Trading up?

If you’ve a second property that you wish to rent out, doing so as a holiday let could allow you tax benefits, says Richard Lishman.

The letting of a property is not a trade. However, the Furnished Holiday Lettings rules allow landlords of furnished holiday properties, which satisfy certain conditions, some of the tax treatments available to traders.

In the April 2009 Budget, changes were made to the rules for Furnished Holiday Lettings. These changes will potentially affect owners who let their UK holiday home out on a short-term basis and who are liable to pay UK tax. Overruling a previous UK tax which rent out furnished holiday accommodation in the European Economic Area (EEA) will also be affected by the new rules. Since 1984, special tax rules have applied to the business of furnished holiday lettings (FHL). These rules give FHL some of the tax reliefs afforded to trading businesses provided certain conditions are satisfied.

Historically, to qualify as a furnished holiday letting, the following conditions have had to be satisfied:

1. **Commercial condition**
   - The property must be let on a commercial basis.
   - The tenant must be entitled to the use of the furniture.
   - The property must be available for letting to the public for at least 210 days and actually let for at least 45 days, in a 12-month period.
   - No one person should occupy the property for a continuous period of more than 31 days in a five month period (including the 140 days above).

The five-month period is calculated on a daily basis – the days do not need to be consecutive and the period itself does not need to consist of whole months. It is possible to let the property for under seven months to the same person, and for the property to still qualify as a holiday let. This would not be uncommon in areas with defined holiday seasons, and where a reduced rent is charged over the winter to ensure occupation.

However, notice was effectively served on the tax efficiency of FHLs (following the requirement to extend the relief to EU properties – holiday homes abroad – in order to avoid offending non-discrimination) in the Budget 2009, which announced that these tax reliefs will be discontinued from 6 April 2010. From that date, in order to benefit from the special tax reliefs that previously applied, businesses operating as FHLs will need to demonstrate that they are operating as trades.

The lettings were short term, genuine and commercial. The letting of property is not always regarded as undertaking a trade. However, it is desired to keep the tax advantages of a trade with effect from 6 April 2010, it will be necessary for the business concerned to qualify as a trade in the owner’s right. This means the business will need to be registered as a trade under Class 2 and Class 4.

**Tax reliefs available**

- The business will be treated as trading and therefore any income will be taxed as earned income.
- Any losses that arise can, as trading losses, be offset against other income and capital gains.
- Capital gains tax roll-over relief, hold-over relief and entrepreneurs’ relief will be available.
- An FHL will be counted as a qualifying activity for capital allowance purposes.

The current FHL rules

To qualify as an FHL, a business must currently satisfy both the (1) commercial condition and (2) the letting condition.

**Furnished Holiday Lettings**

1. **Commercial condition**
   - The property must be let on a commercial basis with a view to the realisation of profits. It is important to note that the property must be commercially let to obtain the tax reliefs. This is particularly important when one is considering loss relief.
   - For example, if losses arise over three consecutive years, it may be difficult to justify that the property is being let commercially.

2. **The position on 6 April 2010**
   - It is proposed that the statutory reliefs for FHL will be repealed from tax year 2010/11. This means that for a FHL business to continue to qualify for all the tax reliefs mentioned above, it will need to be able to demonstrate that it does, as a matter of fact, operate as a trade – this is exactly the position that existed before Finance Act 1984.

3. **Operating as a trade**
   - There is little statutory guidance on what is a trade other than the definition in section 980 ITA 2007 which defines trade as including any venture in the nature of trade. Further guidance can be obtained from the judgements in various Court cases. The fundamental point will frequently be whether a person is deriving income by trading or is a mere landowner who is deriving income from exploiting the property.

**Defining a trade**

Frequently, for example, the activity of a hotelier would amount to a trade because of the extensive services that are provided whereas at the other end of the spectrum a person offering a self-catering apartment for hire and who was not providing any ancillary services would probably be regarded as undertaking an investment business. There will, of course, be many cases in between and property owners should contact their tax advisers in advance of 6 April 2010 to make sure that their business profile gives them maximum scope for tax reliefs.

- (i) **National Insurance aspects**
   - Typically, FHL income has been regarded as land and property income for NIC purposes. After all, given the special statutory provisions that exist, there has been no need to try to justify that an FHL is a trade. However, it is desired to keep the tax advantages of a trade with effect from 6 April 2010, it will be necessary for the business concerned to qualify as a trade in the owner’s right. This is not the case under the existing rules. The owner of FHL will need to demonstrate that a reasonable level of services is provided by the owner to the tenants.

- (ii) **Inheritance tax aspects**
   - In the context of FHL, inheritance tax business property relief does not rely on a business satisfying the (1) commercial condition and (2) the letting condition. However, the current FHL rules require that the business must currently satisfy both the (1) commercial condition and (2) the letting condition.

4. **Extension to EEA**

In the meantime (and very possibly one of the main reasons for the changes), the current statutory relief is being extended to all parts of the European Economic Area and this will open up opportunities to recover tax relief for previous years with scope to go back and amend previously submitted tax computations. For 2007 returns, HMRC has extended the amended deadline to 31 July 2009. Professional advice is essential.

**About the author**

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