Plummer Parsons
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Furnished Holiday Lets

The Active Business Series

Introduction

The 'furnished holiday lets' rules are to be abolished on 5 April 2010.

Under the existing furnished holiday let (FHL) rules, only landlords with income from furnished holiday accommodation in the UK are treated as if they were trading for certain beneficial tax reliefs. Conversely, landlords with income from furnished holiday accommodation elsewhere in the European Economic Area (EEA) do not qualify for this treatment.

On 22 April 2009, the UK government determined that the difference in tax treatment could contravene European Law. As a result, it was decided that the FHL rules would be repealed from 2010/11 and accordingly the beneficial tax reliefs associated with the FHL rules would also be withdrawn. In the interim HM Revenue & Customs ruled that the FHL rules would not just apply to furnished holiday accommodation in the UK but also furnished holiday accommodation in the EEA.

Consequently, a property owned by an individual, company or partnership in any of the EEA countries will now qualify as a FHL until April 2010 providing it is:

- Let furnished; and
- Available for letting to the public for at least 140 days a year; and
- Actually let for at least 70 days a year at proper commercial rates; and
- Available for short term rentals only, i.e. less than 31 days at a time; and
- Let on a longer term basis (if at all) for a maximum of 155 days a year.

The removal of the FHL rules in 2010/11 will mean that rather than being treated as a trading business, the FHL will fall under the less favourable property income rules. The implications of the above changes and the withdrawal of the various reliefs are considered in more detail below.

Income Tax

Loss Relief

Currently, if a qualifying FHL makes an overall loss then it qualifies for loss relief and the loss can be offset against other income (e.g. employment income, investment income etc) reducing overall taxable income. Under the property taxation rules, the loss created can only be offset against profits made on another property business or instead carried forward to offset against profits in future years. Thought should be taken as to whether further investment should be made prior to the rule changes to enable the loss to be relieved rather than simply carried forward. For example, this may encourage some landlords to bring forward repair and maintenance projects so that any loss can be utilised against other income.

Capital Allowances

In contrast to the FHL rules, capital allowances cannot be claimed on expenditure incurred in providing plant and machinery under the property income rules. With the new property income rules there is no allowance for the initial purchase of furnishings. Instead an annual wear and tear allowance can be claimed or the cost of any replacements can be made in full.

However, for continuing FHL businesses, where expenditure on qualifying plant and machinery takes place prior to 2010/11, then capital allowances will continue to be available after the date of the repeal. Certain considerations may include whether new plant and machinery purchases should be made prior to the rule changes particularly in light of the £50,000 annual investment allowance available.

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Income Tax
(continued)

Pension Relief

Income from a FHL is treated as relevant earnings for an individual when calculating the maximum relief for their pension contributions. Under the transitional rules this will also include income from a FHL in the EEA. From April 2010 FHL income will not be included in an individual's relevant earnings and this may have a vast impact on the amount of pension contributions that should be made in a tax year.

Capital Gains Tax

Entrepreneurs' Relief

Gains on a FHL property will no longer qualify for entrepreneurs' relief as it will no longer be considered a trade, profession or vocation. The implications are that this will see the capital gains tax rate on a FHL increase from 10% to 18%. A tax review should look at whether such properties should be disposed of prior to April 2010 to crystallise the gain at 10% although appropriate consideration should be made to the current property market conditions and values. Transferring a FHL into a limited company may be another option to crystallise the gain, however, a tax strategy should look at the cost and practical implications of such a transfer.

Holdover Relief

As a trading business, FHL accommodation can be gifted and any capital gains tax can be rolled over until the beneficiary disposes of the property in the future. On the other hand property income is considered an investment activity and therefore if the property is gifted, for example, to your children for nil proceeds, capital gains tax may be due with the proceeds deemed to be at market value at the time of the gift. Individuals with large estates may wish to consider longer term estate planning and if there is little need of the property's income stream, they could also consider a capital gains tax-free gift to family members using holdover relief in an attempt to try and reduce the value of their estate for inheritance tax purposes (providing the transferor survives seven years after the gift).

Rollover Relief

Under the new provisions, FHL's will no longer qualify for business asset rollover relief, meaning that upon the sale of the property, the landowner will not be able to roll over capital gains into other trading assets – nor will FHL properties qualify as assets into which gains can be rolled. Disposals prior to April 2010 may allow you to roll over the gain into a new business asset that will continue to qualify for entrepreneurs' relief under the new rules but without crystallising a gain immediately chargeable to capital gains tax.

Summary

All landlords who own and let properties qualifying as a FHL within the EEA may benefit from a strategic review of their present property tax planning due to these changes. It is vital that the narrow window of opportunity occasioned by this change be fully exploited and with 2010/11 fast approaching it is essential sufficient time is allowed to consider and implement the income tax, capital gains tax and inheritance tax planning opportunities.

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