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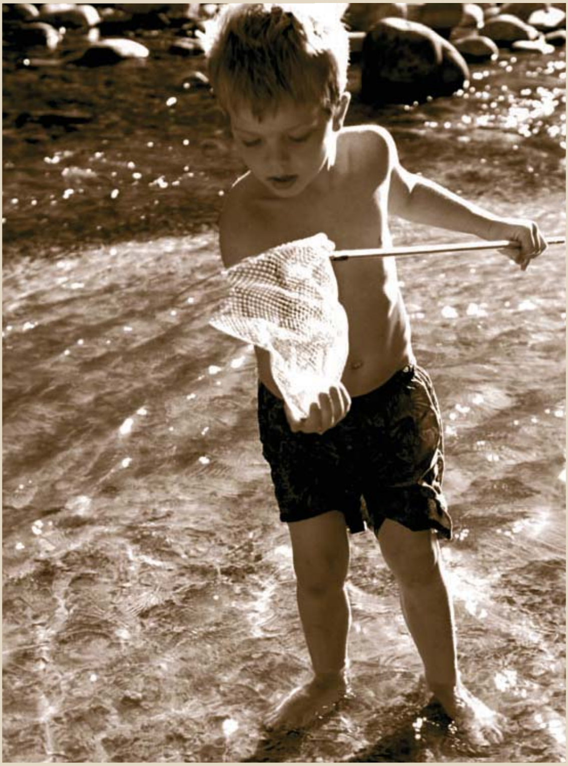
Take a tax break



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Tax & Furnished Holiday Lettings

INTRODUCTION

Since the 1980s, owners of furnished holiday lettings (FHL) property have qualified for a number of significant tax breaks. The tax breaks arise from the fact that the rental activity is treated as a "trading" activity for tax purposes, rather than simply an "investment" activity which would normally be the case.

In 2009, the Labour government announced that these tax breaks would no longer apply from 6 April 2010, but this decision has now been overturned and the favourable tax breaks are to continue into the foreseeable future.

If anything, furnished holiday let properties have now become even more attractive from an investment and tax planning perspective, given that individuals will be facing higher levels of income tax and capital gains tax in the future, as the new coalition government attempts to reduce the country's financial deficit.

QUALIFYING CONDITIONS

In order to qualify for the special tax breaks, a number of conditions must be satisfied:

- the property must be available for letting to the public on a commercial basis for at least 140 days of the year, and
- the property must be occupied by paying guests for at least 70 days of the year (but any individual letting must not exceed 31 days, otherwise this does not count towards the 70 days threshold), and
- the property must be furnished, and
- the property can be let on a long-term basis (i.e. for periods of more than 31 days), but these periods are restricted to a maximum of 155 days per year.

These conditions are relatively easy to achieve, particularly if a property can be purchased that already has bookings for the season ahead, such that the owner should normally be able to secure the various tax breaks. In addition, if an individual has more than one furnished holiday let property, they can elect to operate an "averaging" basis for the purposes of the above 70 days test e.g. if property A is rented for 100 days, then property B would only need to be rented for 40 days in order for both properties to qualify as furnished holiday let for tax purposes.

TAX ADVANTAGES

The tax reliefs that are available to furnished holiday let properties are wide ranging and cover income tax, capital gains tax and inheritance tax.

Income Tax

Whilst the rental income will be taxable income for the owner, there are a large number of expenses that can be offset against the rental income in calculating whether the individual has to pay any income tax on the rent that they receive. Please see the example over.

In addition, the owner will be able to claim capital allowances on any expenditure that has been incurred on buying "furniture" (e.g. beds, chairs, carpets, curtains, cooker, fridge etc).

Example of Income Tax Calculation

Rental income	**20,000**
Less qualifying expenses:	
Letting Agent's commission	(4,000)
Mortgage interest	(3,000)
Cleaning and gardening	(1,000)
Utilities, such as electricity and water	(1,000)
Building and contents Insurance	(500)
Accountancy and legal	(500)
Other (e.g. advertising, phone calls, travel)	(250)
Taxable income before capital allowances	9,750
Less capital allowances (see below)	(9,750)
Taxable income	**Nil**

Capital allowances can also be claimed in relation to the electrical, heating and plumbing systems that form part of the property and were effectively purchased when the property was acquired.

Since April 2008, owners of furnished holiday let properties have been able to claim a very favourable capital allowances relief called AIA (annual investment allowance). This relief allows the owner to offset 100% of the cost of qualifying items (i.e. furniture, electrical, heating and plumbing systems) in the year of purchase. In general terms, up to 40% of the cost of a purpose built holiday chalet may be eligible for capital allowances. Hence, even though the owner in the above example is obtaining a commercial return on their rental investment, it is quite likely that they will not have to pay any income tax on their profit (at least for a number of years).

If the capital allowances exceed the net rental income figure, then the individual can offset the loss against other taxable income, which can produce income tax savings of up to 50% depending upon the financial circumstances of the individual.

Capital Gains Tax

There are two main capital gains tax reliefs that apply to furnished holiday let properties.

The first is that the purchase of the property qualifies for roll-over relief. This means that if the individual has incurred a capital gain from selling an asset in the last 3 years (or the following 12 months period) that has been used in their trading business, including a furnished holiday let property, the capital gain can be rolled over into the cost of the property. If the individual has paid tax to HMRC in respect of this capital gain, they will be able to obtain a repayment of this tax.

Likewise, on a future sale of the property, any capital gain will be eligible for further roll-over relief if the sale proceeds are reinvested into another asset that is used in a trading business.

The second capital gains tax relief is that furnished holiday let properties qualify for “entrepreneurs’ relief” which means that on any future sale of the property, the maximum rate of capital gains tax will be 10% (which is very low when compared to the 40% and 50% capital gains tax rates that are expected to apply to other types of investments in future years).

Inheritance Tax

In the past, furnished holiday let properties were normally accepted by HMRC as qualifying for a relief (called Business Property Relief), which meant that the value of the property was exempt from inheritance tax.

The position has recently changed in that HMRC now look at properties on a case by case basis and consequently it cannot be assumed that all furnished holiday let properties will definitely qualify for Business Property Relief and thereby be exempt from inheritance tax.

Owners will have a better chance of securing Business Property Relief if they provide additional services and activities to their letting customers e.g. welcome packs, “meet and greet” on arrival, supply of basic food for the fridge etc. HMRC are happy to accept that these services and activities can be subcontracted by the owner to an agent, such as the park operator.

VAT

Most individuals will not have to worry about VAT, unless their annual turnover exceeds the VAT registration threshold of £70,000. If an individual has a number of furnished holiday let properties, or has another business, then VAT may have to be considered and advice should be sought from an accountant.

Dealing with HMRC

Individuals who purchase a furnished holiday let property and rent it out should inform HMRC no later than 6 months after the end of the tax year in which rental income is fi rst received.

Likewise, individuals will normally have to submit a tax return to HMRC on an annual basis.

In view of the fact that furnished holiday let properties offer a number of tax saving opportunities, most owners will benefit from speaking to an accountant to ensure that they claim all the reliefs that are available. An accountant will normally deal with HMRC on your behalf, including the preparation and submission of your tax return to HMRC.

Please call 0114 283 6620 for more information.