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Furnished Holiday Lets

Your Emergency Tax Planning Guide

By Carl Bayley BSc ACA

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About the Author

Carl Bayley is the author of a series of 'Plain English' tax guides designed specifically for the layman. Carl's particular speciality is his ability to take the weird, complex and inexplicable world of taxation and set it out in the kind of clear, straightforward language that taxpayers themselves can understand. As he often says himself, "my job is to translate 'tax' into English".

Carl enjoys his role as a tax author, as he explains: "Writing these guides gives me the opportunity to use the skills and knowledge learned over almost twenty-five years in the tax profession for the benefit of a wider audience. The most satisfying part of my success as an author is the chance to give the average person the same standard of advice as the 'big guys' at a price which everyone can afford."

Carl takes the same approach when speaking on taxation, a role he frequently undertakes with great enthusiasm, including his highly acclaimed annual 'Budget Breakfast' for the Institute of Chartered Accountants.

In addition to being a recognised author and speaker on the subject, Carl has often spoken on property taxation on radio and television, including the BBC's 'It's Your Money' programme and BBC Radio 2's Jeremy Vine Show.

Carl began his career as a Chartered Accountant in 1983 with one of the 'Big 4' accountancy firms. After qualifying as a double prize-winner, he immediately began specialising in taxation.

After honing his skills with several major international firms, Carl began the new millennium by launching his own tax and accounting practice, Bayley Miller Limited, through which he provides advice on a wide variety of taxation issues; especially property taxation, Inheritance Tax and tax planning for small and medium-sized businesses.

Carl is a member of the governing Council of the Institute of Chartered Accountants in England and Wales and a former Chairman of the Institute Members in Scotland group. He has co-organised the annual Peebles Tax Conference for the last eight years.

When he isn't working, Carl takes on the equally taxing challenges of hill walking and writing poetry and fiction. Carl lives in Scotland with his partner Isabel and has four children.

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Introduction

For many years, furnished holiday lettings have enjoyed the best of all worlds. In effect, they are treated as investment properties whenever that is more beneficial, but get treated like a normal trading business whenever most trading reliefs are up for grabs.

They can sometimes qualify as private residential accommodation and yet still get so many of the advantages generally reserved for commercial property. Until now, getting a property to qualify as furnished holiday accommodation has been the property tax equivalent of winning the lottery!

Sadly, all this is about to come to an end, as the Government proposes to abolish the furnished holiday letting regime with effect from 6th April 2010.

The announcement of the impending abolition of the furnished holiday letting regime in the Budget on 22nd April 2009 provided landlords with little more than eleven months' notice and came as quite a shock to the holiday rental sector.

The abolition of the regime will fundamentally alter the tax position of thousands of landlords and yet the Government did not provide any details of how the change will be handled until the Pre-Budget Report on 9th December 2009: leaving holiday letting landlords to 'wait and wonder' for almost eight months!

Throughout this eight month period, many questions were being asked but going unanswered by the Government. Questions like 'How will holiday lettings be treated in future?', 'Will everyone be treated the same?' and 'What will the transitional rules to deal with the change be like?'

Finally, with the publication of the detailed transitional rules on 9th December 2009, we can begin to answer these questions.

It must be admitted, however, that a few areas of uncertainty do still remain. For one thing, the transitional rules are only in draft and the final version may not become law until **after** the furnished holiday letting regime has been abolished.

Some aspects of the transition are also open to a great deal of interpretation: especially the issue of what constitutes a trading business (see Chapter 8). It may be many years before a definitive view emerges in court.

What follows in this guide is therefore based on the transitional rules as they currently stand and on existing case law. Although we may see some changes in the months and years ahead, this must be the best basis on which furnished holiday letting landlords can plan their affairs.

Many important tax reliefs are currently available on furnished holiday letting properties and it is vital for landlords to consider action **now** in order to reap the benefit of these reliefs before the abolition of the regime on 6th April 2010.

In this guide I am therefore going to show you precisely which tax reliefs are going to be taken away from furnished holiday lettings, what you can do about it before it's too late and just how much tax you might save by taking the right steps.

I will begin by providing a brief recap of the current furnished holiday letting regime and its advantages.

I will then proceed to look in detail at the planning opportunities between now and 5th April 2010 by examining each of the main tax reliefs currently available in turn and considering what action can be taken to maximise the value of those reliefs before the regime is abolished.

As we consider each of the main tax reliefs currently available, I will also guide you through the potential future tax landscape for furnished holiday lettings after 6th April 2010. This tour of the future will end with a look at a possible escape route in Chapter 8, where I will consider the possibility that some furnished holiday letting businesses might become trading businesses.

Chapter 9 then covers some important additional points which need to be considered when undertaking any of the planning outlined in this guide.

Finally, in Chapter 10 at the end of the guide, I will also look at the recent extension of the furnished holiday letting regime to the European Economic Area.

Scope of this Guide

Both the impending abolition of the furnished holiday letting regime and its recent extension to property throughout the European Economic Area apply to all business entities, including companies. In this guide, however, we will mainly concentrate on unincorporated furnished holiday letting businesses run by individuals or partnerships, as these are more common.

This guide is also aimed primarily at UK resident landlords owning furnished holiday letting property in the UK or elsewhere in the European Economic Area (see Appendix B).

This guide deals only with the UK tax consequences of investing in furnished holiday lettings. Foreign taxation is beyond its scope.

For tax purposes, the UK does not include the Channel Islands or the Isle of Man, but comprises only England, Scotland, Wales and Northern Ireland.

Wealth Warning

It is important to remember that both UK residents investing in property overseas and non-UK residents investing in UK property may also face foreign tax liabilities on their property income and capital gains. Each country has its own tax system, and income or gains which are exempt in the UK may nevertheless still be liable to tax elsewhere.

Additionally, in some cases, citizens of another country who are resident in the UK for tax purposes may nevertheless still have obligations and liabilities under their own country's tax system. The USA, for example, imposes this type of obligation on its expatriate citizens.

It is only when talking about taxpayers who are both UK residents and UK citizens, and who are investing exclusively in UK property, that we can be absolutely certain that no other country has any right to tax the income or gains arising.

More detailed information on the taxation issues encountered when investing in property overseas, including foreign taxation, is provided in the Taxcafe.co.uk guide *'How to Avoid Tax on Foreign Property'*.

Finally, the reader must bear in mind the general nature of this guide. Individual circumstances vary and the tax implications of an individual's actions will vary with them. For this reason, it is always vital to get professional advice before undertaking any tax planning or other transactions which may have tax implications. The author cannot accept any responsibility for any loss which may arise as a consequence of any action taken, or any decision to refrain from action taken, as a result of reading this guide.

A Word about the Examples in this Guide

This guide is illustrated throughout by a number of examples.

Unless specifically stated to the contrary, all persons described in the examples in this guide are UK resident, ordinarily resident and domiciled for tax purposes.

In preparing the examples in this guide, we have assumed that the UK tax regime will remain unchanged in the future except to the extent of any announcements already made at the time of publication, including the Pre-Budget Report on 9th December 2009.

Whilst it is probable that proposals announced to date will become law, it is nevertheless worth bearing in mind that some of these proposals are not yet law and may undergo some alteration before they are formally enacted.

If there is one thing which we can predict with any certainty it is the fact that change **will** occur. The reader must bear this in mind when reviewing the results of our examples.

All persons described in the examples in this guide are entirely fictional characters created specifically for the purposes of this guide. Any similarities to actual persons, living or dead, or to fictional characters created by any other author, are entirely coincidental.

The Current Regime

1.1 QUALIFYING PROPERTIES

To begin our look at furnished holiday lettings, we need to consider what properties actually qualify under the current regime.

The qualification requirements for a property to be regarded as a furnished holiday letting are as follows:

- i) The property must be situated in the European Economic Area (see Appendix B).
- ii) The property must be furnished (to at least the minimum level which an occupier would usually expect).
- iii) It must be let out on a commercial basis with a view to the realisation of profits.
- iv) It must be available for commercial letting to the public generally for at least 140 days in a 12-month period.
- v) It must be so let for at least 70 such days.
- vi) The property must not normally be in the same occupation for more than 31 consecutive days at any time during a period of at least seven months out of the same 12-month period as that referred to in (iv) above. This seven month period need not be a single continuous period but must include the lettings under (v) above.

The 12-month period referred to in (iv) and (vi) above is normally the UK tax year (see Section 1.4), but see Section 9.1 regarding newly acquired property. A taxpayer with more than one furnished holiday letting property may use a system of averaging to determine whether they meet test (v).

Whilst the property need not be in a recognised holiday area, the lettings should strictly be to holidaymakers and tourists in order to qualify.

Where a property qualifies, as set out above, then it generally qualifies for the whole of each qualifying tax year, subject to special rules for the years in which holiday letting commences or ceases.

1.2 THE BENEFITS OF FURNISHED HOLIDAY LETTINGS

In essence, properties qualifying as 'furnished holiday lettings' enjoy a special tax regime, which includes many of the tax advantages usually only accorded to trading properties.

At the same time, however, the profits derived from furnished holiday lettings are still treated as rental income.

We will be exploring each of the available reliefs listed below in more detail later in the guide, when I will also explain all of the terminology used in this section.

The current taxation benefits of qualifying furnished holiday lettings include the following:

Capital Gains Tax

- Entrepreneurs' relief.
- Rollover relief on replacement of business assets.
- Holdover relief for gifts.
- Incorporation relief.
- Relief for 'loans to traders'.

Income Tax/Corporation Tax

- Capital allowances for furniture and equipment, fixtures and fittings and integral features.
- Losses may be set off against other income of the same tax year or the previous one.
- Losses arising in 2008/9 or 2009/10 may also be carried back for set off against furnished holiday letting profits from the same business in the previous three years (with a £50,000 limit on losses arising in each year carried back more than a year).
- Furnished holiday letting profits are qualifying 'earnings' for pension contribution purposes.

And Yet ...

- Despite its 'trading-style' advantages, National Insurance should not usually be payable in respect of income from furnished holiday accommodation (although some local tax offices do insist on collecting Class 2 contributions at £2.40 per week).
- A non-UK resident investing in UK furnished holiday accommodation would usually continue to be exempt from Capital Gains Tax.

A furnished holiday letting business may also be exempt from Inheritance Tax where the lettings are generally short-term (e.g. weekly or fortnightly) and the owner (or their agents or employees) is substantially involved with the holidaymakers' activities.

The available reliefs extend to any property used in a furnished holiday letting business. This will include not only the holiday accommodation itself but also any office premises from which the business is run.

Where there is some other use of the property, some of the Capital Gains Tax reliefs described above may need to be restricted.

Nevertheless, it remains possible for the landlord and their family to use the property privately as a second home during the 'off season' and still fit within the qualifying conditions set out in Section 1.1. This opens up the possibility that, under the right circumstances, a furnished holiday letting property may also qualify for principal private residence relief and private letting relief (see the Taxcafe.co.uk guide *'How to Avoid Property Tax'* for further details).

However, whilst partial private use of the property carries some potential advantages, it is important to remember that the property must be let out on a commercial basis with a view to the realisation of profits. Hence, in practice, the property must be made available for letting to third parties for a sufficiently large proportion of the year to give its owners a realistic expectation of profits.

The result of failing to meet this test would be the loss of furnished holiday letting status and hence the consequent loss of all the additional reliefs which that status provides.

More commonly, a furnished holiday letting property may qualify for principal private residence relief and private letting relief as a result of its occupation as the landlord's main residence at some other time during their ownership.

1.3 DISADVANTAGES

The furnished holiday letting regime does carry some minor disadvantages, most notably:

- The 10% wear and tear allowance is not available.
- The landlords' energy-saving allowance is not available.
- It would not generally be possible for a furnished holiday letting property to qualify for rent-a-room relief.

In addition, the letting of holiday accommodation is a standard-rated supply for VAT purposes. This is a consequence of VAT legislation rather than the furnished holiday letting regime and is not dependent on whether the property meets the qualifying conditions set out in Section 1.1.

A landlord must therefore register for VAT if annual income from UK holiday lets exceeds £68,000. Foreign VAT registration will also often be required in respect of holiday lettings elsewhere within the European Union (see Appendix B).

As far as Stamp Duty Land Tax is concerned, furnished holiday lets are treated like any other residential property. The Stamp Duty Land Tax threshold for residential property was reduced back to its former level of £125,000 on 1st January 2010 and this will lead to extra costs of up to £1,750 on some transactions.

Properties used as holiday lets with the intention of letting the property for short periods totalling 140 days or more in the tax year are subject to Business Rates rather than Council Tax. Although the intended rental period is the same as under test (iv) in Section 1.1, this rule is not dependent on the furnished holiday letting regime.

1.4 SOME TERMINOLOGY

Properties which meet the conditions set out in Section 1.1 and thus qualify under the furnished holiday letting regime may variously be referred to as furnished holiday lettings, furnished holiday lets or qualifying furnished holiday accommodation. These terms all mean the same thing.

The UK tax year runs from 6th April in one calendar year to 5th April in the next calendar year. The current UK tax year is therefore the year ending 5th April 2010 and this is commonly referred to as 2009/10.

Individuals with any form of property rental business, including furnished holiday lets, should generally prepare accounts for the tax year. Companies may choose their own accounting periods.

1.5 SPOUSES AND PARTNERS

Throughout this guide, you will see me refer to 'married couples', spouses or husbands and wives.

It is important to remember that, unless specified to the contrary, the tax treatment being outlined applies to legally married couples only.

Civil Partnerships

Since December 2005, same sex couples have been able to enter into a civil partnership affording them all of the same legal rights and obligations as a married couple. This equality of treatment extends to all UK tax law.

Again, the couple will need to be in a legally registered civil partnership for this to apply. Otherwise, they will remain in the same position as any other unmarried couple.

Unlike many other countries, the UK has refused to adopt the term 'marriage' for a same sex couple entering a civil partnership. Nevertheless, any references to 'married couples' throughout this guide should be taken to also include registered civil partnerships.

Similarly, any reference to the taxpayer's 'spouse' will also include their civil partner where relevant.

Unmarried Partners

As we shall see later, there are sometimes advantages to being in an unmarried couple. When I use the term 'unmarried partner' in this guide this means a member of a couple who are not married to each other and not in a civil partnership together. It also refers to a life partner and not to a business partner.

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