Taking a holiday?

Richard Lishman of money4dentists discusses the current issues concerning furnished holiday lettings for businesses

Though the letting of property in itself does not constitute a trade, the Furnished Holiday Letting (FHL) rules mean that landlords of furnished holiday properties are entitled to some of the tax treatments available to traders.

In the past, to qualify as a furnished holiday letting, a property must be let on a commercial basis, with the tenant making use of the furniture, and must be publicly available to let for at least 140 days and actually let for at least 70 days, in a twelve month period.

However, in the April 2009 Budget, changes were made to the rules for Furnished Holiday Lettings. In order to qualify as an FHL, a business would have to meet both the commercial condition and the letting condition. This means the property must be let on a commercial basis in order to acquire profits and obtain tax reliefs. This is an important consideration when taking loss relief into account because, for example, if losses arise over three years, it may prove challenging to validate that the property is being let commercially.

In addition to this, the Budget 2009 announced that the previous tax reliefs would be discontinued from 6 April 2010 (1 April 2010 for companies) and in order to benefit from the previous tax reliefs, businesses operating as FHLLs will need to prove that they are functioning as trades. Ironically, this was the situation that existed before Finance Act 1984.

Conversely, the new coalition government has announced that the Budget 2009 will not now take place. Instead, the previous FHL rules will apply during 2010/11. The government plans to consult over the summer on the change of the tax treatment of furnished holiday lettings from 6 April 2011.

The government has declared that the FHL rules need to be changed to comply with EU law. They are seeking to change the rules in a way that is consistent with deficit reduction and without compromising UK businesses.

The FHL rules granted the following tax conditions to lettings that qualify as a trade:

- Loss relief
- Capital allowances
- Landlords Energy Saving Allowance (LESA)
- Certain capital gains reliefs.

These include:
- Business asset roll-over relief
- Entrepreneurs' relief
- Relief for gifts of business assets
- Relief for loans to traders and exemptions
- Disposals of shares by companies with a substantial shareholding
- Relevant UK earnings when calculating the maximum relief due for an individual’s pension contributions.

It is worth noting that, as a trade, any income received from the property will be taxed as earned income. But what defines a trade? There appears to be little in the way of a legal definition, aside from section 989 ITA 2007 which defines trade as including any venture in the nature of trade. This is rather limited as definition and although judgements in various court cases can provide some guidance, the crux of the matter will be whether a person’s income is being obtained through trading or if they are a mere landowner who is exploiting the property for income.

For example, a hotel would amount to a trade due to the services that are provided, whereas a person letting a self-catering apartment without providing any services, would most likely be regarded as undertaking an investment business.

With regards to National Insurance, FHL has been regarded as land and property income for NIC purposes. There has been no need to justify that an FHL is a trade due to the statutory provisions that are in place. In addition, in the context of FHL, inheritance tax business property relief does not rely on a business satisfying the statutory definition within section 525(2) ITTOIA 2005. However, the FHL must be a business that is not an investment business, ie: it should not deal in or hold investments, in this case land.

As they did previously, these FHL rules will continue to apply to holiday lettings situated in the UK during the tax year 2010-11. Furthermore, HMRC will continue to apply the FHL rules to properties situated elsewhere in the European Economic Area (EEA) during the tax year 2010-11. However, holiday lettings located outside the EEA do not qualify under the FHL rules and are instead taxed under the normal property income laws.

The Government is looking to reintroduce the FHL rules from 6 April 2011 (1 April 2011 for companies) for effect from tax year 2011/12. These will not only ensure the FHL rules apply equally to properties in the EEA but will also change the way in which FHL loss relief is given. Furthermore, it will increase the number of days FHL businesses have to be available to let as commercial holiday letting.

Full details about the proposed changes will be discussed over the summer, and the legislation will be drafted in the autumn. With the matter details unclear at this point, property owners should seek out professional tax advice in advance of 6 April 2011 to make sure that their business profile gives them maximum scope for tax reliefs.