

The End of Furnished Holiday Lettings

October 2009

Holiday cottage owners, whose properties have fallen within the Furnished Holiday Lets (FHL) rules, are facing uncertain times. The FHL rules are due to change from 6 April 2010, with the result that some income tax and capital gains tax reliefs that are presently available, will be lost.

Income Tax Changes

1. The major income tax loss relief that is about to be abolished, is the ability of an individual to offset losses from FHLs against other income. Instead, they will only be available to offset losses against other, similar rental income in the future. This comes at a particularly difficult time for many owners, as letting income is being squeezed and it may be some years before profits are made again.

Where FHL owners own many properties, it may be possible to offset these losses against rental profits from other properties but in many cases this will not be possible.

2. FHL owners are presently able to claim capital allowances on assets within their properties but this will cease from April 2010. This regime will be replaced by a simple "wear and tear" allowance to cover depreciation.

This charge may actually benefit FHL owners if they do not spend a great deal of money on upgrading their property. It should be noted that the treatment of repairs will remain unchanged.

3. Income from FHL will no longer be 'relevant' earnings for pension purposes from April 2010. This will mean that an individual will not be able to make a pension contribution based on income arising from FHL properties.

Capital Gains Tax (CGT) Charges

1. Prior to 5 April 2010, anyone selling FHL property may be able to claim Entrepreneur Relief on the disposal. Following the changes, normal flat rate CGT rules would apply.
2. Gains presently arising on the disposal of a FHL property can be "rolled over" into the purchase of another business asset (often another FHL property). This very useful relief effectively defers the tax payment date until the final qualifying replacement asset is sold, as opposed to tax being paid on each disposal. This will cease on 6 April 2010.
3. Where business assets (including FHL property until 6 April 2010) are given away during an individual's lifetime, the gain can be "held over" and the resultant potential tax paid only when the beneficiary disposes of the asset.

What can be done before the Changes?

As can be seen from the previous comments, the FHL rules have been very attractive to certain investors and they need to look carefully at what the future holds to see how best they can plan for the new regime.

In some cases it may be that a few subtle changes in the way the rental business is run will lead to the owner being able to retain the ability to offset losses against other income. Where a rental business is run as a “proper” trade, its profits will be taxed under Schedule D and losses may be available to be set off in the same way as is presently possible.

Owners should take advice about what changes, if any, are needed to the way that they deal with their FHL property to give them the best chance of making the transition into a property business and therefore take advantage of the beneficial loss set-off rules. Some of the CGT reliefs (“Rollover” and “Holdover” reliefs) may also be available to properly formed furnished holiday businesses.

While the present CGT reliefs are still with us, owners may wish to take steps now to mitigate future CGT liabilities from arising. These may involve transferring an interest in the properties to family members, trusts or companies.

Summary

Whilst these are undoubtedly some very unwelcome changes to the FHL rules coming into place from April 2010, careful planning and possibly small changes to business models, will mean that some owners will continue to be taxed as though the FHL changes never happened.