

# Grace and favour

Julie Butler explains how the grace period and averaging elections for furnished holiday lettings interact.

## Letting conditions

There has been much written about furnished holiday lets (FHLs) rule changes and the impact these will have in practice. The real worry for the taxpayer is if the new threshold of 105 days of actual letting out of the property (the 'letting condition') is not achieved, what action should be taken? The new letting condition comes into force from 6 April 2012 so there is time to plan.

## Period of grace

The new ITTOIA 2005, s 326A allows a 'period of grace'. Once a property qualifies as FHL in one tax year the owner may elect to treat the property as continuing to qualify for up to two later years even though it does not meet the 'letting condition' (based on 105 days) in those years. The grace election may only be made if an averaging election under ITTOIA 2005, s 326 has NOT been made in respect of the same year. The grace election has to be made in the first tax year in which the letting condition is not met.

The election for a period of grace can only be applied provided that the FHL status is failing ONLY on the 105-day test, ie, it is imperative all the other conditions are met. This election must be made on or before the first anniversary of 31 January for the tax year concerned. If the election is not made for the first year, it cannot apply to the 2nd year, i.e. it can apply to the first year, and the first and second year together, but not the second year in isolation.

Therefore it is important to look at future plans for FHLs in 2012/13

and 2013/14 to see how marginal properties can meet the FHL conditions.

## Averaging

An added complexity is the condition of not being able to apply averaging in the new period of grace provisions. The current FHL legislation already allows for the averaging claim. Existing rules allow a claim to average two or more FHL properties let by the same person so that the existing 70-day test for actual letting is reached by all the properties within the averaging claim.

It is possible to specify and restrict those properties that the taxpayer wants within the averaging claim. This allows a property that might otherwise ruin an averaging claim (if all properties had to be included) to remain outside the claim. The claim must be made by no later than the first anniversary of 31 January following the tax year to which the claim is to apply.

The new rules, as implemented

by FA 2011, still include the averaging claim except the actual let period must be 105 days from 6 April 2012 (new

ITTOIA 2005, s 326), and non UK (but EEA) properties cannot be within a claim for UK property averaging. Therefore UK and non-UK properties will have their own separate averaging claim to consider (new ITTOIA 2005, s 326(7)). The averaging calculations will have to be based on separate pools of United Kingdom properties and 'elsewhere in the EEA' properties.

## FHL eligibility

There are those that would argue that

prior to the current changes the FHL rules have been so generous with regard to the 'letting condition' of 70 days that not many FHL owners have had to resort to the complexity of averaging, so this will be a new procedure to consider. Clearly as the period of grace can only be claimed when averaging has not been claimed, there is going to have to be a serious review of all FHL eligibility in the future. It would appear that a 'FHL eligibility audit' is required for all FHL properties.

For those properties that cannot be 'saved' and cannot achieve the FHL letting condition despite greater marketing or the benefit of averaging, then the period of grace will have to be considered. As a planning point the owners of FHLs which can only be let for a limited period, might consider purchasing an FHL which achieves a high number of let days to help 'average' the weak property.

## Capital Allowances and the FHL

Another practical tax planning point facing the FHL industry is the historic lack of claims for capital allowances for FHL owners. A large number of FHL property owners are being approached by 'capital allowance specialists' who will inspect the property and identify 'unclaimed' capital allowances. This situation can arise on the purchase of an FHL property, where those advising have not identified the elements that qualified for capital allowances, or on conversion or improvement where the eligible capital allowance claims are not properly identified.

It is, however, essential that the claim by the FHL owner is not too over enthusiastic in the attempt to define plant. The case of *McMillin* (TC 943) raises issues on claiming capital allowances on plant and machinery in respect of 'eco-plant' for FHLs. In this case the First-tier Tribunal denied capital allowances on flooring, windows, stone floors, organic paint and an earth bund.

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These items might be environmentally friendly but do they have the function of plant?

**Pro-active time for the FHL**

There are lots of 'windows' for tax planning opportunities for the FHL in the months and years ahead. With

the period of grace, the emphasis of averaging and the possibility of buying and selling FHL properties together with trying to identify capital allowances that might have been forgotten – now is the time to review all FHL properties from a practical tax planning perspective. TPT

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