

ICAEW REPRESENTATION

TAXREP 10/10

WITHDRAWING THE FURNISHED HOLIDAY LETTINGS RULES

Memorandum of comment submitted in February 2010 by The Institute of Chartered Accountants in England and Wales, in response to the HMRC Technical Note, Withdrawing the Furnished Holiday Lettings Rules from 2010/11, published in December 2009

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the HMRC Technical Note, *Withdrawing the Furnished Holiday Lettings Rules from 2010/11*, draft legislation and impact assessment, published in December 2009.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
4. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

MAJOR POINTS

Problems with the proposal to abolish FHL status

5. We remain very disappointed by the announcements and further papers concerning furnished holiday letting (FHL) published with the Pre-Budget Report on 9 December 2009.
6. The figures used to form the basis of the impact assessment are highly implausible. They fail to include the many businesses which report this income as part of a larger trading activity, such as farming and also FHL income generated by companies.
7. The FHL scheme is being abolished because landlords with income from furnished holiday accommodation elsewhere in the European Economic Area (EEA) could not qualify for FHL treatment. The Government is concerned that this difference may not be compliant with European law.
8. We accepted this concern of HM Treasury and, with that in mind, sought to find a compromise through a series of meetings and correspondence, working with other professional bodies and HMRC. We proposed modifications to the existing scheme which would, we believe, have made retention of the current regime, extended across the EEA, more acceptable, albeit in a restricted form.
9. Our aim in doing this was not focussed on how much tax such businesses pay, but rather their administrative burden in determining whether each business was a trade.
10. A variant of our suggested compromise has been considered briefly as option 3 of the impact assessment, but does not feature as part of a wider consultation. In our view, retaining the scheme, extended to properties elsewhere in the EEA but restricting the tax benefits available, would have been preferable to abolition. We regret that our proposals for compromise have not been pursued.

11. 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. This creates an unnecessary and unwelcome administrative burden.
12. The guidance in the Technical note issued on 9 December 2009 is inadequate and avoids all the difficult issues. The position of each business will need to be considered on a case by case basis and reviewed every year. This will lead to costly Tribunal hearings, which will waste public money and give rise to a new body of case law. This could and should have been avoided.
13. A clear statement is needed on where the dividing line is between trading and passive income from letting property. This should include how HMRC will in future distinguish hotels from other furnished holiday lets.

SPECIFIC COMMENT

Draft legislation

14. The draft legislation appears satisfactory to achieve abolition of the FHL scheme. It leaves an unwelcome and unnecessary gap in establishing a dividing line between property businesses and trades.

Technical note

15. There is an increasing trend for brief legislation to be supplemented by HMRC guidance. Our position remains that guidance has no legal authority and is no substitute for clear, unambiguous legislation.
16. Before the Finance Act 1984 defined FHL, taxpayers relied on case law to determine whether their property income was generated from a trade or merely a property business. Government then chose to define FHL and create a more beneficial tax treatment in order to provide support for the tourism industry. An extremely welcome and simplifying by-product of this was the objective rule which distinguished FHL from other property businesses.
17. Counting the number of days and pattern of letting was relatively simple and made it easy to self assess. The abolition of this definition takes us back 25 years.
18. The two examples given in the Technical note are too simplistic, however, they make it clear that owner occupation is the essential and distinguishing feature of a trade. Unfortunately, occupation is not defined. It is unclear whether an owner occupied farmhouse around a courtyard with converted outbuildings will be occupation. Travelodge businesses will also fall into a grey area.
19. We understand from discussion that businesses which operate as essentially 'hotels without walls' will be trades, but this is not clear from the current guidance.
20. Capital allowances continue to be available for some items of plant and machinery, but not for plant used in a dwelling house. A dwelling house is not defined.
21. We welcome the decision to allow capital allowances to be claimed on the remaining balances of plant pools being carried forward in addition to the wear and tear allowance. However, we note that the availability of the annual investment allowance for many of the smaller FHL businesses will mean that the total of these balances will be insignificant.

22. There is no mention of the impact of withdrawing trade status from FHL on tax credit claimants. This needs further consideration where hours worked have been used to substantiate working tax credit claims.

Impact assessment

23. The figures used to form the basis of the impact assessment are implausible. Option 1 which has been recommended by HMRC assumes that there will not be any ongoing costs if the FHL scheme is abolished. We disagree with this assertion. We have explained to HMRC through meetings and with examples of real cases that for many property businesses the decision about whether or not they are trading is not clear cut. It will require regular review creating an unwelcome and unnecessary administrative burden.
24. The number of businesses on which the figures are based, completely ignore the many businesses which report this income within other trading profits and FHL income generated by companies not separately identified. This further understates the costs involved.

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APPENDIX

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.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160