Furnished holiday lets and IHT relief

by Julie Butler

It is known in the tax world that furnished holiday lets (FHLs) may qualify for Business Property Relief (BPR) for IHT, provided the owner plays an active part in the management of the tenancies.

Many clients can use this as an active tax-planning tool to ensure that existing property does qualify and to swap non-qualifying assets, eg, let property, for the FHL.

Helping the parents

One of the most practical uses of the potential IHT relief can be for clients' parents! Many of the ageing population (known affectionately in the marketing world as the 'silvers') have purchased a retirement holiday home that they use and let out.

The property must meet certain requirements to qualify as an FHL and be eligible for the tax reliefs thereon.

The property does not have to be in a tourist area, but the pattern of lettings must satisfy these three conditions (*ITTOIA* 2005, pt 3, ch 6):

1. The property must be available for commercial letting as holiday accommodation for at least 140 days a year.
2. It must actually be let as holiday accommodation for at least 70 days a year.
3. It must not normally be let for a continuous period of more than 31 days to the same tenant in seven months of the year, and those seven months include any months in which it is actually let as holiday accommodation.

The guidance is found in Share Valuation Manual SVM 27600. The manual states:

> 'In some instances the distinction between a business of furnished holiday lettings and, say, a business running a hotel or a motel may be so minimal that the Courts would not regard such a business as one of "wholly or mainly holding investments" for the purposes of s. 105(3).
>
> You may therefore normally allow relief where:
>
> - the lettings are short-term (for example, weekly or fortnightly); and
> - the owner – either himself or through an agent such as a relative or housekeeper – was substantially involved with the holidaymaker(s) in terms of their activities on and from the premises even if the lettings were for part of the year only.
>
> If you encounter any difficulties in this area you should refer to the Appeals Team.'

Further guidance was formerly given in the IHT Manual 25278, as follows:

> 'You should continue to refer to Litigation Group (IHTM01083) cases where relief is claimed and:
>
> - the lettings are longer term (including Assured Shorthold Tenancies); or
> - where the owner had little or no involvement with the holidaymaker(s) – for example a villa or apartment abroad; or
> - where the lettings were to friends and relatives only; or
> - where it is clear that no services were provided to the holidaymakers.'

This has now been replaced by: '(The text at this point has been witheld under the Code of Practice on Access to Government Information)'.

The tax-planning confusion rests with the extent of the involvement with the tourist. The tax relief is helped if there are lots of services provided, eg, 'the meet and greet', organising car hire, cleaning and laundry, supply of basic food for the fridge, etc. The owner can subcontract out these services. The important point is the extent of the involvement with the holidaymakers, even if this is handled by an agent. The key is to ensure there is a contemporaneous record of the services provided. Further examples are visits to the cottage with local maps and guides to historic attractions, and organising the maintenance of the property before, during and after the period of let, including gardening.

Whereas non 'holiday let' periods can qualify for the income tax, National Insurance (NI) and capital gains tax (CGT) advantages, in order not to fall foul of *IHTA* 1984 s.105(3), greater evidence of the provision of practical services to genuine holidaymakers will help.

Other relevant factors might be:

- the cottage is located in a tourist area;
- the property is marketed professionally;
- small business rates are paid;
- the cottage is awarded a rating by the English Tourist Board or equivalent;
- public liability insurances are paid on the property;
- the operation of the business is commercial, and profits are made and tax paid accordingly.

Sharpening the knives

When claiming BPR on FHLs, one is more than likely going to meet great opposition by HMRC, and you need to be prepared to fight. Fortunately, there is plenty of internal guidance in the IHT manuals that actually supports the claim – one of the more interesting texts can be found at IHTM 25277 (Caravan sites and furnished lettings: Hotels, Bed and Breakfast and Residential Homes), for example:

'*IHTA* 84 s. 105 (3) will not usually apply to these businesses in view of the level of services provided. This has been recognised by the courts, which have distinguished these businesses from mere exploitation of land. In *Griffiths v Jackson* at page 593[1], Vinelott J observed:

"The distinction between a hotelier or a lodging house keeper, on the one hand, and the owner of a property who lets furnished rooms and provides services is no doubt in practice a narrow one, more particularly in these days of self-service hotels and motels, but the principle is clear and in the present case there can be no doubt on which side of the line the taxpayer's activities fall."

Only in cases where it is clear that *IHTA* 1984 s. 105 (3) applies should you pursue it. Any doubtful cases must be referred to the Litigation Group (IHTM01083) before an entrenched position is taken.'

Other taxes

So what are the income tax and CGT advantages?

Commercial furnished holiday letting is treated as a trade for many tax reliefs, although it is not actually a trade.

Losses from the FHL can be set against other income of the same year, unlike normal property income losses, which must be carried forward to set against property income in future years.

The capital gain made on the disposal of a FHL property:

- attracts Business Asset Taper Relief (BATR) as opposed to non-business taper relief;
- can be rolled over into the purchase of another FHL property or into a different business asset, which defers the gain until the replacement asset is sold; and
- can be held over as a gift of business assets, so CGT is deferred until the recipient disposes of the property.

In addition, the FHL may qualify for BPR as long as the owner plays an active part in the management of the tenancies.

So what are the disadvantages? The issue of Class II NI Contributions (NIC) on property income is a strange one, as guidance cannot be found in the HMRC manual: indeed the Property Income Manual clearly states that as furnished holiday letting is not a trade, class IV NIC is not due (PIN 4120).

However, Class II NICs are frequently demanded where various types of lettings are undertaken, although in the case of *Rashid v Garcia*[2], HMRC argued the opposite when Mr Rashid tried to claim benefits based on the Class II NICs he had paid. It was held that Mr Rashid was not in business although he let and managed four properties.

VAT at 17.5% will apply to the rents from an FHL if the property is advertised as such and the owner is, or should be, VAT registered. So if the total of rental income received from the FHL properties plus any other VATable supplies already made by the landlord exceeds £61,000 in 12 months (VAT registration limit from 1 April 2006), the landlord must register for VAT. If the landlord is already VAT registered for another business they must charge VAT on the rents from the FHLs.

Obviously, having to account for VAT on income from what are assumed to be non-VAT registered holidaymakers could have an adverse impact on profitability, but input VAT on the associated costs will be claimable, subject to the normal rules.

The important point is the extent of the involvement with the holidaymakers, even if this is handled by an agent

Conclusion

The burden of IHT for the current band of pensioners, who have often accumulated their wealth through thrift and hard work, has been well documented by the popular press. They have even campaigned for action – well, simple tax planning action is very close to hand. For those planning to move furnished property to an FHL, the two-year rule for IHT must be remembered.

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1 *Griffiths (Inspector of Taxes) v Jackson* [1983] BTC 68
2.*Rashid v Garcia* SpC 348