



**THE INSTITUTE
OF CHARTERED
ACCOUNTANTS**
IN ENGLAND AND WALES

ICAEW REPRESENTATION

TAXREP 42/10

FURNISHED HOLIDAY LETTINGS CONSULTATION

Tax Faculty response to a consultation published in July 2010

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the Furnished holiday lettings consultation published jointly by HM Treasury and HMRC consultation in July 2010.

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

Overview

5. We welcome the decision to retain special rules for identifying and taxing furnished holiday letting (FHL) income.
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 is taxed as a trade or as property income can be highly problematic but is crucial for determining the tax position.
7. To address this problem, the FHL scheme was introduced in 1984 and has 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. The repeal of the existing rules would have created uncertainty as to this distinction. In the absence of a statutory test the boundary between trading and land and property income is based on tax case law decisions.
8. The definition for FHL is based on a set number of letting days, s 325, ITTOIA 2005, 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.
9. 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.

General comments

Additional changes proposed

10. One side affect of increasing the number of days when a property is required to be let is that more properties will become marginal.

11. The old test of 70 days was roughly equal to the UK holiday letting season. 105 days will be more difficult to achieve.
12. 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.
13. We would be pleased to discuss further how these tests could be applied.

Enactment of ESC B47

14. Earlier this year, draft legislation was published for the enactment of ESC B47. We are not clear whether this is also being taken forward as part of this consultation.

Overseas property businesses

15. In relation to foreign properties there are considerable foreign exchange issues to be dealt with, particularly for non domiciled taxpayers.
16. We suggest that on the grounds of simplification it would be simpler to adopt the 'Qualifying Business Unit' approach which is used in the USA. In this way, the business's transactions are recorded in the currency of the business and only the result is translated. HMRC does not lose revenue over the life of the business although the profit calculated in this way may be higher or lower than the strict basis for any particular year.

Answers to specific questions

Q1 How would increasing the minimum period over which a property is available for letting from 140 to 210 days impact on businesses?

17. For an ongoing business, this should not be a problem in normal letting periods. However, extending the minimum period to 210 days may cause difficulty where major refurbishments are carried out, for example if a roof replacement is undertaken. Allowance should be made for such renovation periods otherwise properties may fall out of the FHL regime, stranding losses associated with the repairs.

Q2 Would the increase in the minimum availability period cause current suppliers to stop providing furnished holiday lettings? If so what would the impact be on:

- the furnished holiday lettings industry that continued to operate; and
- the tourism industry as a whole?

18. See answer to Q1. Although the increase in minimum availability is unlikely to cause suppliers to stop providing accommodation altogether, it may cause difficulties at certain times. FHL treatment is not an optional tax treatment. Losses arising in a void period, for example from carrying out a major refurbishment, may lead to a property needing to be kept outside the FHL scheme in order to utilise the losses.

Q3 How would increasing the minimum period over which a property is actually let to the public from 70 to 105 days impact on businesses?

19. This proposed restriction has caused more cause for concern amongst our members than any of the other suggested changes.

Existing businesses

20. To let a FHL for 105 days in a period sets a fairly high bar in some areas given the nature of the British holiday season and the huge regional variations. For example, commercially letting a cottage in the Cotswolds follows a very different commercial pattern to letting in Cornwall. The profile of the lessee is different as are the letting periods. Both can be run commercially at a profit because the differential is often reflected in the rental income per week, but the letting year can be very different.
21. A typical British holiday year consists primarily of the school holidays plus half terms. Christmas is mixed in that some people like to go to cottages in the country, but Cornwall can be less popular.
22. Equally the holiday season in Cornwall (and other seaside places) does not really get going until after Easter, which can be surprisingly quiet dependent upon whether Easter is early or late.
23. As many FHLs are aimed at the family market, the core letting period is made up of six or seven weeks of summer plus three half terms and then perhaps Christmas and Easter. Clearly there will be ad hoc weeks, but achieving 15 weeks will be challenging, particular where the economy is struggling.
24. For example, it is possible for two Easter week-ends to fall in one tax year, and none in another tax year, affecting holiday bookings. An outbreak of foot and mouth could cause a property to be unlet for sufficient period to cause it to fail the test in one year.
25. Seasonal variations caused by the weather will also be a problem for many FHL businesses in the north of the UK. It will be easier to achieve lettings on the coast in the south than in the north.
26. Better weather will also make it easier to let overseas properties where sun is guaranteed, than in the UK where it is not.
27. This will mean some owners continually moving in and out of the FHL rules.

Suggested alternatives

28. Subject to dealing with longer term letting in the winter months, we think that increasing the days for which the property is available for letting to an even higher figure than the 210 suggested, would be sufficient to focus the relief on genuine FHL businesses rather than taxpayers who may use the relief to finance holiday homes, if this is the government's concern.
29. Section 326, ITTOIA 2005 contains averaging rules which can be used for under-utilised holiday accommodation. These rules should be retained in the new regime. They could also be extended to allow averaging for the actual number of let days to be considered on, say, a three year rolling basis. The existing rules require this relief to be made by way of a formal claim. We suggest that the administration associated with this relief would be reduced if it could be self assessed and just used by taxpayers whose lettings qualify.
30. If the higher day counts are to be introduced, it would be helpful to have an opt out election. At the moment, a person is either in or out of the FHL regime, looking at each period separately. For administrative reasons and simplicity, it will be easier for some taxpayers if they could just opt out of the FHL regime permanently and then not have to keep watching the day count.
31. Stricter rules could be imposed on the restriction of costs where there is owner usage at some point in the year. This could perhaps be achieved by further guidance to be issued by HMRC as to how this should be calculated.

New businesses

32. Achieving 105 days during the first 12 months of a new business will be very challenging. This will be particularly difficult in those areas of the UK where the letting season is more seasonal. It could cause a barrier to entry and reduce competition in the sector.
33. When a taxpayer first sets out to let holiday property they often have fewer lettings. These build up over time.
34. We suggest that there should be a three year period of averaging of days for new businesses, subject to the 'opt out election' described above. There could be a presumption that the business will qualify as a FHL, with clawback if it fails the test at the end of three years. This could be taken as three tax years for an unincorporated business or 36 months for a company.

Q4 Would the increase in the minimum occupancy period cause current suppliers to stop providing furnished holiday lettings? If so what would the impact be on:

- the furnished holiday lettings industry that continued to operate; and
- the tourism industry as a whole?

35. See comments to Q3 above.

36. We believe that most of the difficulties will be administrative. The impact on the tourism industry is more likely to be adversely affected than the FHL industry overall. This is because of the reliance of tourism on holiday periods rather than on casual trade. Travel lodge type businesses are less seasonal.

Q5 Is the proposal likely to impact differently in different regions of the UK or the EEA, for example because of differences in letting patterns or the length of the tourism season? If so, what evidence is there to suggest a regional or national variation?

37. We speculate that in relation to properties aimed towards tourists and holiday makers, longer periods of good weather will incline property purchase decisions towards the south of England, or towards southern Europe over the UK. It is also true that businesses do achieve much longer seasons where there is a good transport connections and the properties are accessible to large population areas. For this reason we believe that there would be an adverse impact on those regions at the extremities of the UK as well as those with a relatively poorer climate.

Q6 What would be the impact of the proposed restriction to loss relief on qualifying furnished holiday lettings businesses? What proportion of businesses would be affected by this restriction? What types of business would be most affected? What would the commercial impact on the businesses be? Would this be due to a lack of capacity to use losses against the same qualifying furnished holiday lettings business in the future?

38. Sideways and backwards loss relief is particularly important in the early years of a new business. We believe that the existing rule which requires the business to be operated on a commercial basis with a view to realising a profit should be sufficient to prevent 'hobby' losses being relieved against other income. If there is particular concern about this, then the existing rules which prevent sideways loss relief in six consecutive years by hobby farmers could be mirrored here.

39. There is also the problem that a business may meet the conditions to be taxed as a FHL in some years but not in others, so that losses could be stranded as the property moves from one set of rules to another.

Q7 How should the proposed restrictions to loss relief be implemented? How should losses brought forward be treated for furnished holiday lettings businesses that are no longer

qualifying? How should losses brought forward be treated for furnished holiday lettings businesses, some lettings of which are no longer qualifying?

40. Transitional rules would need to cater for losses brought forward on properties which were historically taxed as FHLs but which no longer qualify to avoid the losses being stranded.

41. The rules should be made as simple as possible. Perhaps simply have one pot of losses for UK property business and one for overseas property business.

Q8 What are the potential commercial impacts of applying the current rules to every person operating furnished holiday letting businesses and bringing in a capital allowance disposal event every time they failed to qualify under the new qualifying conditions?

Q9 What effect would the proposed treatment of notional pools be likely to have on the administrative burden placed on a business that:

- continually operates as a furnished holiday letting under the new conditions; and
- sometimes qualified as a furnished holiday letting under the new conditions?

42. Considering questions 8 and 9 together, simplicity should be key. We consider that having cessations every time a void period arises increases complexity and administrative costs. We recommend the carry forward of pools until the business ceases permanently, with notional writing down allowances in non-qualifying periods, with a separate pool for each property.

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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