



**Withdrawing the Furnished Holiday Lettings Rules
from 2010-11**

Technical Note
9 December 2009

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Introduction

Landlords with income from furnished holiday accommodation in the United Kingdom (UK) are currently treated as if they are trading for certain tax purposes, as long as they satisfy certain tests, under the Furnished Holiday Lettings (FHL) rules.

Landlords with income from furnished holiday accommodation elsewhere in the European Economic Area (EEA) could not qualify for this treatment. They were treated instead in the same way as landlords of other types of overseas property, under the property income rules. This difference may not be compliant with European law.

At Budget 2009 the Government announced its intention to include legislation in Finance Bill 2010 to repeal the FHL rules from 2010-11.

HM Revenue and Customs (HMRC) published a technical note, [*Furnished Holiday Lettings in the European Economic Area*](#), at Budget 2009 explaining that until the FHL rules are repealed, HMRC will accept that the FHL rules also apply to the commercial letting of furnished holiday accommodation elsewhere in the EEA.

HMRC published draft legislation for this change at the Pre-Budget Report 2009: *Draft Legislation to Repeal the Furnished Holiday Lettings Rules*.

This note explains in more detail how FHL landlords will be affected by the repeal.

Chapter 1 - Overview

Who is likely to be affected?

Individuals, partnerships and companies who let furnished holiday property situated within the UK and other EEA countries, and who are liable to UK tax on the income and capital gains from the property.

What are the FHL rules?

The letting of property is not a trade. Income from letting property is taxed under the property income rules. However, the FHL rules treat the commercial letting of furnished holiday accommodation as a trade for certain specified tax purposes.

Under the FHL rules, those who let qualifying holiday accommodation are treated as though their FHL business is a trade for the following purposes:

- loss relief;
- capital allowances;
- Landlords Energy Saving Allowance (LESA);
- certain capital gains reliefs (including business asset roll-over relief, entrepreneurs' relief, relief for gifts of business assets, relief for loans to traders and exemptions for disposals of shares by companies with a substantial shareholding); and
- relevant UK earnings when calculating the maximum relief due for an individual's pension contributions.

For further information on the tax treatments available for FHL businesses, please see <http://home.inrev.gov.uk/pimmanual/PIM4105.htm>.

What does this change mean?

From 2010-11, FHL businesses will be treated in the same way as other types of property business. Those with FHL income will no longer be treated as though their qualifying FHL business is a trade for certain tax purposes, instead they will be treated as running a property business and the normal property income rules will apply.

Chapter 2 – Effects of the Repeal

Computation of business profits

Those who let furnished holiday accommodation currently compute their profits under the property income rules, even though they are treated as a trade for certain other purposes. In general the repeal will not affect the calculation of the business profits, but it will change the tax relief available for capital expenditure (see capital allowances section below).

FHL businesses may continue to claim their business expenses as a deduction when they compute their taxable income in the same way as they do now. Business expenses may include; mortgage interest, repairs, business utility bills, employee wages etc.

For further information about the property income rules, please see

<http://www.hmrc.gov.uk/manuals/pimmanual/index.htm>.

Capital allowances

Up until 1 April 2010 an ordinary property business, an overseas property business and a FHL business are all qualifying activities for plant and machinery capital allowances purposes. However, from 1 April 2010 a FHL business will no longer be a qualifying activity, instead it will either form a part of a UK property business, or an overseas property business. Those with FHL will not be treated as starting a new qualifying activity as a result of this change. There will be no deemed disposal and reacquisition at market value, any existing plant and machinery pools will simply continue.

Capital allowances will continue to be available for capital expenditure on plant and machinery used by the property business, but which is not for use in a dwelling house. However, under the capital allowances rules for property income, no capital allowances are available for expenditure incurred in providing plant and machinery for use in a dwelling house.

After 5 April 2010 for individuals and partnerships (or 31 March 2010 for companies) expenditure incurred in providing plant and machinery for use in a FHL dwelling house will not qualify for plant and machinery capital allowances.

However, for continuing businesses, where expenditure on plant and machinery for use in an FHL property was incurred before 5 April 2010 for individuals and partnerships (or 31 March 2010 for companies), then plant and machinery capital allowances will continue to be available after the date of repeal. For such expenditure, the normal rules on disposal proceeds, balancing charges and balancing allowances will also continue to apply.

For further information about capital allowances for property businesses, please see <http://www.hmrc.gov.uk/manuals/pimmanual/PIM3010.htm>.

10 per cent Wear and tear allowance

After the repeal, FHL businesses may claim the wear and tear allowance. The allowance is 10 per cent of the net rent from letting the furnished accommodation.

Continuing businesses may claim the wear and tear allowance, in addition to any capital allowances that they are entitled to (see above section on capital allowances).

For further information about the wear and tear allowance for furnished residential lettings, please see <http://www.hmrc.gov.uk/manuals/pimmanual/PIM3200.htm>.

Landlords Energy Savings Allowance (LESA)

FHL businesses will be entitled to claim a deduction under the LESA for expenditure incurred on or after 6 April 2010 (or 1 April 2010 for companies) for the purposes of acquiring or installing energy-saving items in the let property.

For further information about the LESA, please see <http://www.hmrc.gov.uk/manuals/pimmanual/PIM2072.htm>.

Loss Relief

After the FHL rules are withdrawn, tax relief will still be available for losses incurred through letting furnished holiday accommodation, but the way in which those losses can be used will change.

Income Tax

An unused FHL loss, arising from the commercial letting of furnished holiday accommodation in 2009-10, or previous tax years, will be treated for income tax purposes as a loss made in a property business in the tax year 2009-10. It can be deducted from the profits of that property business in 2010-11 and subsequent tax years.

Losses arising from the commercial letting of furnished holiday accommodation in 2009-10 or future tax years will be treated as a property business loss.

Corporation Tax

An unused FHL loss, arising from the commercial letting of furnished holiday accommodation in accounting periods starting before 1 April 2010, will be treated for corporation tax purposes as a loss made in a property business during the first accounting period starting on or after 1 April 2010. It can be deducted from the profits of that property business in that accounting period, and subsequent accounting periods.

Losses arising from the commercial letting of furnished holiday accommodation in accounting periods ending on or after 1 April 2010 will be treated as a property business loss.

For further information about the way in which UK property business losses can be used please see <http://www.hmrc.gov.uk/manuals/pimmanual/PIM4200.htm>.

Capital gains

FHL businesses will cease to be treated as a trade, for capital gains purposes, from 6 April 2010 for individuals and partnerships (or from 1 April 2010 for companies).

The repeal will not affect disposals of chargeable FHL assets (including shares in companies carrying on an FHL business) before 6 April 2010 for individuals and others liable to capital gains tax, (or 1 April 2010 for companies liable to corporation tax).

For disposals of chargeable FHL assets on or after 6 April 2010 (or 1 April 2010 for companies):

- the business will continue to be treated as a trading business up until 5 April 2010 (or 31 March 2010 for companies); and
- the business will be treated as a property income business from 6 April 2010 (or 1 April 2010 for companies).

The effects of this change for each of the capital gains reliefs are set out in more detail below.

Entrepreneurs' relief

For the purposes of the entrepreneurs' relief provisions, an FHL business will be deemed to have ceased on 5 April 2010. Where the FHL business continues after that date it will not be a qualifying business for entrepreneurs' relief purposes after the date of the deemed cessation.

Disposals of the whole or part of an unincorporated FHL business before 6 April 2010 will remain eligible for entrepreneurs' relief under the current rules. Disposals of the whole or part of an unincorporated FHL business on or after 6 April 2010 will not be eligible for entrepreneurs' relief.

Gains on assets used in an unincorporated FHL business up to the deemed cessation of the business will therefore qualify for entrepreneurs' relief if the asset is disposed of within three years of that deemed cessation, provided the other conditions for entrepreneurs' relief are satisfied. Disposals of assets after the end of that three year period will not be eligible for entrepreneurs' relief.

Similarly, where an unincorporated FHL business actually ceases before 5 April 2010, disposals of assets previously used in the business will remain eligible for entrepreneurs' relief under the current rules if the disposal is made within three years following the actual cessation, including cases where the disposal falls after 5 April 2010.

Disposals of assets previously used in an unincorporated FHL business which is deemed to have ceased on 5 April 2010 will not be eligible for the relief if the business began after 6 April 2009 (because the requirement for a trade to have been carried for at least one year before the business ceased will not be met).

Where a company (or group of companies) has an FHL business, disposals before 6 April 2010 of shares in the trading company in question (or the holding company of the trading group in question) will remain eligible for entrepreneurs' relief under the current rules. Disposals of shares in such companies on or after 6 April 2010 will not be eligible for entrepreneurs' relief unless either:

- the company continues to be a trading company (or the group continues to be a trading group) after the deemed cessation of the FHL business on 5 April 2010, in which case the normal entrepreneurs' relief rules will continue to apply; or
- the company ceased to be a trading company (or the holding company of a trading group) before 6 April 2010, including cases where the ending of that status results from the deemed cessation of the company's (or group's) FHL business on 5 April 2010, in which case disposals of shares in the company made within three years from that cessation will remain eligible for entrepreneurs' relief if the other qualifying conditions are met.

Disposals associated with a relevant material disposal ('associated disposals') will remain eligible for entrepreneurs' relief where

- the cessation of the FHL business took place before 6 April 2010, including cases where the FHL business is deemed to have ceased on 6 April 2010; and
- the other qualifying conditions are met.

Roll-over relief on the replacement of business assets

Disposals of FHL assets before 6 April 2010 (or 1 April 2010 for companies) will be eligible for roll-over relief if all the qualifying conditions are met.

Disposals of FHL assets on or after 6 April 2010 (or 1 April 2010 for companies) will not normally qualify for roll-over relief. Some roll-over relief may be due, if all qualifying conditions are met, where the person carrying on the FHL business carries on another trade, but relief on the disposal of the FHL assets will be restricted to take account of the time and extent of non-trade use, including the period after the deemed cessation of trading on 5 April 2010 (or 31 March 2010 for companies).

Gains that have been rolled over into acquisitions of FHL assets before 6 April 2010 (or 1 April 2010 for companies) will not be affected by the repeal.

Acquisitions of FHL assets occurring on or after 6 April 2010 (or 1 April 2010 for companies) will not be qualifying acquisitions for the purposes of roll-over relief.

Gains that have been *held over* (under section of the 154 Taxation of Chargeable Gains Act 1992) against a depreciating FHL asset, before 6 April 2010 (or 1 April 2010 for companies), will not be treated as accruing on 6 April 2010 (or 1 April 2010 for companies) as a result of the repeal. The held over gain will be treated as accruing on the earliest of:

- the date the asset is disposed of;
- the date the asset ceases to be used for the purposes of the FHL business; or
- the tenth anniversary of the acquisition of the asset.

Relief for gifts of business assets

Gifts of FHL assets made before 6 April 2010 will be eligible for the relief for gifts of business assets (if the qualifying conditions are met).

Gifts of FHL assets made on or after 6 April 2010 will not qualify for the relief for gifts of business assets.

Relief for loans to traders

Loans made before 6 April 2010 (or 1 April 2010 for loans to companies) for the purposes of an FHL business will still be qualifying loans for the purposes of the relief for loans to traders (including the relief for guarantee payments), even where the claim is made after that date.

Loans made on or after 6 April 2010 (or 1 April 2010 for loans to companies) for the purposes of an FHL business will not be qualifying loans for the purposes of the relief for loans to traders (nor the relief for guarantee payments).

Exemptions for disposal of shares by companies with substantial shareholdings

For periods up to 1 April 2010, FHL business will continue to be treated as a trade for the purpose of the substantial shareholdings exemption.

From 1 April 2010, an FHL business will not be treated as a trade for the purpose of the substantial shareholdings exemption.

A disposal of shares in company B (which carries on an FHL business) by company A, on or after the 1 April 2010, may still qualify for the substantial shareholdings exemption, if:

- subject to meeting certain conditions, the disposal would have qualified for the main substantial shareholdings exemption had it occurred at some time in the two years preceding the disposal (this will include the case where such a disposal in the period before 1 April 2010 would have qualified because company B's FHL business was treated as a trade); and
- at some point during the two year period leading up to the disposal, company A, (or a member or members of company A's group) controlled company B.

Pension relief

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 relevant UK earnings.

Individuals cannot include income from FHL, arising on or after 6 April 2010, within their relevant UK earnings when calculating the maximum relief due for their pension contributions.

Jointly owned property

Where furnished holiday accommodation is jointly owned by individuals who are married to each other, or who are civil partners of each other, and who live together, profits and losses from the letting are treated as arising in equal shares unless:

- the spouses (or civil partners) are entitled to the income in unequal shares; and
- their beneficial interests in the income correspond to their interests in the property from which the income arises; and
- they make a joint declaration in writing to HMRC.

Basis Periods for Income Tax

Individuals (and others within the charge to income tax) are normally assessed on both their property income and FHL income on a tax year basis. The repeal will not affect the basis period.

Professional and trading partnerships

If an FHL business is carried on by a partnership, and that partnership also has trading or professional income, then, for each partner, the basis period used for rental profits is the same as that used for the trading or professional income. In such a situation the basis period may not be the year to 5 April 2010. For periods of account spanning 5 April 2010, the profits or losses should be apportioned, on a reasonable basis, between the period up to 5 April 2010 and the period from 6 April 2010.

Accounting Periods for Corporation Tax

This change will not affect the way in which a company defines its accounting periods.

Inheritance Tax

The inheritance tax (IHT) rules remain unaffected by this change.

IHT business property relief (usually at 100 per cent) applies only to non-investment businesses, where the conditions of the relief are satisfied. The short-term letting of furnished holiday accommodation is primarily an investment activity and is therefore a business of holding investments. As such it would not usually qualify for IHT Business Property Relief (BPR) though this will depend on all the facts. More detailed guidance about holiday lettings and BPR can be found on the HMRC website at <http://www.hmrc.gov.uk/manuals/ihtmanual/IHTM25271.htm>.

Value Added Tax (VAT)

The repeal does not affect the VAT treatment. FHL businesses will still need to charge VAT at the standard rate if its income is above the VAT registration threshold.

Further information about the VAT treatment of holiday accommodation can be found at Section 5 of HMRC's [Notice 709/3 Hotels and holiday accommodation](#).

Business Rates

The business rates rules remain unaffected by this change. Properties used as holiday lets where the intention is to let for short periods totalling 140 days or more should be on the local rating list and will be liable for business rates rather than council tax.

Chapter 3 – Property Business or Trade?

Is my lettings business a trade?

The distinction between trade and property income is a long established principle in UK tax law. In most cases it is clear whether income derived from the ownership and occupation of land is chargeable to tax as profits of a property business or of a trade.

The commercial letting of furnished holiday accommodation will usually be a property business. The owner derives income by allowing a third party to occupy property for a specified period.

The owner may provide services of the kind normally provided by a landlord, such as:

- arranging new tenancies, including advertising and taking bookings;
- rent collection;
- the provision of hot water and heating;
- the cleaning of stairs and passages in multi-unit premises; or
- arranging for repairs to the property.

The fact that any or all of these services are provided does not make the property business a trade nor that any separate income from those services arises from a trade. The receipts are part of the property business.

The general principle is that:

- a person who is in legal occupation of the premises, retains control over them, and provides services or facilities to a third party is trading; and
- a person who allows a third party into occupation or possession of the premises for payment is carrying on a property business.

Each case will depend on its facts but it will be unusual for the provision of furnished holiday accommodation to amount to trade, or for the services provided by a landlord of furnished holiday accommodation to amount to a separate trade.

Example 1

A person provides bed and breakfast accommodation in their property. The owner lives in the property, retains control of it and provides meals to guests. The owner is carrying on a trade.

Example 2

A person owns a holiday complex which includes five cottages which are let as holiday accommodation. The cottages are let furnished and bed linen and heating are included in the cost of the rent, as is access to other facilities on the site, which include a tennis court, swimming pool and a games room. The cottages are cleaned at the beginning of each letting.

The owner deals with all booking enquiries, reservations and payments. She arranges for cleaning, laundry and maintenance of the cottages and grounds. She also provides information to visitors about local tourist attractions, restaurants etc.

The owner is carrying on a property business. The owner is generating income from the property by allowing others to use it for specified periods in return for payment. The owner is not providing services over and above those provided by a landlord.

Separate trade in addition to property business

To run a separate trade of providing services (in addition to their property business) the person needs to show that what they offer goes well beyond the services normally provided by a landlord.

A person who has a large property business may need to devote a substantial amount of time in order to provide these services; but that does not change the nature of the services. If the provision of services is to be treated as a separate trade in addition to the property business, the services must go beyond those which landlords normally provide, examples of which are given above.

Examples of services which go beyond those normally provided, and which may amount to a separate trade are:

- the regular cleaning of rooms when they are let, and not just between changes of tenant;
- the regular supply of clean linen; or
- the regular provision of meals.

The provision of these services does not, however, make the whole activity a trade.

Receipts from the trading services are taken into account in calculating a separate trading profit. Receipts from letting the property are taken into account in calculating the property business profits.

A single payment which covers the two separate activities must be apportioned for tax purposes. The apportionment should be on a reasonable basis that reflects the value of each activity. Expenses may also need to be split between trade and property business.

Whilst not conclusive, it is more likely to be appropriate to treat the services as being provided in the course of a separate trade if there is a separate charge for them. But this is not necessarily the case, especially if the customers have no option to pay the rent only, and do without the services and the charge for them.