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Dear Mr Payne

Thank you for your letter of 17 June to the Chancellor of the Exchequer about the Budget proposal to repeal furnished holiday letting rules. I have been asked to reply and I am sorry for the delay in doing so.

You are concerned at the way the changes in the Budget will affect the owners of self-catering properties in your region.

The Government attaches priority to supporting a thriving UK tourist industry. In deciding to repeal, it has assessed viable options taking into account this objective, as well as its objectives on fairness and value for money, and its obligations under EU law.

As explained below, there is a need to change from the existing position (notwithstanding the scale of potential negative impacts). The options between which we could have chosen could each have had an impact on UK tourism. The government believes it has made the right choice and is pursuing the most effective way to support its tourism objectives. It is providing £130 million between 2008 and 2012 for marketing Britain overseas and England to the British. In addition, between £3.3 and £3.5 million is provided annually to the Regional Development Agencies for tourism support. The Government announced last year a significant investment on skills in the tourism industry, including an additional £210 million on the sector through the Train to Gain compact and £350 million to helping small businesses, including tourism SMEs, get the training they need to get through the economic downturn.

To explain further, it may be helpful if I give some background to the Budget announcement made on 22 April. In general, the letting of property is treated as a property business and not as a trade. Landlords are normally taxed on their rental income under the property income rules. UK

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Jim Harra (Director)

resident landlords are taxed in the UK on their property income, where ever in the world the property is situated. Non-resident landlords are taxed in the UK on any income they receive from property situated in the UK.

Under the furnished holiday letting (FHL) rules, landlords of furnished holiday properties in the UK are taxed under the property income rules. However, subject to certain qualifying conditions, they are treated as if they were trading for some tax purposes. This means that they can obtain more flexible loss relief, additional capital allowances, certain capital gains tax reliefs, and relevant earnings treatment for pension purposes.

Landlords with income from furnished holiday accommodation that is situated elsewhere in the European Economic Area (EEA) did not qualify for the special treatment available to landlords with furnished holiday accommodation situated in the UK. They were treated instead in the same way as landlords of other types of overseas property, under the property income rules. This difference may not be compliant with European law. Therefore the Government had to choose whether to extend the preferential tax treatment to those who invest in European FHL properties, or withdraw the FHL rules. If the Government modified the FHL rules, in the way you suggest, they would still need to extend the new FHL rules to properties situated in the EEA.

Recent years have seen strong growth in the number of taxpayers owning properties abroad. This trend is likely to continue and could increase further if the FHL rules were extended to include EEA properties on an indefinite basis. Therefore it is likely that an indefinite extension of the FHL rules to EEA properties would also negatively impact upon UK tourism.

In addition, the FHL rules provide an anomalous tax treatment and are seen as discriminatory and unfair to other types of landlord. In particular, some residential landlords provide similar services and undertake similar activities to some FHL landlords but are unable to benefit from the preferential tax treatment available.

The Government supports the objective of a thriving UK tourism industry but doubts a distortion to the tax system is the best way of promoting it and has therefore decided to repeal the FHL rules from 6 April 2010 for income tax and capital gains tax purposes, and from 1 April 2010 for corporation tax purposes.

The decision was taken to announce the withdrawal at Budget 2009, in order to provide a period of notice to those affected, and thus allow them time to plan for the change in tax treatment. HMRC will provide further details about the repeal later this year. Draft legislation will be published at the Pre-Budget Report, and the Government are open to comment on its fitness for purpose. An Impact Assessment will also be published alongside the draft legislation.

Under the new rules, landlords of FHL accommodation will continue to be taxed under the property income rules, but they will no longer be treated as if they were trading for some tax purposes. They may still claim business expenses such as mortgage interest, the cost of repairs, rates, utilities and employees' wages as a deduction when they compute their taxable income from the property, in the same way as they do now.

Currently those individuals who run commercial FHL businesses, with a view to a profit, are able to set their FHL losses against profits from other sources of income. Whilst the repeal of the FHL rules will change the way in which FHL losses can be used, loss relief will still be available. Individuals will be able to set their FHL losses against other property income in the year or future years, and companies will set their losses against income from other sources in the year or future years.

Capital allowances will not be available for new expenditure on plant and machinery used within the FHL property once the FHL rules are repealed but the landlord will be able to claim the wear and tear allowance instead. The wear and tear allowance is a deduction of 10% of net rents intended to cover the costs of renewing furniture or furnishings in let residential property. The

Landlord's Energy Savings Allowance will also be available for capital expenditure on certain energy saving items.

The repeal of the FHL rules will not affect the tax treatment of hotels or bed and breakfast accommodation, as these are trading activities. Those who let caravans, and carry on material trading activities connected with the operation of the caravan site, will continue to treat their income from letting caravans as trading income after the repeal. Some people who let out holiday cottages also provide additional services to their customers, for example the provision of meals. Where a landlord provides services over and above those normally provided by a landlord, some or all of the activity may amount to a trade. This may apply in the case of a holiday complex consisting of self catering accommodation with additional on-site services for example a bar / restaurant, sports facilities and laundry. HMRC have published guidance on this point at www.hmrc.gov.uk/manuals/pimmanual/PIM4300.htm.

I hope you will find this reply useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Has Mukh Haria', with a stylized, cursive flourish.

Hasmukh Haria
Policy Officer