



Furnished Holiday Lettings

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Under the Furnished Holiday Lettings (FHL) rules, income from furnished holiday accommodation may be treated as income from a trade for tax purposes, although generally the letting of property is not a trade. In the 2009 Budget the Labour Government announced that FHL rules would be repealed from April 2010, raising about £20m in 2011/12 – in part because of concerns that the scope of the relief would have to be extended to property across the EU to ensure compliance with EU law. It maintained its position, despite representation from home owners, landlords, and the tourist industry, and following the March 2010 Budget, legislation to this effect was included in the *Finance Bill 2010*. Parliamentary scrutiny of the Bill was considerably shortened by the timing of the 2010 General Election, and to achieve cross-Party consent for the Bill to pass, the Labour Government *withdrew* the provisions in the Bill on holiday lettings.¹

Following the Election, the Conservative-Liberal Democrat Coalition Government stated that it would “take measures to fulfil our EU treaty obligations in regard to the taxation of holiday letting that do not penalise UK-based businesses.”² On 27 July the new Government launched a public consultation on changing the rules from April 2011, to ensure these rules would “meet EU legal requirements in a fiscally responsible way, by changing the eligibility thresholds and restricting the use of loss relief.”³ In December the Government confirmed that the response to its proposals had been generally positive, and legislation to this effect would be introduced in the Finance Bill after the 2011 Budget.⁴

Since then the issue has become much less contentious with relatively little discussion in the House or comment in the press. In the 2011 Budget the Government confirmed that from April 2011 individuals or companies will only be entitled to offset losses from this type of business against income from the same FHL business, while the thresholds on letting and availability which determine eligibility for this relief will be increased from April 2012. These changes are anticipated to cost £20m in 2011/12, and raise £5m in 2012/13.⁵

¹ HC Deb 7 April 2010 c1105

² HM Government, *The Coalition: our programme for government*, 20 May 2010 p31

³ HC Deb 27 July 2010 cc80-82WS

⁴ HM Treasury, *Furnished holiday lettings: summary of responses*, December 2010

⁵ *Budget 2011* HC 836 March 2011 para 2.42, Table 2.2 (item ag)

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1 **Budget 2009**

In the 2009 Budget report the Labour Government announced a change in the tax treatment of holiday accommodation: "Budget 2009 announces the repeal of the Furnished Holiday Lettings (FHL) rules from April 2010. Until the repeal takes effect, the FHL rules will be extended to those with qualifying furnished holiday lettings elsewhere in the European Economic Area."⁶ At this time HM Revenue & Customs published a technical report on the proposed changes, which gave a short introduction to this change, and an explanation of how the FHL rules work:

Landlords with income from furnished holiday accommodation in the UK are currently treated as if they are trading for certain tax purposes, as long as they satisfy certain tests, under the Furnished Holiday Lettings (FHL) rules. Landlords with income from furnished holiday accommodation elsewhere in the European Economic Area (EEA) cannot currently qualify for this treatment. They were treated instead in the same way as landlords of other types of overseas property, under the property income rules. This difference may not be compliant with European law. The Government has decided it should repeal the FHL rules from 2010-11. Until the FHL rules are repealed, HMRC will regard the FHL rules as applying to furnished holiday accommodation elsewhere in the EEA ...

What are the Furnished Holiday Lettings (FHL) rules?

The letting of property is not a trade. However, the Furnished Holiday Lettings rules allow landlords of furnished holiday properties, which satisfy certain conditions, some of the tax treatments available to traders.

Under the FHL rules, landlords are treated as though their qualifying FHL business is a trade for the following purposes:

- loss relief;
- capital allowances;
- Landlords Energy Saving Allowance (LESA);
- certain capital gains reliefs (including business asset roll-over relief, entrepreneurs' relief, relief for gifts of business assets, relief for loans to traders and exemptions for disposals of shares by companies with a substantial shareholding); and
- relevant earnings when calculating the maximum relief due for an individual's pension contributions. ...

⁶ *Budget 2009* HC 407 p111

Qualifying conditions

Certain conditions must be met in order to qualify for the tax treatment provided under the FHL rules:

- the property must be situated in the EEA;
- the business must be carried on commercially, and with a view to a profit;
- Availability: the property must be available for commercial letting as holiday accommodation to the public for at least 140 days during the relevant 12 month period;
- Letting: the property must be commercially let as holiday accommodation to members of the public for at least 70 days during the relevant 12 month period. A letting for a period of longer term occupation is not a letting as holiday accommodation for the purposes of the letting condition; and
- Pattern of occupation: not more than 155 days must fall during periods of longer term occupation.

A period of longer term occupation is a continuous period of more than 31 days during which the accommodation is let to the same person. For individuals with a continuing FHL business, the relevant 12 month period will be the tax year to 5 April.⁷

A summary of the FHL rules is also given on the DirectGov website.⁸

The Budget report stated that these changes were expected to cost £15m in 2010/11, and raise £20m in 2011/12 (table A1, item 30, p152).

Following the Budget, there were a series of PQs asking for details of the cost of this relief, the numbers of taxpayers and businesses affected by its withdrawal, and the taxable profits made from this sector; three examples are reproduced below:

Mrs. Gillan: To ask the Chancellor of the Exchequer (1) how many people in (a) Wales, (b) Scotland, (c) Northern Ireland and (d) England claim tax relief under the furnished holiday letting rules; and what the amount claimed was in each of the last two years; (2) what recent assessment he has made of the effect of the repeal of the furnished holiday letting rules from April 2010 on those claiming tax relief under those rules.

Ian Pearson: We estimate that the amount claimed under the Furnished Holiday Lettings rules in 2006-07, the last full year for which information is available, was £15 million. In 2006-07 15,000 individuals offset losses from furnished holiday lettings in the UK against income from other sources and capital gains with an average tax benefit of £1,000 per annum. HM Revenue and Customs do not have information on the location of furnished holiday lettings within the UK.⁹

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Mr. Weir: To ask the Chancellor of the Exchequer what estimate he has made of the number of businesses which will be affected by the abolition of furnished holiday lettings tax relief.

⁷ HM Revenue & Customs, *Furnished Holiday Lettings in the European Economic Area : Technical Note*, 22 April 2009 p2, pp4-5. The department's online *Property Income Manual* gives a detailed explanation – see paras PIM4100-130, which are at: <http://www.hmrc.gov.uk/manuals/pimmanual/PIM4100.htm>

⁸ http://www.direct.gov.uk/en/MoneyTaxAndBenefits/Taxes/TaxOnPropertyAndRentalIncome/DG_4017930. The provisions are consolidated in ss322-8 of the *Income Tax (Trading and Other Income) Act 2005*.

⁹ HC Deb 5 May 2009 c64W. According to a subsequent written answer, estimates for the cost of this relief for earlier years “are of a similar magnitude” (HC Deb 20 July 2009 c896W).

Mr. Timms: HM Revenue and Customs' (HMRC) administrative systems do not record the number of companies with income from furnished holiday lettings. Based on information held by Companies House, we estimate that fewer than 500 companies have furnished holiday lettings as their main source of income. There may also be a number of companies who have a small amount of furnished holiday lettings income to supplement their main source of income. More broadly, in 2007-08, the last full year for which information is available, approximately 60,000 individuals declared income from furnished holiday lettings to HMRC. An impact assessment will be published at the pre-Budget report 2009 alongside draft legislation.¹⁰

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Mr. Ellwood: To ask the Chancellor of the Exchequer what revenue accrued to the Exchequer under the furnished holiday letting rules in each year since 1997; and what estimate he has made of revenue under such rules in each year to 2012.

Mr. Timms: The estimated taxable profits from 1996-97 to 2007-08 for those who made a net profit on furnished holiday lettings is shown in the following table. Following the changes announced at Budget 2009, figures for tax years 2006-07 and 2007-08 include profits from furnished property lettings within the European Economic Area. The revenue accruing to the Exchequer would depend on the marginal rate of each taxpayer, which depends on their specific circumstances.

	Profits from FHL properties (£million)
1996-97	60
1997-98	60
1998-99	60
1999-2000	70
2000-01	70
2001-02	70
2002-03	80
2003-04	90
2004-05	90
2005-06	90
2006-07	100
2007-08	140

No estimates are available for later years.¹¹

2 Initial responses to the repeal of the FHL rules

Although the total Exchequer cost of FHL relief is relatively small, there was a strong reaction from the tourism industry to the Labour Government's decision.¹² The Country Land & Business Association published a brief on the rules which argued that this reform might have a serious impact on the rural economy:

The FHL rules are simple, objective tests that enable both taxpayers and HMRC to be easily certain of the tax consequences of letting furnished holiday accommodation. Without them, numerous disputes are likely to arise because the fiscal boundary then becomes set by a complex edifice of forensic principles. In addition, a number of FHL

¹⁰ HC Deb 19 October 2009 c1288W

¹¹ HC Deb 4 November 2009 cc1007-8W

¹² For example, "Tax break repeal a 'hidden attack' on tourism", *Financial Times*, 25 April 2009; "£20 million tax on second homes", *Western Morning News*, 24 April 2009; "The end of the holiday", *Taxation*, 19 May 2009.

owners have indicated to me their intention to sell their property if this change goes ahead. If this becomes widespread, then many FHL properties will become second homes (and are very unlikely to ever become FHL again). Many rural economies are dependent upon money spent by holidaymakers as are many rural jobs. This raises the serious question as to whether any short-term gain to the Exchequer from the withdrawal of FHL will be outweighed by the behavioural effects of the change of use of FHL properties.¹³

In September, the Tourism Alliance, which brings together a number of trade bodies in this sector, published a paper, critical of the way in which the Government had made this decision, and concerned about its impact on the industry:

There was no prior consultation about the scrapping of the rules with those involved in the tourism industry in general, and the self-catering sector, in particular ... If just 10% of businesses decide to cease trading as a result of the repeal of the FHL rules, tourism expenditure will decrease by almost £110m per annum and over 2,400 jobs will be lost. When the impact on Holiday Parks is included, the potential overall impact is a reduction of over £200m in tourism spend and the loss of over 4,500 jobs in rural and seaside economies – substantially greater than the Treasury estimate of a £20m impact.

The majority of these job losses would occur in the South West, Scotland, Wales and the North West. We are therefore calling upon the Treasury to undertake a review to fully evaluate the economic impact of repealing the FHL rules so that the consequences of this policy can be fully understood and measures introduced to mitigate against the negative impacts. Considering the impact on tourism, rural areas and regional economies, it is important that input to this review is provided by DCMS and DEFRA, and their colleagues in Scotland and Wales, as well as the Industry.¹⁴

The two principal professional accountancy bodies flagged this change in their submissions on the 2009 Budget. In their initial response to the Budget, the Chartered Institute of Taxation noted that the change had been given little publicity in the relevant Budget publications, but that it could well have a negative impact on property owners:

Furnished Holiday Lettings (FHL) (Red Book paragraph 5.116)

It seemed strange to omit from the Budget Notes the announcement of the extension of FHL relief to qualifying furnished holiday lettings elsewhere in the European Economic Area, followed by a withdrawal of the relief, while including details of other relief changes in BN50. The abolition of FHL is likely to have unwelcome effects, including attempts by many FHL property owners to mitigate the tax effects. This could include sales of properties to bank any entrepreneurs' relief, leading to an excess supply of property in the market in the short transitional period. Administratively, abolition of the FHL rules will mean a return to the pre-FHL income tax rules, with owners needing to prove to HMRC that they are running a trade, leading to significant additional burdens for both business and HMRC in retaining records to evidence and agree this: the very reasons the rules were originally introduced. This proposal should be reconsidered.¹⁵

¹³ Country Land & Business Association, *Furnished holiday lettings*, undated
http://www.cla.org.uk/policy_docs/fhlWEB.pdf

¹⁴ Tourism Alliance, *The Impact on the Self-Catering Sector of the Proposed Changes to Furnished Holiday Lettings Rules*, 9 September 2009 p1

¹⁵ *Budget 2009: CIOT initial comments*, 1 May 2009 pp3-4

The Institute of Chartered Accountants were also critical of the change, in their submission to the Treasury Committee:

Abolition of the furnished holiday lettings rules

55 We were surprised to see that the special tax rules for Furnished Holiday Lettings (FHLs) will be extended in 2009/10 to include properties in the EEA but will then be abolished entirely for 2010/11.

56 We appreciate the potential problems with compliance with EU rules, but we suspect that this change is likely to have a serious impact on the provision of holiday lettings in tourist areas. There is concern that it could encourage FHLs to be sold off (most likely as second homes) or transferred to being let as unfurnished residential accommodation and thus reduce the stock of tourist accommodation. There is particular concern about the impact on investment in multiple unit complexes if entitlement to capital allowances is lost.

57 We think that an economic analysis of the proposal needs to be undertaken and whether the concerns about the EU aspects of this could be resolved in a way that does not involve the complete withdrawal of the scheme.

58 We assume that there is concern that the more generous loss treatment could lead to a loss of revenue to the Exchequer if claims are made on holiday homes. However, the FHL activity must be commercial and if necessary the existing rules could be tightened.

59 The deemed trading qualification of FHLs overcomes the lack of a substantive definition of what constitutes a trade in the Taxes Acts. If the FHL rules are to be abolished in their entirety then clear and detailed guidance will be required as to what level of services establishes a trading activity. Further, the cost of furnishing properties is substantial and it is entitlement to capital allowances that remains most important as well as start-up loss relief to help finance the considerable capital costs.

60 We are also concerned about the implications of the abolition of the FHL rules on hotel companies as it has been common since the 1980s for seaside hotels to also provide some furnished self-catering accommodation. If FHLs will no longer be entitled to capital allowances then will it be necessary to distinguish between furnishings in hotel rooms as opposed to self-catering units? This is likely to be practically very difficult.

61 We recommend that there should be detailed consultation on the implications of this significant and unexpected proposed change in the legislation.¹⁶

At Treasury Questions on 9 June 2009, Andrew George asked if it would not be possible to extend relief for property clearly designed for this use:

T4. Andrew George (St. Ives) (LD): In respect of the Government's planned changes to furnished holiday lettings tax rules, could the Financial Secretary to the Treasury clarify whether it would be possible to distinguish between properties that are purpose-built chalets, caravans, and other properties with occupancy restrictions that are clearly intended for the holiday lettings industry, and other properties that have been lived in and could be lived in again by local families in need?

The Financial Secretary to the Treasury (Mr. Stephen Timms): I would not want to encourage the hon. Gentleman in the view that that might give a way forward on this issue. Our position is that we have given support in the past. It is clear, under European Union rules, that that support would need to be extended to furnished accommodation not only in the UK but across Europe. We are therefore making that

¹⁶ ICAEW (Tax Faculty), *2009 Budget Submission to the Treasury Select Committee: TAXREP 23/09*, April 2009 pp9-10

change, but only for a year; then our intention would be to withdraw the relief altogether, not just for some but for all furnished holiday accommodation.¹⁷

Following this, the Labour Government confirmed that draft legislation would be published at the time of the 2009 *Pre-Budget Report*, along with an assessment of its likely impact.¹⁸ Nevertheless, on 23 June Janet Anderson MP put down an EDM critical of this decision, arguing that the Government should “conduct a full consultation and review of this policy change as soon as possible.” 100 Members signed this Motion, and 135 signed a similar EDM which Ms Anderson put down on 1 December 2009 after the Queen’s Speech.¹⁹

At the Report stage of the Finance Bill on 7 July, the Opposition put down a new clause to require the Government to publish a report on the impact of this change on the tourist sector. Speaking for the Conservatives David Gauke was particularly critical about the apparent lack of consultation prior to the announcement in the Budget:

Until the late 1970s the provision of holiday accommodation was regarded rather informally by the Inland Revenue as a business activity for tax purposes. Consequently, there was favourable income tax and capital gains tax treatment of it. The Inland Revenue changed this practice in the early 1980s and started to treat the activity as an investment, rather than a business. There was considerable disquiet, and in 1984 furnished holiday lettings were formally treated as a business activity for tax purposes. This year the beneficial treatment of furnished holiday lettings is being extended to properties in the European economic area, but it was announced in the Red Book that the Government intend to abolish the furnished holiday letting rules next year and owners will need to prove that they are running a trade in order for it to be treated as a business activity ...

The concern expressed to us is that a number of properties that are currently let out as furnished holiday lettings will be sold before April 2010 to benefit from the advantageous capital gains tax regime. Some may think that there are advantages in doing so, given that such properties tend to be located in attractive rural parts of the country where locals often find it difficult to secure affordable housing. However, we are hearing that many of those homes are likely to be sold to second-home owners, who will use the cottages only occasionally. As a consequence, the properties will not be in use as often; there will be fewer visitors to the countryside; and there is the potential for significant damage to the rural economy. The situation will become more difficult for those currently owning furnished holiday lettings and for holidaymakers wanting to rent out a holiday home in the UK. In rural areas that are popular with tourists, there is particular concern that the measure will have a major impact on their economy. I note that there is particular concern in Devon and Cornwall, where there are some 62,000 furnished holiday lets. They could be substantially affected ...

Why was there no consultation prior to the publication of the announcement? ... why has there been no attempt to look more imaginatively at whether there is a revenue-neutral approach that would still provide some protection or favourable treatment to those owning furnished holiday lettings, given the impact that the measure may have on the tourist industry and the unfortunate dynamic effects that may occur?²⁰

¹⁷ HC Deb 9 June 2009 c649

¹⁸ HC Deb 20 July 2009 c896W

¹⁹ EDM 1730 of 2008-09, 23 June 2009; EDM 307 of 2009-10, 1 December 2009

²⁰ HC Deb 7 July 2009 cc905-6

In response the then Financial Secretary, Stephen Timms, reiterated the point that the Government would, “publish draft legislation and an impact assessment at the time of the pre-Budget report” and that “Treasury officials will be happy to consider any comments on the proposed legislation at that time.”²¹

3 Pre-Budget 2009 & March 2010 Budget

The Labour Government confirmed its intention to repeal the FHL rules in the 2009 *Pre-Budget Report*, published on 9 December,²² more details were in a Budget note:

In general, the letting of property is not a trade, and income from letting property is taxed under the rules for property businesses. Under the FHL rules, those who let furnished holiday properties are taxed under the rules for property businesses, but if certain conditions are satisfied they are treated as if they are trading for specified tax purposes. This means that they can obtain more flexible loss relief, additional capital allowances, certain capital gains reliefs and relevant UK earnings treatment for pension purposes. Until the repeal takes effect [from April 2010], the current FHL rules will also apply to those UK taxpayers with qualifying furnished holiday lettings elsewhere in the European Economic Area (EEA).

After the FHL rules are withdrawn, those who let furnished holiday accommodation (but whose FHL business is not actually a trade) will no longer be treated as if they were trading for certain tax purposes. Instead they will be taxed for all tax purposes under the normal rules for property businesses.

This change will affect the way in which losses from letting the property can be used for loss relief purposes. Any FHL losses incurred before 6 April 2010 (or in accounting periods starting before 1 April 2010 for companies), which have not been relieved at that date, will be treated as losses carried forward from a property business. Such losses may be set against the future profits of that property business. Any losses incurred after 6 April 2010 (or in accounting periods starting on or after 1 April 2010 for companies) will be treated as losses from a property business. For example, individuals may set their property business losses against other profits of that property business in the year or in future years.

The business will cease to be treated as a trade for capital gains purposes from 6 April 2010 (or 1 April 2010 for companies). Businesses will be treated as a property business for all periods after these dates, but they may continue to treat periods prior to those dates as trading periods. This change affects the availability of the following capital gains reliefs:

- business asset roll-over relief;
- entrepreneurs’ relief;
- relief for gifts of business assets;
- relief for loans to traders; and
- exemptions for disposals of shares by companies with a substantial shareholding.

Capital allowances will not be available for expenditure incurred on or after 6 April 2010 (or 1 April 2010 for companies) on plant and machinery for use within the let

²¹ HC Deb 7 July 2009 c916. In the event the Opposition withdrew the amendment.

²² Cm 7747 December 2009 para 5.105

property. Those who let furnished holiday accommodation on a commercial basis may continue to claim capital allowances on qualifying expenditure incurred before that date, in the normal way. They may also continue to claim capital allowances on expenditure incurred after that date on plant and machinery which is not for use within the let property.

From 6 April 2010 (or 1 April 2010 for companies), those letting furnished holiday accommodation may claim the 10 per cent wear and tear allowance and the Landlord's Energy Savings Allowance (LESA). From 6 April 2010, income from letting furnished holiday accommodation will not be relevant UK earnings for pension relief purposes. This may affect the maximum income tax relief available for pension contributions.

Those affected by this change will still be entitled to various tax reliefs under the tax rules for property businesses. For example, they will still be able to claim their business expenses as a deduction when they compute their taxable profits, in the same way as they do now (e.g. mortgage interest, the cost of repairs, rates, utilities and employees' wages).²³

As the last section of this Note commented, those no longer qualifying for FHL relief would still be entitled to other reliefs on this income, as underline in a PQ at this time:

Annette Brooke: To ask the Chancellor of the Exchequer what assessment he has made of the potential effect of the repeal of the furnished holiday lettings rules on farmers who have diversified into tourism and related businesses.

Mr. Timms: In 2007-08 approximately 60,000 individuals declared income from Furnished Holiday Lettings to HM Revenue and Customs (HMRC), approximately 2,500 of whom also declared income from farming. After the Furnished Holiday Lettings rules are withdrawn, these businesses will still be able to claim various tax reliefs including loss relief, a deduction for business expenses, and an allowance for capital expenditure. Therefore the impact on continuing, viable businesses is expected to be limited. HMRC published an impact assessment on 9 December 2009, available at: www.hmrc.gov.uk/pbr2009/furnished-holiday-ia-3760.pdf²⁴

In its impact assessment of this change the department estimated that overall the one-off compliance costs associated with these changes will be of the order of £1.4m, with an ongoing reduction of administration costs of £65,000. The assessment also argued that the changes would not have "a material impact on the wider tourism industry", even in rural areas, because, in the department's view, it would not lead to a drop in either the supply of lettings, or the demand for holiday accommodation.²⁵

Nevertheless, tourism groups and tax professionals continued to strongly oppose the change;²⁶ in a commentary on the department's draft legislation, which it issued in February, the Institute of Chartered Accountants argued, "the fundamental problem with abolishing the scheme altogether, is that businesses must now self assess whether a property business is carrying on a trade and be taxed as a trade, or whether it is to be taxed as property income.

²³ HM Revenue & Customs Pre-Budget Notice PBRN24, 9 December 2009. At this time the department issued [draft legislation](#) to give effect to this change.

²⁴ HC Deb 14 December 2009 c857W

²⁵ HMRC, *Impact assessment: Withdrawing the Furnished Holiday Letting rules*, December 2009 p15, p14, 24

²⁶ For example, "Between the lines: How the PBR has failed to help Scotland's holiday lets", *The Scotsman*, 15 December 2009; "Pre Budget report: owners of holiday homes hit", *Daily Telegraph*, 11 December 2009

This creates an unnecessary and unwelcome administrative burden.”²⁷ Andrew George raised this issue in a Westminster Hall debate on 24 February, when he argued that there was “increasing alarm throughout the legitimate holiday letting sector”:

The impact of the changes will be far-reaching in areas such as my constituency and the rest of Cornwall and the Isles of Scilly, where many businesses are demonstrably not investment companies because they operate as holiday parks that provide whole holiday experiences, rather than property lettings. Properties that are fundamental to purpose-built holiday complexes, such as chalets, cannot be sold separately as part of investment activity. Of course, the rules will not apply to bed and breakfasts and hotels, even though they clearly compete in the same environment. As a result of the rules, there will be no encouragement for holiday businesses to invest in improving and modernising their facilities.²⁸

In response the then Economic Secretary, Ian Pearson, suggested that, “some of the issues raised, including those raised by people outside the House, are due to a misunderstanding, as many believe that this change takes away their entitlement to tax relief and their business expenses, such as mortgage interest, utility bills, the cost of repairs and employee wages”, but that this was “not true. They will still be entitled to all of those.” The Minister went on to give a series of examples of how the changes might work in practice:

A is employed in the City and is a higher-rate taxpayer. He bought a property in Cornwall as an investment and intends to retire there. He lets the property as furnished holiday accommodation through an agent for 10 weeks a year and generally makes a loss. He has no other income. Currently, A can set his furnished holiday letting loss against his employment income, and so pays less tax in the year that he makes an FHL loss. After the FHL rules are withdrawn, he will be able to set his loss against future profits of his FHL business or any other rental income. Generally, there will be a timing impact: A will not be able to reduce his employment income tax bill in the year he makes the loss, but he will pay less tax once his FHL business returns to profitability. However, if his FHL business does not return to profitability, and if he does not have any other rental income in the future, he will not be able to claim tax relief on the loss.

B-let us call him Fred-is a farmer who has converted three barns on the edge of his farm into self-catered holiday accommodation. He generally makes a profit, but in one year he makes a loss. The impact would be one of timing. Instead of setting his FHL loss against his farming profits in that year or the previous year, he will set it against his FHL profits in future years. Fred will receive the same amount of tax relief, but he would get the relief earlier under the FHL rules.

Carol decides to sell her FHL property in order to buy a larger one and makes a £150,000 capital gain. Under the FHL rules, the capital gain can be rolled over into the larger FHL property, which means that the tax charge on the smaller property will be deferred until the larger FHL property is subsequently sold. Carol will pay no tax on the capital gain now, but she will have a larger tax bill when she sells the new FHL property. Once the FHL rules are withdrawn, roll-over relief will still be available, but it will be limited on a time basis. Periods before April 2010 will qualify for roll-over relief, but periods after April 2010 will not. That means that Carol may have to pay some capital gains tax if she sells the smaller property after April 2010, but she may be able to defer a proportion of the gain until the larger FHL property is subsequently sold. For

²⁷ ICAEW (Tax Faculty), *Withdrawing the FHL rules: TAXREP10/10*, February 2010 para11

²⁸ HC Deb 24 February 2010 c112WH

example, if she sold the smaller FHL property in April 2011 after owning it for 10 years, she could roll over nine tenths of the £150,000 gain, which is £135,000. Only £15,000 of the gain would be immediately liable for CGT.

... Let me give a further example that relates to capital allowances. Jo converts a barn that she owns into self-catered holiday accommodation. She spends £60,000 on qualifying plant and machinery and receives £12,000 a year in net rents. In year five, she sells the barn at a profit, at which point the plant and machinery are valued at £50,000. Under the FHL rules, in year one, Jo's taxable profits are reduced by £50,000 under the normal annual investment allowance. In year two, her taxable profits are reduced by £2,000; in year three, by £1,600; and in year four, by £1,280. In year five, her taxable profits increase by £44,880. That represents the excess capital allowances that she has received. As a result, over the life of the business, she was entitled to £10,000 tax relief for her capital expenditure. Under the wear-and-tear allowance in the new regime, her taxable profits are reduced by £1,200 a year. Over the life of the business, she was entitled to £6,000 tax relief for the capital expenditure.

One brief further example is of someone who owns a house, perhaps in the Lake district, which she lets furnished to a local family. They move out and the owner decides to convert it to furnished holiday accommodation. She spends £25,000 replacing the kitchen and the bathroom and redecorates throughout. She receives £8,000 a year in net rents. This is revenue expenditure, and so taxable profits are reduced by £25,000. Therefore, she makes a £17,000 loss. Under the FHL rules, no capital allowances are due. Under the wear-and-tear allowance, taxable profits are reduced by £800 a year.

Those examples show some of the complexity of this issue, but I think that they are helpful. People who run such businesses need to understand how some of the changes will be implemented.²⁹

In a speech in early March the then Shadow Chancellor, George Osborne, stated that a future Conservative government would maintain the FHL rules.³⁰ In a second speech a few days later Mr Osborne explained that a Conservative administration would “reverse the abolition in a way that is responsible and fiscally neutral, for example by changing the thresholds for the relief or amending the interest deductibility criteria.”³¹

The then Chancellor, Alistair Darling, presented the 2010 Budget on 24 March: the Budget report did not mention this issue, though an updated impact assessment issued at the time gave estimates of the expected tax yield:

We estimate that the total impact on the tax received by the exchequer will be a £10 million reduction in tax in 2010-11, a £25 million increase in tax in 2011-12, and a £15 million increase in tax in 2012-13. The ongoing increase in tax may change over the longer term. These figures have been estimated on a receipts basis. The impact on tax receipts are normally shown on a receipts basis, because this is the impact felt by the Exchequer. Under self assessment, income tax is normally paid by instalments. Some tax will not be paid until after the end of the tax year to which it relates, this affects the year in which tax changes are recognised.

²⁹ HC Deb 24 February 2010 c121WH, cc 122-4WH

³⁰ “Tories to restore holiday home tax break”, *Daily Telegraph*, 13 March 2010

³¹ Conservative Party press notice, *Speech by George Osborne: Small business can't afford another five years of Gordon Brown*, 19 March 2010

The reduction in tax in 2010-11 is a result of the temporary extension of the FHL rules to properties situated elsewhere in the EEA, which was announced at Budget 2009. The increase in 2011-12 is much larger, because it includes the full increase in tax for 2010-11 and some of the increase in tax for 2011-12. This is a result of using the receipts basis.³²

HM Revenue & Customs' evaluation of the compliance costs for the change were unaltered from the 2009 PBR, and, as in that earlier document, the department took the view that abolishing the FHL rules would not have a material impact on the tourist sector, or the rural economy, suggesting that "some individuals may pay more income tax as a result of the change, but the impact on continuing, viable, businesses is expected to be limited."³³ The department acknowledged that the new rules might act as a negative factor in the decision to *start* letting property in this way, but that this was unlikely to have a significant impact:

The changes to the way relief is given for losses and capital expenditure may affect new FHL businesses as they enter the market. Some FHL businesses require a large initial capital investment. These costs include converting non-residential properties into holiday homes, and providing furniture and equipment within the property. Currently capital allowances can be claimed on some of these costs, and if this creates a loss that loss can be set against the individual's other income. This can provide additional financial support in the early years of the business by reducing the individual's tax bill at that time. The changes will mean that, in these circumstances, the individual may not be able to reduce their tax bill at that time, but they will pay less tax on the business' future profits instead.

The rules for relieving company property business losses will mean that new FHL businesses run by companies will not be affected in this way. Changing the time at which tax relief is given in these circumstances could dissuade some new businesses from entering the market. Over time this could reduce the total number of FHL properties. However, taxation is only one of the many factors individuals consider when starting a new business. The self catering market has shown strong growth in recent years, with self-catered holiday travel increasing by around 20% last year, and market forces are likely to be a continuing driver for growth in this sector.³⁴

Following the Budget, the Labour Government published the Finance Bill on 30 March. The Bill was shorter than normal, containing only some of the measures set out in the Budget. This was in anticipation that the time for scrutinising the Bill would be severely curtailed by the timing of the General Election, ending the Parliamentary Session sometime in April. (With an election occurring soon after the start of the tax year, a number of key tax measures need to be enshrined in legislation before the dissolution, and it is common practice in these circumstances for a second Finance Act to be passed later in the same tax year by the new Government.³⁵)

And so it proved. On 6 April the then Prime Minister, Gordon Brown, announced that Parliament would be dissolved on 12 April, and the Election held on 6 May – leaving three days of Parliamentary time for the 'wash-up': the process by which the Government and Opposition agree on the share of legislation which is still before the House to be enacted, largely by being agreed without debate. The need for cross-Party consent often results in

³² HMRC, *Impact assessment : Withdrawing the Furnished Holiday Letting rules*, March 2010 pp11-12

³³ *op.cit.* pp13-14

³⁴ *op.cit.* p14

³⁵ see, *The Budget and the annual Finance Bill*, Library standard note SN/BT/813, 18 March 2011

unpopular measures being dropped from Bills, and this is exactly what has happened to the provisions in the Finance Bill to withdraw the FHL rules.

On 7 April the House approved a Business Motion to complete all of the stages of the Finance Bill that same day.³⁶ The then Financial Secretary, Stephen Timms, opened the second reading debate, and explained that following consultation with the Opposition, four changes would be made – including the withdrawal of the FHL rule changes, though these would be brought back in a second Finance Bill after the Election and the start of the new Parliament.³⁷ Speaking for the Conservatives, Mark Hoban MP reiterated the party's opposition to removing the FHL rules, stating that if returned to office, "we would consult on a regime to allow holiday cottages to be treated as a trade on a fiscally neutral basis."³⁸ Finally, the House approved of the changes to the Bill set out by the Financial Secretary at the close of the three hour debate.³⁹

4 Recent developments

During the General Election campaign this issue was not discussed very much,⁴⁰ but following the Election, the new Government mentioned it in its Coalition agreement, stating it would "take measures to fulfil our EU treaty obligations in regard to the taxation of holiday letting that do not penalise UK-based businesses."⁴¹ The new Government's first Budget was on 22 June, and in this it confirmed that it would consult publicly on changing the rules to comply with EU law "in a fiscally responsible way":

The proposal inherited by the Government to repeal the special tax rules for furnished holiday lettings will not be implemented. Instead, the Government will consult over the summer on a proposal to ensure the tax rules meet EU legal requirements in a fiscally responsible way, by changing the eligibility thresholds and restricting the use of loss relief. Any changes will take effect from April 2011, and in the meantime the current rules continue to apply for the 2010-11 tax year.⁴²

HM Revenue & Customs published further details on their website at this time, confirming that the consultation would "specifically look at a proposal which would:

- ensure the FHL rules apply equally to properties in the EEA;
- increase the number of days that qualifying properties have to be available for, and actually let as, commercial holiday letting; and
- change the way in which FHL loss relief is given."⁴³

The Budget report estimated that keeping the rules would cost £30m in 2011/12, though this was projected to fall to £10m by 2013/14.⁴⁴

³⁶ HC Deb 7 April 2010 c1000-4

³⁷ HC Deb 7 April 2010 c1058

³⁸ HC Deb 7 April 2010 c1066

³⁹ HC Deb 7 April 2010 c1105

⁴⁰ In a speech on 2 May 2010, David Cameron, leader of the Conservatives, mentioned his party's success in having halted the abolition of the rules, as one of the ways it had pushed for issues of particular interest to the South West of England (Conservative Party, *Speech by David Cameron: Our contract for jobs*, 2 May 2010).

⁴¹ HM Government, *The Coalition: our programme for government*, 20 May 2010 p31

⁴² *Budget 2010* HC 61 June 2010 p51

⁴³ <http://www.hmrc.gov.uk/budget2010/furn-hol-lets.htm>. HMRC also posted a [Q&A document on its site](#).

By and large, immediate reactions to the June 2010 Budget focused on other measures, though the Chartered Institute of Taxation welcomed the announcement on FHL as a “welcome sign the Government listening to calls we and other have made to consult before bringing in changes.”⁴⁵

On 27 July the Treasury published a number of consultation documents which had been trailed in the June Budget, including proposals to amend the FHL rules.⁴⁶ As it had signalled at the time of the Budget, the Government’s approach was to maintain the FHL rules for properties *across* the EEA, but reduce the cost of this relief by tightening the qualifying conditions for relief, and changing the use of losses. First, the paper proposed that to qualify, properties would have to be available, and actually let, for more of the tax year, “to balance the need not to penalise UK businesses with the need to ensure that the rules are better targeted at those who run furnished holiday lettings as commercial businesses”:

The increase in the minimum periods over which the property is both available for letting and actually let to the public, from 140 days to 210 days and from 70 days to 105 days respectively, reflects the changes in the tourism industry since the furnished holiday lettings rules were introduced in 1984. The letting season has widened and allows for commercial letting throughout more of the year, with variation in school holiday periods, the peak summer season alone has expanded and more letting is seen over the Christmas and Easter periods. The existing 70 day limit is no longer in line with the modern tourist industry. The other qualifying conditions would not change.⁴⁷

Second, losses made from this activity could be offset against income from the same business *only*:

- a loss from a UK qualifying furnished holiday lettings business should only be available to set against future profits from that UK qualifying furnished holiday lettings business.
- a loss from an EEA qualifying furnished holiday lettings business should only be available to set against future profits from that EEA qualifying furnished holiday lettings business.⁴⁸

The Government also proposed to simplify the way businesses may qualify for capital allowances on assets for use in FHL properties. Responses to the paper were invited by 22 October.

The *Financial Times* reported that some practitioners had suggested the new day count for eligible properties might have an uneven effect across the country:

Tax experts said the increases in the minimum periods of availability and actual renting are clearly intended to restrict the tax relief to properties that are primarily dedicated to letting. Under the new rules, only properties available to rent for more than half of the year will qualify. However, Scott Bentley of Winterrule, the Truro-based accountancy firm, pointed out that the ease of meeting the new criteria will vary from region to

⁴⁴ HC 61 June 2010 p40 (Table 2.1 : item 18)

⁴⁵ CIOT press notice, *Budget response: only a temporary reprieve for FHL*, 22 June 2010

⁴⁶ HC Deb 27 July 2010 cc80-82WS. The consultation paper is available from the Treasury’s site at: http://www.hm-treasury.gov.uk/d/consult_furnished_holiday_lettings_condoc.pdf

⁴⁷ HM Treasury/HM Revenue & Customs, *Furnished Holiday Lettings Consultation*, July 2010 para 3.8-3.10

⁴⁸ *op.cit.* para 3.12

region. "Here in the south-west, owners may find it easier than others due to the milder climate and recent trends," he said. "Elsewhere in the country, actually achieving 15 weeks occupancy may be more challenging even if owners are seriously marketing the property." ...

The most significant change is the proposal to restrict losses to the same business, said tax experts. Around 20,000 of the 65,000 owners of furnished holiday lets currently offset their losses against other income, according to the Treasury's own figures. Mike Warburton of Grant Thornton said the change will hit those owners who have recently bought a property with a large mortgage. "If interest rates start going up and they start to see a loss on it, then they aren't going to be able to offset that against their other income anymore," he explained.⁴⁹

In their formal response the Tax Faculty of the Institute of Chartered Accountants argued that the day count test could be improved:

The definition for FHL is based on a set number of letting days ... and reduces the administrative burden considerably so that holiday letting businesses are easily identified. The set number of days is a blunt instrument, but it has stood the test of time, is easy to apply and understand and is seen as a fair test. Of the proposed changes, the increase of the number of days actually let from 70 to 105 is seen as the most onerous, particularly for businesses whose letting season is very short.

One side affect of increasing the number of days when a property is required to be let is that more properties will become marginal. The old test of 70 days was roughly equal to the UK holiday letting season. 105 days will be more difficult to achieve. To avoid businesses which are at the margin falling in and out of the rules from year to year, we recommend two further changes:

- A system of averaging for the days let. This would be particularly helpful for new businesses.
- An opt out election where those businesses which do not want the administrative burden of day counting, can choose to be simple property businesses rather than FHLs.⁵⁰

On 9 December the Government published responses to a number of consultations launched after the Budget, and, in a departure from usual Budgetary practice, draft legislation for much of the Finance Bill to be introduced the next year.⁵¹ On FHL, the Government had received 229 responses; the department noted that this evidence tended to support its views of the likely impact of the new rules "for example the estimate [given in the impact assessment that] 75 per cent as being approximately the proportion of Furnished Holiday Letting businesses that would continue to qualify under the Government's proposals, should there be no behavioural change, is unaltered." Further to this, the key findings from the consultation exercise were:

1 The proposals would be unlikely to have any material effect on UK tourism.

2 Impact would be likely to be greater for properties in more remote areas.

⁴⁹ "Offset upset for furnished holiday lets", *Financial Times*, 31 July 2010

⁵⁰ ICAEW (Tax Faculty), *Furnished Holiday Lettings Consultation – TAXREP 42/10*, 26 October 2010 pp2-3

⁵¹ This is collated on the Treasury's site: http://www.hm-treasury.gov.uk/consult_finance_bill_2011.htm

3 Some commercial businesses with UK properties (up to 25 per cent), particularly smaller businesses, could be excluded by the higher thresholds, particularly the proposed occupancy threshold.

4 Some of the concern over thresholds came from those feeling their circumstances were such that they would never be in a position to meet the revised levels (particularly occupancy); additionally there was significant concern from those who foresaw an increased chance of failing to meet requirements in a single year, or for some properties but not others, perhaps because of temporary circumstances. There were concerns this could cause uncertainty, inhibiting investment, and add complexity, increasing costs.

5 The restriction of loss relief would be effective in targeting support away from those whose businesses were not, in practice, profitable in the medium term. For commercial businesses, the cash-flow disadvantage would create potential risks for new businesses and for those reinvesting in order to maintain quality of provision.⁵²

In the light of this the Government would proceed with the proposed changes to loss relief, though it would delay implementation of the higher thresholds for availability and occupancy for one year:

A minority of businesses, estimated to be up to a quarter, currently fall short of the revised qualification conditions ... [The Government] appreciates that in some circumstances, businesses which meet existing thresholds would have difficulty in meeting the revised ones. Consultation responses provided evidence that customers may book holiday accommodation up to eighteen months in advance, and that there can be a lag between businesses acting to increase occupancy, and higher occupancy levels being achieved. Bearing this in mind, for the benefit of those businesses which do have a prospect of adapting, the Government has decided to modify its proposals. **The revised availability and occupancy thresholds will now apply with effect from April 2012** rather than April 2011 (changes to loss relief will still apply from April 2011).⁵³

In its view, concerns about the impact on the more remote areas of the country were not sufficient reason to cancel the higher thresholds, but provision would be made for businesses who met these tests in some years but not in others:

The consultation revealed concerns that businesses with multiple properties might face considerable complications where some properties met thresholds and others did not. There were calls for averaging across properties to be allowed. In fact, the current system allows for all properties within a business to qualify where on average they meet the occupancy threshold (and other qualifying conditions)⁵⁴

Under the current system, some businesses meet qualifying conditions in some years but not others. Consultation responses suggested that the increased thresholds would be likely to increase the frequency of this happening. This will be maintained under the Government's proposals.

⁵² HM Treasury, *Furnished holiday lettings: summary of responses*, December 2010 paras 4.2, 4.4

⁵³ *op.cit.* paras 4.12-13

⁵⁴ See Section 326 of the Income Tax Trading and Other Income Act 2005, and Section 268 of the Corporation Tax Act 2009

The Government has considered representations made, and agrees that intermittent qualification causes uncertainty and cost. To address this, it proposes that **businesses which meet the occupancy threshold in one year may elect to be treated as having met the occupancy threshold in each of the two following years**, providing that they meet certain criteria in each of those two following years. This will reduce the frequency of capital allowances valuation and disposal events (for which existing rules will continue to apply). The Government believes this provides a better solution than the proposal for notional pools made in the consultation document. Full guidance on the operation of this provision will be published in good time for April 2012 implementation of the increase in availability and occupancy thresholds.⁵⁵

The department published a series of 'tax information and impact notes' alongside its tranche of draft legislation for *Finance Bill 2011*; in the note covering the new FHL rules, it said a little about the numbers who would be affected:

It is estimated that approximately 65,000 individuals will be affected by this change ... Overall, the impact on continuing, viable furnished holiday property businesses is expected to be limited. Those businesses that continue to qualify may pay more tax relative to the 2010-11 position, primarily because losses can no longer be offset against non-FHL income. Those businesses which cease to qualify are estimated on average to gain as much from wear and tear allowances as they lose from capital allowances, although those with particularly high capital expenditure relative to rental income will lose. Businesses which cease to qualify may also lose in the long term from the lack of capital gains tax reliefs, but will be better in a better position than had the rules been abolished.⁵⁶

There was relatively little comment on this issue, though in a survey of this draft legislation the *Financial Times* noted that the Government had "largely succeeded" in finding an alternative to the previous Government's proposals which did not damage the tourist industry.⁵⁷ In a short submission the Tax Faculty of the Institute of Chartered Accountants welcomed the delay in applying the new thresholds and the proposed averaging tests, but suggested individuals might be given an option to opt out of the FHL regime, even where they were eligible, to avoid the need to count days.⁵⁸ Similarly there has been little mention of the issue in the House, though in answer to PQs, the Government confirmed it did not intend to publish any further analysis of the impact of the new regime, nor change the occupancy thresholds for the current year on account of the weather over Christmas and the New Year.⁵⁹

Following the Budget the *Finance (No.3) Bill 2011* was published on 31 March: clause 52 & schedule 14 covered these reforms to the FHL regime, and were the subject of a short debate at the Committee stage of the Bill on 7 June. Speaking for the Opposition David Hanson MP raised concerns about the impact of the new let test of 150 days: "the length of the days in the far north of the country means that the tourist season in both Scotland and Northern Ireland is very short, so dealing with that higher let-out day count from 70 to 105

⁵⁵ *Furnished holiday lettings ...*, December 2010 paras 4.17-.19. As noted above the availability threshold is to be 210 days, and the occupancy threshold is to be 105 days.

⁵⁶ HMRC, *Furnished holiday lettings (TIIN 1775)*, 9 December 2010. The department's note also made the point that the 'vast majority' of those affected would be individuals, though around 500 companies and a similar number of partnerships would also be affected.

⁵⁷ "Proposed changes: Furnished holiday lettings", *Financial Times*, 10 December 2010. For a technical discussion of the new rules see, "Longer letting", *Taxation*, 17 March 2011.

⁵⁸ ICAEW, *Draft Finance Bill 2011: FHL – TAXREP 11/11*, 9 February 2011 paras 9,12,14

⁵⁹ HC Deb 17 January 2011 cc579-80W; HC Deb 1 February 2011 c776W

days will be difficult.” Mr Hanson went on to ask whether there was sufficient guidance for taxpayers on whether the business they ran would count as a rental business and thus qualify for this relief – and if the Government had any formal plans to review the new rules:

There have also been discussions on the uncertainty among taxpayers on the distinction between a trading business and a rental business such as a furnished holiday letting. I would welcome some clarity from the Minister on the boundary between self-catering accommodation, bed-and-breakfast and budget hotels, because it is difficult to determine ... [The Chartered Institute of Taxation has] asked how and when the impact of these changes will be felt. In particular, it is referring to the economic impact on the recovery. Is the Minister likely to review this policy at any time?⁶⁰

In response the Exchequer Secretary David Gauke said the following:

The Government recognise that remote locations face particular challenges. They also have particular attractions. The Government encourage people in remote locations to find innovative ways of exploiting their advantages and overcoming their obstacles so as to meet new occupancy thresholds. The period of grace is designed to help businesses that fail to meet the occupancy threshold for up to two years. Therefore, a business needs to meet the thresholds for only one year, not three. The introduction of the increased thresholds has been delayed by a year to allow businesses to adapt their letting strategies. Those should be particularly helpful to regions where the new rules may be more challenging ...

The right hon. Gentleman asked about the distinction between furnished holiday lettings and, for example, bed and breakfasts and hotels and so on. The distinction depends on whether the business is a trade or property business. Furnished holiday lettings are actually property rental businesses that are treated as trades for certain tax purposes. The activities performed by the proprietor do not amount to a trade. However, if the proprietor provides significant services—for example, meals—the business may be a trade, in which case it would enjoy all the trade tax benefits. The status of the business will depend on the individual facts of the case.

The right hon. Gentleman asked whether there is an intention to review the issue. There is no intention for a formal review but, as he will be aware, all taxes are reviewed from time to time ... The changes to rules will provide for EU-compliant legislation in a targeted and cost-effective way. We have a good compromise, which protects revenue but maintains the furnished holiday lettings regime that the previous Government sought to remove.⁶¹

Following this exchange the provisions were agreed unamended without a vote.

⁶⁰ Public Bill Committee (*Finance (No3) Bill*), 7 June 2011 cc447-8

⁶¹ *op.cit.* c450