within the FHL rules which grants the valuable Inheritance Tax relief (IHT) known as Business Property Relief (BPR) to FHL properties. BPR is significant because it has the effect of exempting in full or in part qualifying business property from IHT.

In the past HMRC have allowed BPR in respect of FHL businesses where:

- the lettings were short term, and
- the owner directly or through an agent was substantially involved with the holidaymakers in terms of their activities on and from the premises.

However, more recently HMRC have indicated that they will look more closely at the level and type of services provided, rather than who actually provided them. It is therefore essential that professional advice is considered if securing BPR status is important.

As you can see, there have been a number of changes made to the FHL regime. There are many advantages but also pitfalls that are easy to fall into. Please do contact us for further advice specific to your circumstances.