



## Furnished Holiday Lets – applying the tax rules in practice

When the proposed Furnished Holiday Let (FHL) tax changes were announced (or unsightly slipped in a note under the door) on 22 April 2009, i.e. that FHL tax advantages were to disappear from 5 April 2011 there was uproar and much slamming of holiday home doors.

The current FHL tax position which shows a tightening of the tax rules but not the loss of all of the advantages has brought huge relief (pun) to the UK tourist industry and the owners of FHLs.

However, one of the key points to emerge has been the lack of practical understanding of the tax rules. Perhaps that is typical of any element of tax legislation under the microscope.

### Entrepreneurs' Relief (ER) for Capital Gains Tax (CGT)

FHLs should qualify for Entrepreneurs' Relief (ER) provided the conditions are met. Entrepreneurs' Relief is available on the disposal of the whole or part of a business, or of an asset used in a business when that business ceases. It is not available on the disposal of an asset used in a continuing business.

This creates immediate practical problems:

- Where there are a portfolio of Furnished Holiday Lets can ER ever be claimed unless all or the majority of the FHLs are sold?
- If a taxpayer owns two FHL properties and sells one, has he sold part of his business, or merely an asset used in a continuing business?

The principles – and difficulties – of distinguishing between selling 'part of a business' and simply selling business assets are set out in HMRC's *Capital Gains Manual*, paragraphs 63530 to 63543. In an FHL the most important considerations are likely to be geographical proximity and whether there are separate management and advertising arrangements.

It can be argued that to succeed with an Entrepreneurs' Relief claim for a Furnished Holiday Let it is easier if there is only one property because then clearly the business has ceased. Trying to sell several separate properties in different locations at the same time is not just difficult in the property market - it might not be the right commercial decision.

The ease of just owning and selling one property to achieve ER on an Furnished Holiday Let might seem a contradiction with what could be required to achieve Inheritance Tax (IHT) relief on an FHL.

A routine property business does not qualify for ER. On the other hand, if an individual owns a 'buy-to-let' property on which a substantial gain has accrued, it might be worth running that property as a furnished holiday letting for, say, a year, to qualify for ER.

### The current position on the FHL rules

- Furnished holiday lettings in both the UK and EEA are eligible to qualify as qualifying furnished holiday lettings for tax purposes on an ongoing basis;
- The minimum period over which a qualifying property must be available for letting to the public in any 12 month period is increased from 140 days to 210 from 6 April 2012;
- The minimum period over which a qualifying property is actually let to the public in any 12 month period is increased from 70 days to 105 from 6 April 2012; and
- Losses made in a qualifying UK or EEA furnished holiday lettings business may only be set against income from the same furnished holiday lettings business from 6 April 2011.

### Inheritance Tax Relief (IHT)

The FHL "rules" did not incorporate IHT relief, i.e. IHT is not included in the FHL rules and this was the

case before and after 22 April 2009. It is a myth that IHT was included in these rules.

The eligibility for Business Property Relief (BPR) will depend on normal BPR rules, i.e. it is necessary for clients to satisfy HMRC that the property business is operated as a commercial business with a view to making a profit. It will be essential to prove that the FHL does not qualify for BPR as a result of s.105(3) IHTA 1984.

It has always been considered that to make a BPR claim in respect of FHL properties there should be more than one, although I have achieved a BPR claim on one FHL property.

If in order to achieve BPR a portfolio is deemed to be necessary this does create a possible contradiction for claiming ER. Perhaps the answer is that some taxpayers hold FHLs with a view to tax efficient disposal using ER or rollover relief or holdover relief and some use FHLs as a potentially IHT efficient investment.

It is generally considered that to rely on BPR on one FHL or a portfolio of FHLs is dangerous. It is considered that there will be a BPR claim on an FHL destined for the 1st Tier Tribunal under the arguments of HMRC attempting to disallow the BPR claim on the FHL due to s105(3) IHTA 1984. All owners of FHLs should look at the combination of the future CGT and IHT needs in relation to the property.

The case of *McMillin (TC 943)* raises issues on claiming capital allowances on plant and machinery in respect of capital allowances. The First Tier Tribunal denied capital allowances on flooring, windows, stone floors, organic paint and an earth bund.

## **Immediate Tax Planning Criteria**

There is a lot of tax advice for clients to consider immediately with regard to FHLs and take action upon:

- 1a) Ensure FHL owners are aware of the proposed new qualifying criteria and whether they believe they will be able to satisfy these new rules; and
- 1b) Advise FHL owners of the effect of the new rules for the offset of any losses arising.
- 2) Maximise losses in 2010/11 by ensuring maximum capital allowances (including AIAs) are claimed – be careful of points raised in *McMillin*.
- 3) Maximise loss offset against other income in 2010/11.
- 4) It may be beneficial to reclassify qualifying overseas property as furnished holiday lettings in 2010/11 in order to make UK loss relief claims.

For those clients with properties that satisfy the current criteria but will not satisfy the new ones, it will be useful to review tax planning opportunities available before April 2012.

If they sell or gift the property before April 2012 and while they meet the current qualifying criteria, they will be able to claim ER, rollover relief or gift relief as appropriate, and this will not be the case for a disposal after April 2012 of property that does not satisfy the new qualifying criteria.

**Farming and Rural Business Group, May 2011**