

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Revenue and Customs</b>	<b>Title:</b> <b>Impact Assessment of Withdrawing the Furnished Holiday Letting Rules</b>	
<b>Stage:</b> Consultation	<b>Version:</b> 1	<b>Date:</b> 30 November 2009
<b>Related Publications:</b>		

**Available to view or download at:**

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

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**What is the problem under consideration? Why is government intervention necessary?**

At Budget 2009 HMRC announced that the FHL rules would be repealed from 2010-11, and until the repeal takes effect, the current Furnished Holiday Lettings rules would also apply to those with qualifying furnished holiday lettings situated elsewhere in the European Economic Area (EEA).

The tax treatment of landlords with income from certain furnished holiday lettings within the UK was more favourable than for other types of rental property. The difference in the tax treatment between Furnished Holiday Lettings (FHL) in the UK and furnished holiday lettings in the rest of the European Economic Area (EEA) may not comply with European law.

**What are the policy objectives and the intended effects?**

The policy objectives are

- to ensure that the tax treatment of those with FHL properties within the European Economic Area (EEA) is the same as the tax treatment of those with FHL properties within the UK, and
- to ensure that the tax treatment of those who let property is fair and consistent.

**What policy options have been considered? Please justify any preferred option.**

The Government could repeal the FHL legislation, extend the FHL legislation to include properties elsewhere in the EEA, or partially repeal the FHL rules whilst extending the remaining FHL legislation to include properties elsewhere in the EEA.

The preferred option is to repeal the FHL legislation from 2010-11, because it will provide a level playing field for all landlords and so fits with Government objectives. This change will mean that landlords of furnished holiday lettings are treated in the same way as other landlords. Until the rules are repealed, HMRC will regard the FHL rules as applying to furnished holiday lettings in the EEA.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

HMRC intends to review the policy to establish the actual costs and effects in around three years time. This would follow the receipt of data relating to self-assessment returns from 2010-11 during 2012.

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the impact assessment and am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



Date: 30 November 2009

## Summary: Analysis & Evidence

**Policy Option: 1**

**Description: Repeal FHL rules with effect from 2010-11 (includes an extension of the FHL legislation, to include properties situated elsewhere in the EEA, for 2009-10 only).**

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Estimated one-off transitional cost of around £1,400,000 arises because all taxpayers with FHL properties in the EEA (including the UK) would need to familiarise themselves with the changes in tax treatment.
	<b>One-off (Transition)</b>	<b>Yrs</b>	
	<b>£1,400,000</b>	2	
	<b>Average Annual Cost (excluding one-off)</b>		
	<b>£ 0</b>	5	
<b>Total Cost (PV)</b>			<b>£ 1,350,000</b>
Other <b>key non-monetised costs</b> by 'main affected groups' None			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Taxpayers currently making use of the FHL legislation would have a small reduction in their on-going administrative burden as their tax calculation would be easier.
	<b>One-off</b>	<b>Yrs</b>	
	<b>£ 0</b>		
	<b>Average Annual Benefit (excluding one-off)</b>		
	<b>£ 65,000</b>	5	
<b>Total Benefit (PV)</b>			<b>£ 250,000</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' Ensures the tax treatment of income and gains by businesses letting furnished holiday accommodation is EU compliant.			

**Key Assumptions/Sensitivities/Risks** Estimated Exchequer loss of £10 million in 2010-11 and yield of £25 million in 2011-12 and £15 million in 2012-13. Comprehensive data on the extent to which corporate bodies currently benefit from the FHL rules are not available. It has been assumed that individuals are the vast majority of the users of the FHL rules.

Price Base Year 2009	Time Period Years 5	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £ -1,100,000
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What is the geographic coverage of the policy/option?	EEA			
On what date will the policy be implemented?	6 April 2009			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ No change			
Does enforcement comply with Hampton principles?	N/A			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase of	£ 0	Decrease of	£ 65,000
<b>Net Impact</b>			<b>£ -65,000</b>

Key: Annual costs and benefits : Constant Prices (Net) Present Value

## Summary: Analysis & Evidence

<b>Policy Option: 2</b>	<b>Description: Extend the FHL rules to include properties in the EEA</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Estimated one-off cost of around £300,000 for 2009-10 arises because taxpayers with FHL properties in the EEA outside the UK would need to familiarise themselves with the change in tax treatment. On-going annual cost of more complex tax calculation.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	<b>£ 300,000</b>	1	
	<b>Average Annual Cost</b> (excluding one-off)		
	<b>£ 115,000</b>	5	
<b>Total Cost (PV)</b>			<b>£ 850,000</b>
Other <b>key non-monetised costs</b> by 'main affected groups' None			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' None
	<b>One-off</b>	<b>Yrs</b>	
	<b>£ 0</b>		
	<b>Average Annual Benefit</b> (excluding one-off)		
	<b>£ 0</b>		
<b>Total Benefit (PV)</b>			<b>£ 0</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' Ensures the tax treatment of income and gains by businesses letting furnished holiday accommodation is EU compliant.			

**Key Assumptions/Sensitivities/Risks** Estimated Exchequer loss of £15 million in 2010-11, and £5 million per annum thereafter. Comprehensive data on the extent to which corporate bodies currently benefit from the FHL rules are not available. It has been assumed that individuals are the vast majority of the users of the FHL rules.

Price Base Year 2009	Time Period Years 5	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £ -850,000
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What is the geographic coverage of the policy/option?	EEA			
On what date will the policy be implemented?	6 April 2009			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ No change			
Does enforcement comply with Hampton principles?	N/A			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase of	£ 115,000	Decrease of	£ 0
<b>Net Impact</b>			<b>£ 115,000</b>

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Summary: Analysis & Evidence

<b>Policy Option: 3</b>	<b>Description: Partial repeal of the FHL legislation from 2010-11, and extend the remaining FHL legislation to include properties situated elsewhere in the EEA</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Estimated one-off cost of around £825,000 arises because all taxpayers with FHL properties would need to familiarise themselves with the change in tax treatment; those with FHL properties in EEA only, claiming capital allowances would need to familiarise with more complex calculation and on-going cost.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ 825,000	2	
	<b>Average Annual Cost</b> (excluding one-off)		
	£ 30,000	5	
<b>Total Cost (PV)</b>			£ 950,000
Other <b>key non-monetised costs</b> by 'main affected groups' None			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Taxpayers currently making use of the FHL legislation would have a small reduction in their on-going administrative burden as their tax calculation would be easier.
	<b>One-off</b>	<b>Yrs</b>	
	£ 0		
	<b>Average Annual Benefit</b> (excluding one-off)		
	£ 25,000	5	
<b>Total Benefit (PV)</b>			£ 100,000
Other <b>key non-monetised benefits</b> by 'main affected groups' Ensures the tax treatment of income and gains by businesses letting furnished holiday accommodation is EU compliant.			

**Key Assumptions/Sensitivities/Risks** Estimated Exchequer loss of £10 million in 2010-11 and yield of £40 million in 2011-12 and £25 million in 2012-13. Comprehensive data on the extent to which corporate bodies currently benefit from the FHL rules are not available. It has been assumed that individuals are the vast majority of the users of the FHL rules.

Price Base Year 2009	Time Period Years 5	<b>Net Benefit Range</b> (NPV) £	<b>NET BENEFIT</b> (NPV Best estimate) £ -850,000
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What is the geographic coverage of the policy/option?	EEA			
On what date will the policy be implemented?	6 April 2009			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ No change			
Does enforcement comply with Hampton principles?	N/A			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of	£ 30,000	Decrease of	£ 25,000
		<b>Net Impact</b>	£ 5,000

Key:

Annual costs and benefits : (Net) Present Value

## Evidence Base (for summary sheets)

### **Background**

The Furnished Holiday Lettings (FHL) legislation applies to landlords who let qualifying holiday accommodation. In order to qualify, during the relevant period the holiday accommodation must have been:

- available for commercial letting as furnished holiday accommodation to the public for at least 140 days;
- actually let to the public for at least 70 days;
- not let to the same person continuously for more than 31 days, during a period of at least 210 days;
- let with a view to a profit; and
- situated within the UK.

For an individual with a continuing FHL business the relevant period is the tax year. Holiday lettings that do not meet these conditions are subject to the normal rules for tax on income and capital gains from let property

The FHL legislation allows landlords to treat their letting of qualifying UK furnished holiday accommodation as a trading activity for certain tax purposes. These purposes include

- loss relief,
- capital allowances,
- landlords' energy saving allowance (LESA),
- some capital gains reliefs (including roll over relief and entrepreneurs' relief), and
- pension relief.

This treatment differs from the normal tax treatment of income and gains from property. The FHL rules apply to individuals and partnerships within the charge to income tax and capital gains tax, and companies within the charge to corporation tax. For further details please see <http://www.hmrc.gov.uk/manuals/pimmanual/PIM4100.htm>.

### **The Issue**

The FHL rules provide beneficial treatment to those with properties in the UK compared to those with similar properties elsewhere in the EEA. As a result of this discrepancy, the FHL legislation may not comply with European law.

The Government is committed to delivering a fair tax system wherever possible, and recognises that legislation in this area needs to provide clarity and certainty for businesses and their advisers.

### **The Decision**

At Budget 2009 HMRC announced that the FHL rules would be repealed from 6 April 2010 for income tax and capital gains tax purposes, and from 1 April 2010 for corporation tax purposes.

Until the repeal takes effect, the current FHL rules also apply to those with qualifying furnished holiday lettings situated outside the UK, but within the European Economic Area (EEA).

This Impact Assessment is being published alongside draft legislation for the repeal.

## **Policy Objectives and Intended Effects**

The objective of this change is to ensure that the tax treatment of FHL landlords is in line with European law. Retaining a tax treatment which may contravene European law creates uncertainty for taxpayers, in addition to the possible consequences of any potential breach of the UK's obligations under European law.

Treating landlords with FHL in the UK differently, for tax purposes, from landlords with FHL elsewhere in the EEA may impose a restriction on the free movement of capital. The free movement of capital is one of the fundamental freedoms provided under European law, and the UK Government should not place restrictions on it. If the Government does not act to correct this potential restriction, then it may risk intervention by the European Commission, or a challenge in the UK courts or the European Court of Justice.

The second objective is to ensure that the tax system remains fair and consistent. The FHL rules are seen as discriminatory and unfair to other types of landlord, as some residential landlords provide similar services and undertake similar activities to some FHL landlords but are unable to benefit from the preferential tax treatment available. However, without the FHL rules, the tax treatment of FHL landlords could be different to that of other providers of holiday accommodation e.g. hoteliers.

## **The Options**

The Government is obliged to ensure that its legislation does not contravene European law, and is committed to providing certainty of treatment for taxpayers. It is therefore considered unsatisfactory to do nothing.

**Option 1:** Repeal the FHL legislation from 2009-10 onwards (includes an extension of the FHL legislation, to include properties situated elsewhere in the EEA, for 2009-10 only).

A repeal of the FHL legislation would mean that landlords of FHL properties are no longer treated as trading for certain tax purposes. Instead they would be treated as having income from property for all relevant tax purposes.

This change would remove an exception to standard rules, and in this sense would contribute to the government's simplification objectives. This change would provide a level playing field for landlords of furnished holiday lettings and other landlords. It would therefore provide consistency and fairness across the property rental sector.

The FHL legislation gives access to some capital gains reliefs (including roll-over relief on replacement of business assets and entrepreneurs' relief). As capital gains accrue over a period of time, but are charged to tax only on realisation, a period of notice should normally be given before changes to capital gains reliefs take effect. It was not possible to provide such a notice period in respect of 2009-10. As a result, a repeal would take effect from 2010-11 in order to allow those affected time to plan. Until the FHL legislation is repealed, the rules would be extended to include properties in the EEA.

**Option 2:** Extend the FHL legislation to include properties situated elsewhere in the EEA for 2009-10 onwards.

An extension of the FHL legislation, to include properties situated elsewhere in the EEA, would mean that landlords of qualifying furnished holiday accommodation situated anywhere in the EEA would be treated as trading for certain tax purposes.

This option would further expand the gap between the tax treatment of FHL landlords and other types of landlord.

**Option 3:** Partial repeal of the FHL legislation from 2009-10 onwards, and extend the remaining FHL legislation to include properties situated elsewhere in the EEA.

In order to retain some of the existing tax treatments for UK FHL properties, the remaining legislation would need to be extended to include properties situated elsewhere in the EEA.

A partial repeal of the FHL legislation would mean that landlords of FHL properties would no longer be treated as if they were trading for the purposes of loss relief and pension relief. They would continue to be treated as if they were trading for the purposes of capital gains, capital allowances and LESA only.

This option would retain some of the preferential tax treatments available to FHL landlords. This means that there will still be a discrepancy between the tax treatment of other types of landlord when compared to FHL landlords.

**Data Source**

It has been assumed that, prior to 22 April 2009 (Budget day):

- all individuals with qualifying furnished holiday lettings situated in the UK will have completed the FHL section of their income tax return; and
- all individuals with qualifying furnished holiday lettings situated elsewhere in the EEA will have completed the overseas property income pages of their income tax return.

Following the Budget 2009 announcement, individuals with qualifying furnished holiday lettings situated elsewhere in the EEA, who wish to take advantage of the FHL rules, should complete the FHL section of their income tax return. Although the level of data currently held is not sufficient to accurately estimate the number of individuals with European FHL income, it is expected that sufficient information will be available within the next 6 months, and will be used to inform the final impact assessment.

**Taxpayer Populations**

The FHL rules apply to landlords who supply furnished holiday accommodation, which satisfies certain qualifying conditions. The rules do not apply to landlords of furnished holiday accommodation that fail to meet the qualifying conditions during the relevant period. The FHL rules do not apply to hotels, bed and breakfasts, some caravan parks and some holiday parks.

The following table gives estimates of the number of taxpayers who reported income from furnished holiday lettings in the UK and from foreign land and property in 2007-08. It also shows the number reporting losses from these sources and those setting FHL losses against other income.

Number of taxpayers, 2007-08 tax returns			
Income source	All taxpayers with reported income	Taxpayers with reported losses from income source	Taxpayers setting FHL losses against other income
Furnished holiday lettings in the UK	60,000	30,000	15,000
Foreign land and property	45,000	25,000	N/A

E.g. there were 60,000 individuals with UK FHL income, 30,000 of those made an FHL loss and 15,000 of those set the FHL loss against their income from other sources in the year of the loss.

These figures are derived from self-assessment returns. Where a taxpayer has income from foreign land and property we are unable to determine in a robust way the location of the property/properties so cannot accurately identify the number of taxpayers owning foreign property in the EEA. It is also not possible to identify how many of those taxpayers with income from foreign land and property let furnished holiday accommodation rather than other types of land and property. For the purposes of this impact assessment, we have presented an upper bound for the compliance costs and assumed that all taxpayers with income from foreign land and property would be affected by the change in the tax treatment of FHL situated in the EEA.

HMRC administrative systems do not collect such a detailed level of data in respect of companies. We are therefore unable to estimate precisely the numbers of companies which would be affected by repealing the FHL legislation. Companies House records show that 3,000 companies are classified as providing camp sites and other short stay accommodation but not all of those companies identified under this category would be affected by the repeal of the FHL rules: based on their trade description as well, fewer than 500 companies would be considered likely to be affected. There may also be a number of companies who have a small amount of FHL income to supplement their main source of income, but judging by the way in which these companies describe their activities, FHL is unlikely to be a significant part of their income. It has been assumed that individuals form the vast majority of the users of FHL rules.

The following table shows estimates of the total income levels of those individuals with income from Furnished Holiday Lettings, compared with the total income level of the overall population.

2007-08 income tax returns, percentages		
Total taxable income (annual taxable income after deductions and loss relief).	Overall population	Individuals with income from Furnished Holiday Lettings
< £20,000	58%	49%
£20,000 to < £30,000	21%	15%
£30,000 to < £50,000	15%	19%
£50,000 to < £70,000	4%	6%
£70,000 to < £100,000	2%	4%
£100,000 and over	2%	7%

Almost a half of individuals with FHL income have an annual net income of less than £20,000. However, when compared to the income pattern of the UK taxpaying population as a whole, those individuals with FHL income tend to have slightly higher incomes than those without FHL income. In particular, only 8 percent of UK taxpayers earn more than £50,000, but 17% of those with FHL income earn more that £50,000.

**Costs and Benefits / Impacts Option 1: Repeal the FHL legislation with effect from 2010-11 (includes an extension of the FHL legislation, to include properties situated elsewhere in the EEA, for 2009-10 only)**

There are two elements to this option - a one year extension in 2009-10 whereby furnished holiday lettings rules would be applied to all properties in the EEA, followed by repeal of the FHL rules with effect from 2010-11 for all FHL properties.

**Compliance Cost of Temporary Extension**

There would be a one-off compliance cost for taxpayers with furnished holiday lettings in the EEA outside of the UK as the tax treatment would change for 2009-10. All such taxpayers would need to familiarise themselves with the new guidelines as they would no longer be eligible for certain allowances and reliefs in 2009-10. As an upper bound for the one-off increase in compliance costs of the temporary extension we have assumed an average hourly cost of £20 and 20 minutes for all the 45,000 taxpayers reporting income arising from foreign land and property to become familiar with the change in legislation and calculate the tax consequences. This gives rise to a one-off increased compliance cost of £300,000. To mitigate the administration burden on landlords with FHL in the EEA, the interim extension of the FHL rules to EEA properties is optional. Therefore those landlords wishing to remain outside the FHL rules could do so.

**Other Impacts of Temporary Extension**

The tax effects of the temporary extension will be the same as shown under option 2, but these affects will only apply for a limited period.

**Compliance Cost of Repeal**

Once the FHL legislation is repealed, with effect from 2010-11, we expect most FHL landlords would fall within the property income rules, but there are some businesses who may be trading. Such businesses would need to decide whether they fall within the property income rules or the trading income rules. This decision would depend on the facts. Most taxpayers with FHL income from properties situated elsewhere in the EEA would have made such an assessment recently. They would need to update that assessment, but we have assumed this cost would be negligible. For the 60,000 taxpayers with UK FHL income, we have assumed this assessment would take an average of 20 minutes. This acknowledges that the decision would be less time consuming for most taxpayers, but more time consuming for others. At an average hourly cost of £20 we estimate an additional one-off increased compliance cost of £400,000.

For the purposes of this impact assessment we have assumed that the impact on those who are actually trading would be negligible. We have also presented an upper bound for the impacts by assuming that all taxpayers with FHL income would fall within the property income rules.

There would be a one-off compliance cost for all taxpayers with income or gains from UK or EEA furnished holiday lettings. They would need to become familiar with the revised tax treatment around loss relief, capital allowances, LESA, some capital gains reliefs and pension reliefs applicable from 2010-11. The revised tax treatment could affect up to 105,000 taxpayers – of which there are 60,000 taxpayers with furnished holiday lettings in the UK, and up to 45,000 taxpayers with income from foreign land and property. We do not know how many of this latter group have properties within the EEA. We have assumed an average hourly cost of £20 and 20 minutes for all these 105,000 taxpayers to become familiar with the new guidance following the change in legislation, resulting in an additional one-off increased compliance cost of £700,000.

The on-going compliance costs after repeal would be approximately the same as now.

## **Administrative Burden of Repeal**

Once the repeal came into effect there would be an on-going compliance saving for all taxpayers with furnished holiday letting income, particularly for those setting such losses against other sources of income or claiming capital allowances, as they would benefit from having a simplified tax calculation. The 15,000 individuals setting furnished holiday letting losses against other sources of income would no longer be required to calculate this set off. We have assumed an average hourly cost of £20 per hour and a 5 minute saving for the loss relief computation, resulting in a reduction in the administrative burden of £25,000.

The 25,000 individuals claiming capital allowances would move onto the wear and tear allowance, which is simpler to calculate. We have assumed an average hourly cost of £20 per hour and a 5 minute saving for replacing the capital allowances computation with the wear and tear allowance computation, resulting in a reduction in the annual administrative burden of £40,000.

Taxpayers with income from both furnished holiday lettings and other property income could combine their income from these sources on their tax return. It has been assumed that any such reduction in administrative burdens from this would be negligible.

## **Computation of profits**

Currently FHL profits and losses are calculated under the property income rules. This treatment would continue after the repeal. Therefore businesses would still be able to claim business expenses (such as mortgage interest, the cost of repairs, rates, utilities and employees' wages) as a deduction against their taxable income, in the same way as they do now.

## **Loss relief**

Under the FHL rules, losses are treated in the same way as trade losses. Whilst the repeal of the FHL rules would change the way in which FHL losses can be used, loss relief would still be available.

Currently companies can set their FHL losses against their income from other sources in the accounting period of the loss or the previous accounting period, or against future FHL profits. Under the property income rules companies would be able to set their losses against income from other sources in the accounting period or future accounting periods. The main impact on company losses would also be the timing of relief.

Currently individuals can set their FHL losses against their income from other sources in the year of the loss or the previous year, or against future FHL profits. There are special rules for losses incurred in the first four tax years, or the last 12 months of the FHL business. Under the property income rules individuals would be able to set their FHL losses against other property income in the year or future years.

The FHL rules are only available to commercial businesses run with a view to a profit, although some such businesses would make losses from time to time, we anticipate that the majority of these businesses would return to profitability in the longer term. Therefore for individuals and partnerships the main impact on losses would be the timing of relief. We estimate that the impact of changing the way in which loss relief is given would be a £20 million increase in tax due for 2010-11. This is based on the average effective rate of income tax of individuals with FHL income, and the total FHL loss relief claimed in 2007-08 by individuals and partnerships. This impact is likely to decrease over time.

Self-Assessment returns provide some limited information on the characteristics of those affected. Those making use of the FHL loss rules tend to have higher incomes than others with FHL income, and substantially higher than the population in general. This is shown in the table

below. Approximately 15,000 individuals and 500 partnerships set FHL losses against their other income.

2007-08 tax returns, percentages			
Total taxable income (annual taxable income after deductions and loss relief).	All individuals with income from Furnished Holiday Lettings	Individuals with income from Furnished Holiday Lettings with no losses to offset	Individuals with income from Furnished Holiday Lettings with losses offset against total income
< £20,000	49%	54%	34%
£20,000 to < £30,000	15%	15%	15%
£30,000 to < £50,000	19%	18%	22%
£50,000 to < £70,000	6%	5%	9%
£70,000 to < £100,000	4%	3%	7%
£100,000 and over	7%	5%	13%

Tax returns do not capture information on the location of the furnished holiday letting, but analysis of 2007-08 tax returns shows that almost a quarter of those taxpayers setting FHL losses against other income live in London, or the South East. This however does not necessarily reflect the location of their property.

Taxpayers with income from furnished holiday lettings in the UK, by registered address of the taxpayer

Government Office Region	All individuals with income from Furnished Holiday Lettings	Individuals with income from FHL with no losses to offset	Individuals with income from FHL with losses offset against total income
North East	2,000 3%	1,300 3%	700 4%
North West	4,800 8%	3,300 8%	1,400 9%
Yorkshire & Humberside	4,700 8%	3,500 8%	1,200 8%
East Midlands	3,100 5%	2,100 5%	900 6%
West Midlands	3,900 6%	2,600 6%	1,200 8%
East of England	5,300 9%	3,800 9%	1,400 9%
London	5,200 9%	3,600 8%	1,500 9%
South East	7,800 13%	5,300 12%	2,500 15%
South West	13,200 22%	10,200 23%	3,000 18%
Wales	4,100 7%	3,300 7%	900 5%
Scotland	5,200 9%	3,900 9%	1,300 8%
Northern Ireland	800 1%	700 2%	100 1%
<b>Total</b>	<b>59,900</b>	<b>43,600</b>	<b>16,200</b>

NB due to rounding columns and rows may not total

## Capital Allowances

Under the FHL rules, capital allowances are available for expenditure incurred on plant and machinery used within the FHL property. Capital allowances would continue to be available for such expenditure incurred before the date of repeal. After the repeal FHL businesses would be able to claim the wear and tear allowance instead of capital allowances for new expenditure. The wear and tear allowance is a tax deduction equal to 10 per cent of net rents given to landlords of furnished houses (but not currently to FHL landlords), to cover the costs of replacing plant and machinery within those houses. Capital allowances would continue to be available for expenditure incurred on plant and machinery used by the FHL businesses, but not within the FHL property (e.g. a business computer).

In 2007-08 the total capital allowances claimed by individuals and partnerships with FHL businesses was £35 million. In that year, FHL receipts of the same population totalled approximately £530 million, so we estimate that over £50 million would have been available under the wear and tear allowance. The figures declared in the 2006-07 tax returns show a similar result. In the short to medium term therefore we estimate that more allowances would be available after the repeal of FHL rules.

In the longer term, there might be an impact on businesses that incur significant expenditure on new plant and machinery. We expect the number of such businesses, however, to be small.

Capital allowances are also available to companies under the FHL rules. We do not hold specific data on the capital allowances claimed by FHL companies; however we expect the effect on individual companies to be similar to the effect on individuals and partnerships.

Overall, we estimate that the impact of replacing capital allowances with the wear and tear allowance would be a £5 million reduction in tax due.

## LESA

The Landlords Energy Savings Allowance (LESA) allows landlords of residential properties to claim a tax deduction for capital expenditure on certain energy saving improvements to their properties. FHL landlords are currently unable to claim the LESA. After the repeal FHL businesses would be entitled to claim the LESA. We estimate the effect of this change will be negligible.

## Capital Gains

HMRC administrative systems do not collect such a detailed level of data in respect of capital gains. We are therefore unable to estimate the numbers of businesses which would be affected by repealing the FHL legislation. In 2007-08 there were 7,000 individuals with FHL income and capital gains. Not all of these gains would necessarily relate to FHL assets, and only gains relating to FHL assets would be affected by a repeal of the FHL rules.

There are various capital gains reliefs currently available under the FHL rules:

- Entrepreneurs' relief;
- Roll over relief on the replacement of business assets;
- Relief for gifts of business assets;
- Relief for loans to traders; and
- Exemptions for disposal of shares by companies with substantial shareholdings.

The data available to HMRC are not sufficient to calculate the impacts of each relief accurately but it is assumed that rollover relief and entrepreneurs' relief are the most widely used. We estimate the number of claims for the other FHL CG reliefs are likely to be very small, and the yield negligible.

For capital gains purposes, FHL businesses will cease to be treated as a trade from 6 April 2010 for individuals and partnerships (or from 1 April 2010 for companies). After this date, FHL businesses will continue to treat periods up until 5 April 2010 (or 31 March 2010 for companies) as trading periods for capital gains purposes.

For individuals with an existing FHL business that ceases to be treated as a trade from 6 April 2010, entrepreneurs' relief will continue to be available until 5 April 2013 (provided the other conditions for the relief are satisfied) on disposals of assets used in the FHL business at that date. Where the FHL business ceased before 6 April 2010, entrepreneurs' relief will also remain available for up to three years after the date of the cessation. Therefore, the repeal of entrepreneurs' relief for individual's existing FHL businesses will have no effect on Exchequer receipts for the years up to 2013-14. We estimate the impact on new FHL businesses during this period to be negligible.

Where a company has an FHL business that ceases to be treated as a trade from 1 April 2010, the capital gains consequences may be confined to roll-over relief (see next paragraph). Where the FHL business is only a minor part of the company's activities, the cessation of trading treatment may not mean the company ceases to count as a "trading company" (or the "holding company of a trading group"). The substantial shareholdings exemption and the other capital gains reliefs in relation of disposals of shares in trading companies (or groups) may therefore continue to be available. Overall we estimate the impact of repealing the capital gains reliefs for FHL businesses to be negligible where the FHL business is carried on by a company.

Roll-over relief will not be available in respect of disposals or acquisitions of FHL assets from 6 April 2010 for individuals and partnerships (or from 1 April 2010 for companies). Roll-over relief defers the tax charge on capital gains, rather than providing an absolute reduction in tax, so the impact will be one of timing. We anticipate that the number of disposals of chargeable FHL assets in any year will be low. When viewed as group, we do not think that there will be sufficient instances of qualifying chargeable gains, in any one year, for the repeal to have more than a negligible total costing.

We estimate that the additional tax generated from the absence of roll-over relief for FHL businesses will be negligible.

So taking these considerations together, we consider the consequences to Exchequer yield over the next 5 years would be negligible. We anticipate that there will be increased yield from chargeable gains in the longer term, but we do not hold sufficient information to produce a robust estimate of this increase. Although we estimate the number of affected chargeable gains in any year to be low we do recognise that the impact on individual businesses when they make such a disposal may be material.

## **Pension relief**

Pension relief is not available to companies, nor is it available to individuals on distributions from a company, therefore only individuals and partners will be affected by this change.

An individual can claim tax relief on payments they make into a pension scheme. The amount of relief available in a tax year is limited to the greater of £3,600 or 100 per cent of their total qualifying income. Under the FHL rules, FHL income is qualifying income for pension relief purposes. This means that the repeal would reduce the maximum tax relief available for pension contributions.

Very few individuals make sufficient payments into pension schemes to enable them to claim the maximum available pension relief. Most FHL landlords have other qualifying income, or contribute less than £3,600 to a qualifying pension scheme.

In 2007-08 those with FHL income on average claimed pension relief worth a total of £8.5million. Almost two thirds of the FHL landlords who claimed pension relief did not contribute more than £3,600. In 2007-08 less than 1,800 individuals would have been affected by a change to the FHL pension relief rules, however, the majority of those had low taxable incomes.

As individuals can obtain tax relief on contributions to a pension scheme, up to a maximum of £3,600 a year, without regard to their qualifying income, and our analysis shows that the majority of FHL landlords would not be adversely affected by this change, we estimate that the impact of repealing this relief would be negligible.

### **Total impact on tax**

We estimate that the total impact on the tax received by the exchequer will be a £10 million reduction in tax in 2010-11, a £25 million increase in tax in 2011-12, and a £15 million increase in tax in 2012-13. The ongoing increase in tax may change over the longer term.

These figures have been estimated on a receipts basis. The impact on tax receipts are normally shown on a receipts basis, because this is the impact felt by the Exchequer. Under self assessment, income tax is normally paid by instalments. Some tax will not be paid until after the end of the tax year to which it relates, this affects the year in which tax changes are recognised.

The reduction in tax in 2010-11, is a result of the current temporary extension to the EEA that was announced at Budget 2009.

The increase in 2011-12 is much larger, because it includes the full increase in tax for 2010-11 and some of the increase in tax for 2011-12. This is a result of using the receipts basis.

### **Tourism**

Many providers of holiday accommodation (e.g. hotels, bed and breakfasts and those not satisfying the FHL qualifying conditions) will be unaffected by this change. Those businesses that are affected will still be able to benefit from a range of reliefs available under property income rules. Some businesses may pay more tax as a result of the change, but the impact on continuing, viable, businesses is expected to be limited.

For this change to affect the UK tourism industry materially, a significant number of tourists would need to stop using these businesses, or other UK alternatives. This change is unlikely to affect demand for holiday accommodation in the UK. We do not expect this change to materially reduce the overall number of holiday accommodation bed-spaces in the UK. Therefore we do not anticipate that this change will have a material impact upon the wider tourism industry.

### **Other**

Increasing the tax payable on the income arising on FHL properties gives rise to slightly lower returns on investment, which could cause some taxpayers to sell their FHL property or change its use. Additionally some capital expenditure might be deferred.

Eliminating the tax advantage of furnished holiday lettings in the UK over those situated in other EEA countries would allow taxpayers to choose the location of their furnished holiday let without tax distortion. Eliminating the tax advantage of furnished holiday lettings over other types of property would allow taxpayers to choose how they rent their properties without tax distortion.

## **Summary of option 1 costs**

We estimate that there will be:

- a one off compliance cost of £1,400,000
- an ongoing £65,000 reduction of administrative costs
- a £10 million reduction in tax in 2010-11, a £25 million increase in tax in 2011-12, and a £15 million increase in tax in 2012-13. The ongoing increase in tax may change over the longer term.

## **Costs and Benefits / Impacts Option 2: Extend the FHL rules to include other EEA properties from 2009-10 onwards**

### **Compliance Cost and Administrative Burden**

There would be additional compliance costs on those with FHL properties in the EEA (outside of the UK). As with option 1 there would be a one-off increased compliance cost, of around £300,000, as all such taxpayers would need to familiarise themselves with the new guidelines.

There would also be an on-going increase in compliance costs for all taxpayers with furnished holiday letting income in the EEA, as they would have a more complex tax calculation, and would have to keep separate records of their furnished holiday letting income and other foreign property income. Up to 45,000 taxpayers could be affected, although those with losses from furnished holiday lettings in the EEA – of which there are up to 25,000 – or incurring expenditure on plant and machinery could be most affected. Using similar assumptions as outlined above, up to 45,000 taxpayers would need to calculate their entitlement to capital allowances, and up to 25,000 taxpayers with losses arising on properties abroad. Overall for these businesses we estimate that this could lead to an on-going increase of up to £115,000 in the administrative burden.

### **Computation of profits**

As with option 1, the way landlords of furnished holiday accommodation in the EEA calculate their profits or losses will not change. Landlords of furnished holiday accommodation in the EEA will continue to calculate their profits under the property income rules if they are brought within the FHL rules.

### **Loss relief**

An extension of the FHL rules to properties in the EEA, will change the way in which EEA FHL losses can be used.

Under the overseas property income rules, individuals are able to set their FHL losses against other overseas property income in the year or future years. Under the FHL rules, individuals could set their EEA FHL losses against their income from other sources in the year of the loss or the previous year, or against future FHL profits. There are special rules for losses incurred in the first four tax years, or the last 12 months of the FHL business.

Under the property income rules companies set their losses against income from other sources in the accounting period or future accounting periods. Under the FHL rules companies are able to set their EEA FHL losses against their income from other sources in the accounting period of the loss or the previous accounting period, or against future FHL profits.

The sum of losses made by all individuals with overseas income from property and reporting a loss was £80 million. As stated above, we are unable to accurately determine how many of these taxpayers held EEA FHL properties. If we assume the same proportion of losses for EEA FHL is set-off against other income as in the UK then we estimate the cost of extending the loss relief rules to landlords with EEA FHL to be up to £15 million.

### **Capital Allowances**

Landlords with overseas property are not entitled to claim capital allowances, but they may claim the wear and tear allowance. Under the FHL rules they would be entitled to claim capital allowances if they incur expenditure on plant and machinery within the FHL business, but they would no longer be entitled to claim the wear and tear allowance.

In 2007-08 almost 20,000 overseas landlords claimed a total of almost £10 million under the wear and tear allowance. It is not possible to estimate the amount of capital allowances that overseas landlords could have claimed under the FHL rules. However, we know that expenditure on certain types of plant and machinery (e.g. swimming pools) is more common for properties situated in other parts of Europe.

We estimate that the overall impact of replacing the wear and tear allowance with capital allowances for landlords of furnished holiday accommodation in the EEA would be a £5 million increase in tax due in the short term, however the availability of capital allowances could cause a behavioural shift, resulting in a higher cost.

## **LESA**

The Landlords Energy Savings Allowance (LESA) allows landlords of residential properties to claim a tax deduction for capital expenditure on certain energy saving improvements to their properties. LESA is available to landlords of UK and overseas properties, but not FHL properties. After the extension EEA FHL landlords would not be able to claim the LESA. We estimate the effect of this change will be negligible.

## **Capital Gains**

An extension of the FHL rules will allow those disposing of assets used within an EEA FHL business to claim various capital gains reliefs under the FHL rules.

- Entrepreneurs' relief,
- Roll over relief on the replacement of business assets,
- Relief for gifts of business assets,
- Relief for loans to traders,
- Exemptions for disposal of shares by companies with substantial shareholdings.

HMRC administrative systems do not collect such detailed level data in respect of capital gains. We are therefore unable to estimate the numbers of businesses which would be affected by extending the FHL legislation. In 2007-08 there were 5,750 individuals with income from overseas property and capital gains on disposals of property and other assets. Not all of these gains would be attributable to EEA FHL assets: only gains relating to EEA FHL assets would be affected by an extension of the FHL rules.

Given the number of gains declared by those with overseas property income businesses, it has been assumed that the consequences to Exchequer yield over the next 5 years would be negligible. We anticipate that there will be decreased yield from chargeable gains in the longer term, but we do not hold sufficient information to produce a robust estimate of this increase.

## **Pensions relief**

An extension of the FHL rules to properties situated in the EEA would increase the maximum tax relief available for pension contributions by EEA FHL landlords.

Very few individuals make sufficient payments into pension schemes to enable them to claim the maximum available pension relief. We therefore estimate that the impact of extending this relief would be negligible.

## **Total impact on tax**

We estimate that the total impact on the tax received by the exchequer will be a £15 million reduction in tax in 2010-11, a £5 million reduction in tax in 2011-12, and a £5 million reduction in

tax in 2012-13. The ongoing increase in tax may change over the longer term, and it is likely that the reduction in tax will increase over time.

These figures have been estimated on a receipts basis. The impact on tax receipts are normally shown on a receipts basis, because this is the impact felt by the Exchequer. Under self assessment, income tax is normally paid by instalments. Some tax will not be paid until after the end of the tax year to which it relates, this affects the year in which tax changes are recognised.

The reduction in tax in 2010-11, is much larger because it includes the current temporary extension to the EEA that was announced at Budget 2009.

## **Tourism**

Extending the FHL rules to EEA properties would limit their benefit to UK tourism as it would allow UK landlords who invest in holiday accommodation abroad to claim the same preferential treatment. It is likely that an indefinite extension of the FHL rules to EEA properties would also negatively impact upon UK tourism.

## **Other**

The tax distortion between furnished holiday lettings in the UK and EEA would be removed.

Taxpayers with FHL properties in the EEA might benefit from higher post tax income.

In line with the conventions for scoring Budget policy decisions, the costs above are based upon the current estimated levels of FHL ownership. Recent years have seen strong growth in the number of taxpayers owning properties abroad. This trend is likely to continue and could increase further if the FHL rules were extended to include EEA properties on an indefinite basis. Therefore the cost to the exchequer of such an extension to the FHL rules would be expected to rise.

The cost to HMRC of ensuring compliance with the rules elsewhere in the EEA is likely to be more significant than ensuring compliance within the UK alone.

## **Summary of option 2 costs**

We estimate that there will be:

- a one off compliance cost of £300,000
- an ongoing £115,000 increase of administrative costs
- a £15 million reduction in tax in 2010-11, a £5 million reduction in tax in 2011-12, and a £5 million reduction in tax in 2012-13. The ongoing reduction in tax may change over the longer term.

**Costs and Benefits / Impacts Option 3: Partial repeal of the FHL legislation with effect from 2010-11, and extend the remaining FHL legislation to include properties situated elsewhere in the EEA.**

There are two elements to this option - an extension of the furnished holiday lettings rules to all properties in the EEA, and a repeal of the FHL loss relief and pension relief rules for all FHL properties. These changes would take effect from 2010-11.

**Compliance Cost and Administrative Burden**

There would be additional compliance costs on those with FHL properties in the EEA (outside of the UK). As with option 1 there would be a one-off increased compliance cost, of around £300,000, as all such taxpayers would need to familiarise themselves with the new guidelines.

There would be a one-off compliance cost for all taxpayers with income or gains from UK or EEA furnished holiday lettings. They would need to become familiar with the revised tax treatment around loss relief and pension reliefs applicable from 2010-11. The revised tax treatment could affect up to 105,000 taxpayers, including all taxpayers with furnished holiday lettings in the UK, and up to 45,000 taxpayers with income from foreign land and property. We do not know how many of this latter group have properties within the EEA. We have assumed an average hourly cost of £20 and 15 minutes for all these 105,000 taxpayers to become familiar with the new guidance following the change in legislation, resulting in an additional one-off increased compliance cost of £525,000.

The on-going compliance costs after the partial repeal would be approximately the same as now.

Once the repeal came into effect there would be an on-going saving in the administrative burden for all taxpayers with furnished holiday letting income, but particularly for those setting such losses against other sources of income, as they would benefit from having a simplified tax calculation. The 15,000 individuals setting furnished holiday letting losses against other sources of income would no longer be required to calculate this set off. We have assumed an average hourly cost of £20 per hour and a 5 minute saving for the loss relief calculation, resulting in an on-going reduction in the administrative burden of £25,000.

There would also be an on-going increase in compliance costs for all taxpayers with furnished holiday letting income in the EEA, as they would have a more complex tax calculation, and would have to keep separate records of their furnished holiday letting income and other foreign property income. Up to 45,000 taxpayers could be affected, although those incurring expenditure on plant and machinery could be most affected. Assuming a similar proportion of taxpayers claiming capital allowances for UK property we estimate that the number of taxpayers with FHL properties in the EEA could be up to 20,000 who would need to calculate their entitlement to capital allowances. We have assumed an average hourly cost of £20 per hour and a 5 minute saving for the loss relief calculation, resulting in an on-going increase in the administrative burden of £30,000.

**Computation of profits**

As with option 1, the way landlords of furnished holiday accommodation in the EEA calculate their profits or losses will not change. Landlords of furnished holiday accommodation in the EEA will continue to calculate their profits under the property income rules if they are brought within the FHL rules.

## **Loss relief**

As with option 1, whilst the repeal of the FHL rules would change the way in which FHL losses can be used, loss relief would still be available.

We estimate that the overall impact of withdrawing the loss relief FHL rules would be £20 million due in additional tax.

## **Capital Allowances**

As with option 2, we estimate that the overall impact of replacing the wear and tear allowance with capital allowances for landlords of furnished holiday accommodation in the EEA would be a £5 million increase in tax due in the short term, however the availability of capital allowances could cause a behavioural shift, resulting in a higher cost.

## **LESA**

The Landlords Energy Savings Allowance (LESA) allows landlords of residential properties to claim a tax deduction for capital expenditure on certain energy saving improvements to their properties. LESA is available to landlords of UK and overseas properties, but not FHL properties. As with option 2, after the extension, EEA FHL landlords would not be able to claim the LESA. We estimate the effect of this change will be negligible.

## **Capital Gains**

As with option 2, an extension of the FHL rules will allow those disposing of assets used within an EEA FHL business to claim various capital gains reliefs under the FHL rules.

- Entrepreneurs' relief,
- Roll over relief on the replacement of business assets,
- Relief for gifts of business assets,
- Relief for loans to traders,
- Exemptions for disposal of shares by companies with substantial shareholdings.

HMRC administrative systems do not collect such a detailed level of data in respect of capital gains. We are therefore unable to estimate the numbers of businesses which would be affected by extending the FHL legislation. In 2007-08 there were 5,750 individuals with income from overseas property and capital gains on disposals of property and other assets. Not all of these gains would be attributable to EEA FHL assets: only gains relating to EEA FHL assets would be affected by an extension of the FHL rules.

Given the number of gains declared by those with overseas property income businesses, it has been assumed that the consequences to Exchequer yield over the next 5 years would be negligible. We anticipate that there will be decreased yield from chargeable gains in the longer term, but we do not hold sufficient information to produce a robust estimate of this decrease.

## **Pensions relief**

As with option 1, as individuals can obtain tax relief on contributions to a pension scheme, up to a maximum of £3,600 a year, without regard to their qualifying income, and our analysis shows that the majority of FHL landlords would not be adversely affected by this change, we estimate that the impact of repealing FHL pension relief would be negligible.

## **Total impact on tax**

We estimate that the total impact on the tax received by the exchequer will be a £10 million reduction in tax in 2010-11, a £40 million increase in tax in 2011-12, and a £25 million increase in tax in 2012-13. The ongoing increase in tax may change over the longer term, and it is likely that the increase in tax will reduce over time.

These figures have been estimated on a receipts basis. The impact on tax receipts are normally shown on a receipts basis, because this is the impact felt by the Exchequer. Under self assessment, income tax is normally paid by instalments. Some tax will not be paid until after the end of the tax year to which it relates, this affects the year in which tax changes are recognised.

The reduction in tax in 2010-11, is a result of the current temporary extension to the EEA that was announced at Budget 2009.

The increase in 2011-12 is much larger, because it includes the full increase in tax for 2010-11 and some of the increase in tax for 2011-12. This is a result of using the receipts basis.

## **Tourism**

Many providers of holiday accommodation (e.g. hotels, bed and breakfasts and those not satisfying the FHL qualifying conditions) will be unaffected by this change. Those businesses that are affected will still be able to benefit from a range of reliefs available under property income rules. Some businesses may pay more tax as a result of the change, but the impact on continuing, viable, businesses is expected to be limited.

For this change to affect the UK tourism industry materially, a significant number of tourists would need to stop using these businesses, or other UK alternatives. This change is unlikely to affect demand for holiday accommodation in the UK. We do not expect this change to materially reduce the overall supply of holiday accommodation in the UK. Therefore we do not anticipate that this change will have a material impact upon the wider tourism industry.

Extending the remaining FHL rules to EEA properties would limit their benefit to UK tourism as it would allow UK landlords who invest in holiday accommodation abroad to claim the same preferential treatment. It is likely that an indefinite extension of the FHL rules to EEA properties would also negatively impact upon UK tourism.

## **Other**

Taxpayers with FHL properties in the EEA might benefit from higher post tax income.

Increasing the tax payable on the income arising on UK FHL properties gives rise to slightly lower returns on investment, which could cause some taxpayers to sell their FHL property or change its use.

The tax distortion between furnished holiday lettings in the UK and EEA would be removed.

In line with the conventions for scoring Budget policy decisions, the costs above are based upon current the estimated levels of FHL ownership. Recent years have seen strong growth in the number of taxpayers owning properties abroad. This trend is likely to continue and could increase further if the FHL rules were extended to include EEA properties on an indefinite basis. Therefore the cost to the exchequer of such an extension to the FHL rules would be expected to rise.

The cost to HMRC of ensuring compliance with the rules elsewhere in the EEA is likely to be more significant than ensuring compliance within the UK alone.

### **Summary of option 3 costs**

We estimate that there will be:

- a one off compliance cost of £825,000
- a net £5,000 increase in ongoing administrative costs
- a £10 million reduction in tax in 2010-11, a £40 million increase in tax in 2011-12, and a £25 million increase in tax in 2012-13. The ongoing increase in tax may change over the longer term.

## **Administrative Burden**

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular; the admin burden of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model' (SCM), an activity based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

Under the preferred option all the ongoing cost represents a reduction in the administrative burden for those with UK FHL income, but this would be small at £65,000 per annum. Under option 2, those taxpayers with FHL properties in the EEA would face an increase in their administrative burden – this is estimated at £115,000 per annum. Similarly under option 3 there would be a small net increase in administrative burdens, estimated to be £5,000 per annum.

## **Implementation Plan**

The changes will be legislated in Finance Bill 2010. Guidance will be published on the HMRC website. Implementation of the policy will not require additional resources for HMRC.

## **Competition assessment**

Applying the Office of Fair Trading competition filter to the affected sectors to assess the impact of the proposed measure results in the conclusion that an in depth competition assessment is not warranted because the estimated impacts on competition are not significant.

All the options may have a small but positive effect on competition. The current FHL rules may result in a distortion faced by UK individuals choosing where to buy a holiday property: properties in the UK are made artificially more attractive compared to properties in the rest of the EEA. All three of these options may remove this distortion.

The change will reduce the risk of anti-competitive effects arising because the chance of similar businesses being treated differently based on the location of their property will be removed. The focus on fair and equal treatment supports the principle of fair and vigorous competition. The reform will not have an impact on businesses' or individuals' capacity to enter the property or other markets but it will help facilitate competition by ensuring that new and existing businesses are treated equally and by removing actual or potential market distortion based on the location of the property.

One objective of the change is to remove the differences in the tax treatment resulting from owning different types of property. The change will place all landlords on a level playing field, and so remove the distortion faced by individuals choosing whether to rent their properties to holiday makers or to other types of tenant. As other providers of other types of holiday accommodation may be taxed under the trading income rules, this change may create a small distortion within the holiday accommodation sector. To be taxed under the trading income rules providers of holiday accommodation must also provide additional services, such as the provision of meals, and such treatment will depend on the facts of the case. Taxation will be one of a number of factors that will be considered when deciding which type of accommodation to provide. Supply and demand, profitability, and the level of additional work necessary in order to provide additional services are likely to be the primary deciding factors.

## **Small Firms Impact Test**

This change would primarily affect businesses with fewer than 20 employees because businesses letting furnished holiday accommodation tend to be small. The preferred option would bring furnished holiday letting businesses into line with other property businesses, which are also predominantly small.

Analysis of tax returns suggests that the vast majority of businesses setting losses arising from furnished holiday lettings against other forms of income are small.

It was not possible to retain the FHL rules for small FHL businesses, without also extending the rules to small FHL businesses in the EEA. Therefore the change to the FHL rules will also apply to small businesses. In order to give small businesses time to plan for this change, the implementation of the withdrawal has been deferred for one year, until 2010-11.

We have listened to the concerns raised by small businesses since this change was announced, and we are open to comments on the draft legislation.

## **Diversity**

We have considered carefully the impact on race, disability and gender, and have carried out an equality impact assessment initial screening. We have found that some groups will be affected more than others, but only insofar as these characteristics are correlated with the incidence of individuals running FHL businesses. As the changes will treat all those with FHL income equally, we have concluded that the measure has no effect on race, disability, and gender.

If you disagree with our assessment of the impact of this measure on race, disability and gender we would be grateful to hear from you so that your comments may inform the final impact assessment. Please see below for further information on how to send us your comments.

## **Rural Impacts**

HMRC holds information analysing the location of the owners of let furnished holiday properties, but it does not hold information detailing the location of the property itself. We believe that furnished holiday properties are more likely to be located in rural areas. However, many providers of holiday accommodation in rural areas will be unaffected by this change. Those businesses that are affected will still be able to benefit from a range of reliefs available under the property income rules. Some businesses may pay more tax as a result of the change, but the impact on continuing, viable, businesses is expected to be limited.

We do not expect this change to materially reduce the overall number of holiday accommodation bed-spaces in rural areas, and this change is unlikely to affect demand for holiday accommodation in rural areas. Therefore we do not anticipate that this change will have a material impact upon the wider tourism industry in rural areas.

## **Other Impact Tests**

Other impact assessments were undertaken and found that the changes should have no significant impact on legal aid or sustainable development. Assessments for carbon or environmental impacts or health impacts concluded that these issues are not applicable.

## **Consultation**

As there were doubts about whether the FHL rules complied with EU law, the government acted swiftly to equalise the rules as they apply to UK and properties elsewhere in the EEA. In order to avoid creating uncertainty for taxpayers, by announcing a change of view without also announcing how the rules were to be equalised in the longer term, it was decided to make these announcements together. It was therefore not appropriate to consult publicly on the effects of these changes prior to their announcement.

Since the announcement of this change we have listened to the concerns of the tourism industry and the accountancy profession. We have used information provided by the industry to inform this impact assessment.

We would be grateful to hear from you if you have any information which you feel should inform the final impact assessment. Please send your comments, by 26 February 2010, to Jenni Rich at -

HMRC CT & VAT  
100 Parliament Street  
London  
SW1A 2BQ

or email: [jenni.rich@hrcm.gsi.gov.uk](mailto:jenni.rich@hrcm.gsi.gov.uk).

We are publishing this impact assessment alongside the draft legislation for the repeal of the FHL rules, which has been published on the HMRC website in a separate document, *Draft Legislation to Repeal the Furnished Holidays Lettings Rules from 2010-11*. HMRC is open to comment on the draft legislation, for further details please see *Draft Legislation to Repeal the Furnished Holidays Lettings Rules from 2010-11*.

## **Conclusion**

A change is required to ensure that the FHL rules comply with European law. It is recognised that neither a repeal of the rules, nor an extension of the rules to properties in the EEA would be entirely welcome. We have carefully weighed up all the impacts, costs and benefits of this measure and have concluded that withdrawing the FHL rules after a period of notice has the most positive results for stakeholders and government.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No