

ACTIVE PRACTICE UPDATES

MAY 2021

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TAX IMPLICATIONS OF FURNISHED HOLIDAY LETS

COVID-19 prompts high demand for UK holidays.

Owning and letting out a holiday home, otherwise known as a furnished holiday let (FHL), has always been a popular way of investing and earning income.

Not only do FHLs enjoy many tax advantages over normal residential let properties, owners have an asset which they can use for holidays while it largely pays for itself.

While the UK cracks on with vaccinating the population against COVID-19, other nations are lagging behind. This is having a domino effect on people's plans for foreign holidays in 2021 and many are planning to enjoy domestic holidays this summer.

Demand for self-catering accommodation from a public weary of lockdown restrictions is high and the asking prices reflect this. If you own additional property in the UK, there has never been a better time to consider whether a FHL is the right investment.

THE TAX TREATMENTS OF FHLs

Unlike residential property letting, HMRC considers the letting of holiday accommodation to be a trade. As such, the tax treatment of FHLs is different and has many advantages.

If you let a property that qualifies as an FHL, your rental business's profits will count as earnings for pension purposes.

You can deduct **expenses**, such as letting agent fees, cleaning, advertising and utility bills, against rental income where they relate to the trade of being a FHL and aren't capital in nature.

If you have used your FHL for private use during the year, these costs will need to be apportioned as only the element relating to the trade will be allowable. Costs incurred during private use are not allowable in calculating your FHL taxable profit or loss.

Interest and finance charges on any loans associated with the FHL are allowable, while it's possible to deduct any plant and machinery **capital allowances** for purchases such as furniture, equipment or fixtures before arriving at your taxable profit/loss.

Where the property is owned by several partners, the rental profits can be split according to preference, rather than having to follow the actual ownership percentage.

If you sell your FHL, it could qualify for **business asset disposal relief** as long as the gain falls within your £1m lifetime limit.

This allows the whole of any chargeable gain to be taxed at the rate of 10%, unlike residential property gains which are taxed at 18% and 28%, depending on an individual's marginal tax rate.

An FHL also qualifies for **business asset rollover relief** and **relief for gifts of business assets**, which allow any capital gains tax to be deferred to some degree to a future date.

CALCULATING YOUR PROFIT/LOSS

To benefit from these rules, we will first need to identify which properties qualify as FHLs and then calculate the profit/loss from your UK FHL trade separately from any other rental properties you may have.

This separation is also important as you cannot offset any loss you might make on your UK FHL trade against other property rental profits, including any FHL properties you may also own in the European Economic Area (EEA).

However, a word of warning, if taxable turnover from your FHL exceeds £85,000 over the next 12 months, you might need to register for VAT.

Those that are self-employed or are already VAT-registered may similarly find that their FHL income is subject to VAT, even if the FHL itself has not breached the VAT-registration threshold.

QUALIFYING AS A FHL

A number of criteria must be met in order to achieve FHL status and it is something which needs to be considered for each tax year in question.

FHL status can be lost if the criteria cease to be met, which will have knock-on tax consequences. To qualify as an FHL your property must be:

- in the UK or EEA
- furnished to a degree which allows for normal occupation
- let on a commercial basis.

In addition, there are three occupancy conditions which must be met in the tax year. If it is a new FHL, the tests must be met within the first 12 months of trading and on cessation in the 12 months up to when letting stopped.

Pattern of occupancy

The pattern of letting should be short-term lets of less than 31 days. When an FHL is let to the same person for longer than this, it becomes a long-term occupation. The property will not be classed as an FHL if there are more than 155 days a year spent in long-term occupation lets.

Availability

The property must be available as FHL for at least 210 days in the year. You cannot include days where you stay in the property within this total as HMRC will not consider it available for let if you are using the property yourself.

Letting

The property must be let commercially as furnished holiday accommodation to the public for at least 105 days in the year. Any days let to friends or family at a reduced rate cannot be counted towards this total.

You also cannot include any long-term occupation lets in meeting this condition unless the occupier could not leave the property due to an unforeseen circumstance, such as illness or a delayed flight.

Averaging & period-of-grace

All is not necessarily lost, however, if you have not met the 105 days, as HMRC allows two elections to help meet the letting condition. These are known as the averaging election and the period-of-grace election.

The averaging election can be used where you own more than one FHL. If one property falls short of the 105 days, you can elect to apply the letting condition to the average rate of occupancy for all FHLs.

The period-of-grace election allows a property to qualify as an FHL even if the letting condition isn't met, as long as the pattern of occupation and availability conditions are met.

For this to apply, you must have had a genuine intention to let the property in the year but, despite your best endeavours, could not do so for the required number of days.

To make the election, the property must have met the letting condition in the previous year. You may then make a period-of-grace election for two consecutive years, but if it still does not meet the letting condition in the following year, it will no longer qualify as an FHL.

The averaging election and period-of-grace election can be made up to one year after 31 January following the end of the previous tax year.

COVID-19 & FHL STATUS

COVID-19 and the subsequent lockdowns and restrictions which have dominated the past year resulted in many FHL owners being unable to meet all the criteria for operating as an FHL through no fault of their own.

Despite a genuine wish and intention to let their properties, the ability to meet the letting condition has not been possible.

While HMRC has not relaxed the rules to compensate for this, the normal rules do themselves offer a potential solution through the period-of-grace election as outlined above.

It is hoped the two consecutive annual period-of-grace elections will be enough to ensure most FHLs can continue to qualify as such until we've seen the back of the pandemic once and for all.

WHEN A PROPERTY STOPS BEING AN FHL

Your property will no longer be a FHL if the:

- property is sold
- property is used for continuous private occupation
- FHL letting conditions are not met, even with the averaging and period-of-grace elections.

If your property does not qualify as a FHL or stops being a qualifying FHL, the special tax treatment will no longer apply. This could be particularly significant if you are planning to sell the property in the near future.

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