Money Matters

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. Owners liable to pay UK tax who 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 40 days and actually let for at least 20 days in any 12-month period.
   - No one person should occupy the property for a continuous period of more than 14 days in any 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. It is possible to let the property for under seven months. It is possible to let the property for under seven months.

The owner 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 rules 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.

5. **Operating as a trade**
   - There is little statutory guidance on what is a trade other than the definition in section 909 ITA 2007 which defines a 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 landlord 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, if it is desired to keep the tax advantages of a trade with effect from 6 April 2010, it will need to be demonstrated to HMRC that the business concerned is a trade. This means the business will need to be registered as a trade under Class 2 and Class 4.

(ii) **Inheritance tax aspects**

In the context of FHL, inheritance tax business property relief does not rely on a business satisfying the commercial and letting conditions within section 525(2) IHTA 2007. Instead, the FHL business property relief where the property is to be held for trading purposes – holiday homes in particular is 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.

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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.