

Private client services

FURNISHED HOLIDAY LETTINGS



Furnished holiday lettings (FHL) by individuals are treated more advantageously for tax purposes than other property lettings.

THE BENEFITS

The major advantages are:

- capital allowances are available on furniture, furnishings, etc. in the let property, as well as on plant and machinery used outside the property (such as vans and tools);
- certain capital gains reliefs are available as if the activity were a trade, for example rollover relief on the replacement of business assets and the entrepreneurs' relief that charges gains on certain business disposals at a reduced 10% rate;
- the income counts as earnings in calculating the maximum pension contributions that may be paid to a registered scheme; and
- 100% business property relief (BPR) may be available for inheritance tax purposes where services are offered to holidaymakers. However there is no direct link between BPR and the FHL rules and HMRC has tried to tighten up its approach in this area.

Additionally, although the income is treated in many ways as if it were from a trade, it remains assessable as rental income, so Class 4 National Insurance contributions on self-employed earnings are not payable.

(Similar rules apply to lettings by companies, but these are not covered in this factsheet.)

RELIEF FOR LOSSES

Profits or losses may arise in four different categories of property business:

- FHL in the UK;
- an ordinary property business in the UK;
- FHL elsewhere in the EEA. The EEA comprises the EU plus Iceland, Liechtenstein and Norway;
- an ordinary property business elsewhere in the world.

Losses from an ordinary property business within the UK may be set against UK FHL profits in the same or future years. Similarly, losses of an ordinary property business in the EEA may be offset against EEA FHL profits of the same or future years. However, FHL losses may not be set against the profits of an ordinary property business. These must be carried forward and offset against future profits from the same FHL activity i.e. UK FHL losses cannot be set against EEA FHL profits.

WHAT ARE THE CRITERIA TO QUALIFY AS AN FHL?

The property must be located within the UK or elsewhere in the EEA and must, broadly, satisfy the following three criteria:

1. **Availability:** The property must be available for commercial letting to the public for 210 days or more in a year;
2. **Letting:** Actual occupation by holidaymakers must be 105 days or more, excluding periods of continuous occupation by the same

person of more than 31 days. A two-year period of grace election may be made where an individual intended to meet the letting condition but was unable to. Under this election, once a property qualifies as an FHL for one tax year the owner may elect to treat it as continuing to qualify for up to two subsequent years even if it does not meet the letting conditions in those years; and

3. Pattern: The total of all lettings that exceed 31 continuous days must not be more than 155 days in the tax year.

There is nothing to prevent the owner, or friends or family, from using the property, but any period for which it is occupied in this way does not count as 'available to let'.

For multiple FHLs, as long as each property individually satisfies criteria (1) and (3), if (2) is satisfied by the average actual occupation of the properties all of the properties will qualify as FHLs, provided an appropriate election is made. The calculation must be made separately for UK and EEA properties.

Rental income from FHLs is standard rated for VAT, so the taxpayer must be registered for VAT if turnover from this source, together with that from other sources in certain circumstances, exceeds the registration threshold, £85,000 from 1 April 2017. If the FHL is abroad, it may be necessary to consider the VAT rules of the country where the property is situated.

INHERITANCE TAX

As indicated above, 100% BPR may be available for inheritance tax purposes where services are offered to holidaymakers in addition to the letting of the property. HMRC's guidance states that the services offered with an FHL must be significant for the property to qualify for BPR, a view that HMRC have steadfastly adhered to in recent years.

The *Pawson v HMRC* tax case in 2011 challenged HMRC's approach. Mrs Pawson owned and ran the FHL business with other members of her family for a number of years before her death. The Pawsons cleaned the property between visits; the property and garden were maintained by a caretaker; clean bedclothes, a television and a telephone were provided; and the kitchen was fully equipped.

HMRC disallowed the claim for BPR on Mrs Pawson's share of the property and argued that the property was an investment rather than a business because the Pawsons did not provide a significant level of additional services to the guests to distinguish the FHL from that of a normal letting.

The First Tier Tribunal disagreed with HMRC and in summing up said 'we have no doubt that an intelligent businessman would not regard the ownership of a holiday letting property as an investment as such and would regard it as involving



far too active an operation for it to come under that heading'. The claim for BPR was allowed. However, HMRC appealed against the decision to the Upper Tribunal.

The Upper Tribunal, whose decision was published in 2013, disagreed with the First Tier Tribunal and stated that a property could be actively managed and remain an investment. The judge said 'I take as my starting point the proposition that the owning and holding of land in order to obtain an income from it is generally to be characterised as an investment activity'. The fact that the family ran the property as a holiday letting and provided additional services did not stop it being an investment business. The services provided by the family were found to be of a relatively standard nature and there was 'nothing to distinguish it from any other actively managed furnished letting businesses of a holiday property'. The claim for BPR was disallowed.

In October 2013 the taxpayer was refused leave to appeal the Upper Tribunal's decision and the case cannot be taken any further.

This ruling means that BPR will only be available on furnished holiday lettings where the services provided are substantially more significant than the investment aspect of the property ownership, which will not normally be the case.

Should you wish to discuss the tax treatment of FHLs or lettings, please contact your local Moore office.

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