



ICAEW TAX REPRESENTATION

FINANCE BILL 2011

CLAUSE 52 AND SCHEDULE 14: FURNISHED HOLIDAY LETTINGS

Parliamentary Briefing submitted on 19 May 2011 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales setting out concerns with the proposed clause which will change the rules for furnished holiday lettings.

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FINANCE BILL 2011

CLAUSE 52 AND SCHEDULE 14: FURNISHED HOLIDAY LETTINGS

Introduction

1. Clause 52 and Schedule 14 introduce new rules for taxing income from furnished holiday letting (FHL). Clause 52 merely introduces Schedule 14 and all of the substantive provisions are in the schedule.
2. In this briefing we explain a number of concerns with rules in Schedule 14 and propose amendments to address these concerns.
3. The ICAEW supports retaining special rules for this type of income and has made a number of representations on this topic since the previous government announced its intention to change the FHL rules two years ago.
4. There has been extensive consultation on the wording and content of the draft legislation and, subject to the two aspects covered below, we are broadly content with the current version.

Areas of concern

The definition of furnished holiday letting

5. The definition of a FHL (set out in s 325, ITTOIA 2005) is based on satisfying a defined number of letting days. The test 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. It also reduces administrative burdens because FHL businesses are easily identified.
6. The change proposed in paras 2(3)(b), 2(4)(a) 7(4)(a) and 7(3)(b), schedule 14, will increase the number of days for which a property is actually let from 70 to 105. The old test of 70 days was roughly equal to the UK holiday letting season. 105 days will be more difficult to achieve.
7. We understand that this is Government policy and is part of a compromise approach introduced on the change from the Labour to the Coalition administration to try and enable the existing FHL tax treatment to be retained. We do not wish to re-open a debate that appears to be settled but rather to highlight the limited information on which this policy decision has been based and to raise our concern about the potential economic impact on certain parts of the UK holiday industry.
8. This will impact on businesses whose letting season is very short or who are too remote to be able to benefit from occasional weekend lets to boost their business. In particular there is a danger that this change adversely impacts on the remoter parts of the UK – especially Northern Ireland, northern Scotland and its islands, western Wales and west Cornwall and the Scilly Isles. In the various consultation discussions it is clear that there has been no objective assessment of the potential economic impact on these regions because the evidence is not available. However, those engaged in the industry are concerned about the potential impact of this more restrictive tax treatment. This is likely to be exacerbated by recent perceived trends in the holiday industry that suggest that rising fuel prices are already causing a fall in tourists travelling to the more remote locations and instead travelling to more central resorts.
9. **Recommendation: Given the potential economic impact at this stage in the recovery, it seems reasonable for this change in policy to be kept under review. We would therefore suggest that the Government be asked to give an assurance that the**

economic impact of this policy be kept under review and appropriate changes introduced in a subsequent finance bill if necessary.

Distinction between a trading and a rental business

10. In the course of the consultation discussions it became apparent that there is considerable uncertainty for taxpayers on the distinction as between a trading business and a rental business such as an FHL. The boundary between self-catering accommodation, B&Bs and budget hotels is difficult to determine. A distinction based upon whether an FHL owner lives on site and is therefore in occupation has been discussed based upon the established case law. However, this interpretation is not widely applied. There is a lack of clarity as to the distinction and little available guidance published by HMRC.

11. Recommendation: As part of the proposed review of small business taxation the Government should clarify the boundary to provide greater certainty for taxpayers.

Opt out election

12. FHL treatment is not an optional tax treatment. One side affect of increasing the number of days for which a property is required to be let, is that more properties will become marginal.

13. For such businesses, the administrative burden of careful day counting, together with the need for constant assessment of the averaging election or deemed treatment election, will be considerable.

14. We recommend 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.

15. Recommendation: We recommend a new Clause 52(2) as follows:

Schedule 14 will not apply following an election by the owner.

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BACKGROUND

The problem

1. In the 2009 Budget the then Chancellor announced his intention to abolish the furnished holiday letting (FHL) regime. HM Treasury (HMT) explained the reasons for this as follows:
 - The current system which applied only to properties fulfilling certain criteria, required property to be located in the UK. HM Treasury believed this to be in contravention of EU law. The scheme, if retained, would need to be extended to include properties located elsewhere in the European Economic Area.
 - Using the UK tax regime to encourage investment in specific types of let property abroad, while not extending the tax relief to other types of UK letting, would not be in the best interests of the UK economy.
 - The current scheme discriminates unfairly between furnished holiday letting businesses and other property letting businesses within the UK.
2. Consequently the existing rules were accepted as applying to properties throughout the EU with immediate and also retrospective effect. At the same time it was announced that the existing rules would be withdrawn from April 2010. After an informal period of consultation, draft legislation was published at the time of the PBR in December 2009.
3. Due to the impending election, the anticipated withdrawal was dropped from Finance Bill 2010. Consequently, the FHL scheme remains and applies to all let property within the EU.
4. There is a limited amount of information available on which to model the impact of a change to the rules. Individuals and trustees within self assessment system, return the information on specific pages, but there are also FHL properties contained within trades, for example farms, and some are operated by companies. These are not separately identifiable on tax returns. Hence there are conflicting claims as to the impact of these changes.
5. The number of properties potentially qualifying within the EU is also unknown.

The policy purpose behind the FHL scheme

6. Income from letting property is taxed differently to income from trading activities with more generous reliefs being available for trading income and capital expenditure. With the growth of the holiday letting industry, the boundary between whether letting property for holidays was taxed as a trade or as property income became highly problematic but was crucial for determining the tax position. To address this problem, the FHL scheme was introduced in 1984 and provided a relatively simple, straightforward and certain set of rules that have proved effective in reducing problems in this area for the past 26 years. In the absence of a statutory test the boundary between trading and land and property income is based on tax case law decisions.

The definition of a furnished holiday let

7. The Finance Act 1984 rules (now set out in s 325, ITTOIA 2005) allow a special category of property business to be taxed as though it is a trade. In order to qualify as a FHL the property must first be let on a commercial basis with a view to the realisation of profits. If this test is not satisfied, FHL treatment is not available. Assuming this test is met, the property must be available for letting to the public for at least 140 days and actually let for at least 70 days. Periods of letting of more than 31 consecutive days to the same person are ignored for this purpose.

8. The Finance Bill changes will increase these numbers of days from 140 to 210 and from 70 to 105 respectively.
9. 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.

Tax reliefs available under the FHL scheme

10. The FHL provides for a number of tax reliefs which in effect mirror those that are available to trading businesses. Key reliefs are:

- Losses: previously, an FHL business could set losses against other types of income whereas a property business loss could only be used against future income from property. Sideways loss relief will no longer be available from 2011/12 onwards.
- Capital allowances: tax relief is given for expenditure on capital assets through the capital allowances system. Most traders buy plant and machinery, for example computers and equipment they need and claim capital allowances accordingly. The annual investment allowance currently gives full relief for expenditure of up to £100,000 in a year (although this will be reduced to £25,000 from April 2012).

Capital allowances are not allowed for expenditure on plant and machinery in a dwelling-house. Consequently, individuals and companies with property businesses do not get tax relief for these expenses.

- CGT: roll-over, hold-over and entrepreneurs' reliefs are available on sales of FHL which are not available to a letting business.
- Pensions: income from an FHL business is relevant income for paying pension contributions.

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
2. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
3. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx>).