

Furnished Holiday Lettings

Different tax rules apply to income from letting property, which is generally taxed under the property income rules. For many years, the Furnished Holiday Lettings (FHL) rules allowed holiday lettings of UK properties that met certain conditions to be treated as a trade for some specific tax purposes.

At Budget 2009, in response to proceedings instituted by the European Commission, the previous Government announced that the FHL rules would be extended to cover holiday lettings of properties situated elsewhere in the European Economic Area (EEA), from April 2009. However the FHL rules were to be withdrawn from April 2010. The Coalition Government later announced that the FHL rules would not be withdrawn, but would continue with future revisions of the conditions.

Qualifying conditions

The property must be situated in the UK or elsewhere in the EEA. The EEA comprises the 27 states in the EU plus Iceland, Liechtenstein and Norway.

Where there are properties in the UK and the EEA, they are to be treated as two separate property businesses with parallel provisions.

Accommodation is *'furnished'* if the visitor is entitled to the use of furniture. There should be sufficient furniture provided for normal occupation.

The business must be carried on commercially. 'Commercially' means let on a commercial basis and with a view to making a profit. Close season lettings may produce no profit but normally help towards the cost of maintaining the property. This letting can still be treated as commercial. On the other hand, lettings to friends or relatives at zero or nominal rents are not commercial.

After you have decided that your accommodation meets these criteria you will need to see if the property then passes the qualifying tests:

Availability. The property must be available for commercial letting as holiday accommodation to the public for at least 140 days during the relevant period (210 days from 6 April 2012);

Letting. The property must be commercially let as holiday accommodation to members of the public for at least 70 days during the relevant period (105 days from 6 April 2012). A letting to the same person for longer than 31 continuous days (*a period of longer term occupation*) is not a letting as holiday accommodation for the purposes of this condition; and

Pattern of occupation. Total periods of longer term occupation must not exceed 155 days during the relevant period.

Effect of meeting the conditions

Holiday lettings that meet the relevant conditions can be treated as a trade for the following purposes:

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- Entitlement to plant and machinery capital allowances on furniture, white goods etc in the let property as well as on plant and machinery used outside the property (such as vans and tools). The 10% wear and tear allowance that you are entitled to if you have an ordinary rental business is not available as an alternative. There are no capital allowances for the cost of the property itself or the land on which it stands;
- Certain capital gains reliefs (including business asset roll-over relief, Entrepreneurs' Relief, relief for gifts of business assets, relief for loans to traders); and
- Profits count as relevant UK earnings when calculating the maximum relief due for an individual's pension contributions.

The treatment of FHL losses used to follow the pattern of trading losses. However, with effect from April 2011, losses from an FHL business may only be carried forward against future profits from the same business. This means that profits and losses of a UK FHL and an EEA FHL need to be calculated separately.

Holiday lettings where the property is situated outside the EEA do not qualify under the FHL rules. Instead, they are taxed under the normal property income rules.

Relevant periods

There are three possible 12-month periods that may count as *relevant periods* for a FHL property:

- *starting* 12 months beginning with the day on which it is first let as furnished accommodation
- *ceasing* 12 months ending with the last day on which it is let as furnished accommodation
- *continuing*: if neither of the above apply, the tax year itself.

Examples of relevant periods

1) A property has been let furnished on a commercial basis since 2007. For 2011-12 the tests are applied to the year of assessment 2011-12 itself.

2) A property is acquired on 1 January 2012 and is let furnished on a commercial basis from 1 March 2012. To determine whether the letting qualifies for 2011-12 the tests are applied to the 12 months from 1 March 2012. For 2012-13 the tests are applied to the tax year itself.

3) A property has been let as furnished accommodation on a commercial basis for many years but letting ceases on 30 September 2011 and the property is sold on 1 December 2011. To see if 2011-12 qualifies, the tests are applied to the 12 months ended on 30 September 2011.

Occupancy Threshold

There are two elections you can make to help you reach the occupancy threshold. If you have more than one property the 'averaging' election might be helpful and if you have a property that reaches the occupancy threshold in some years but not in others you could use a 'period of grace' election to help you to reach the threshold.

As regards averaging, where a person has a number of units of accommodation that are let for holiday purposes:

- each of them must separately satisfy the availability condition and the pattern of occupation condition, but
- if some are individually let for less than 70 days (105 days from 2012-13), the landlord is allowed to apply the letting condition to the average rate of occupancy of the units
- A unit cannot be used more than once in the same period in a claim for averaging treatment
- You can only average across the properties in a single business – you cannot mix UK and EEA properties.

Example illustrating the averaging rule

Joe lets four holiday cottages during 2011-12, and all would otherwise qualify as furnished holiday lettings. The actual letting periods are:

No 1	90 days
No 2	78 days
No 3	70 days
No 4	50 days
Total	288 days
Average $288 \div 4 = 72$ days	

By averaging the four, all will qualify. Without averaging, No 4 would not qualify.

Period of grace

In addition to the option to use averaging to help meet the occupation threshold there is also the possibility of making an election for a 'period of grace'.

A period of grace election allows you to treat a year as a qualifying FHL year where you genuinely intended to meet the occupancy threshold but were unable to meet it. In order to qualify for this, the property must have reached the occupancy threshold in the previous year, either on its own or because of an averaging election. If the property still does not meet the occupancy threshold in the year after that, providing an election has been made for the earlier year, this can also be treated as a qualifying FHL year.

Example – period of grace

Nalini lets a property in Italy and it would otherwise qualify as an FHL. The actual lettings periods are

Year	Days let	Election?	Qualifies?
2014-15	110	None required	Yes
2015-16	73	Yes	Yes
2016-17	80	Yes	Yes
2017-18	106	None required	Yes

Nalini qualifies in all four years

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If the property still doesn't meet the required letting level in the fourth year (after two years of being treated as qualifying) then that property is no longer an FHL property.

The property must meet the availability threshold (and the pattern of occupation test). You must be able to show that there was a *genuine intention to let* the property in the year for which a period of grace election is made. For example, where you have marketed a property to the same or a greater level than in successful years this might be used as evidence of a genuine intention to let.

If the lettings are cancelled due to unforeseen circumstances, for example, because of extreme adverse weather conditions or an outbreak of foot and mouth disease, then it is likely that you would be able to say that there had been a genuine intention to let.

If you have more than one FHL property, sometimes both averaging and period of grace elections may be used to ensure a property continues to qualify.

Limited companies

The FHL provisions apply to both individuals and companies, although clearly many of them apply only to individuals. However, capital gains exemption for disposals by companies with substantial shareholdings may also apply. Changes in provisions for corporation tax normally run with the financial year (starting on 1 April) rather than the tax year (starting on 6 April), and the April dates mentioned in the text should be read accordingly.