



Taxation for a staycation

Since the pandemic, demand for 'staycations' in the UK has remained buoyant despite overseas holidays being back in vogue. For us, that's meant more tax advice for customers thinking of buying a second home.

While our customers might be considering a second property for use as a holiday home, or to let to the general public, we've found that more often than not, their motivation is a combination of the two. With this in mind, it is worth considering some of the tax rules surrounding furnished holiday lettings.

What is a furnished holiday let?

Unlike a residential let, a furnished holiday let (FHL) is a tenancy entitling a guest to occupy a property for a very limited period of time. From a tax perspective, this creates an unusual hybrid; not quite a 'business' in the conventional sense, but benefiting from a number of useful tax breaks associated with business enterprises unavailable to regular buy-to-let landlords.

To qualify as an FHL, a number of conditions must be met. At a high level these are:

- The property must be let fully furnished (there must be sufficient furniture for guests to enjoy domestic occupation of the property, without having to provide further items for themselves)
- The property must be situated in the UK or in the European Economic Area (the EU, Iceland, Liechtenstein and Norway)
- It must be let on a commercial basis with a view to realising a profit (letting the property at below market rent to say, family or friends, will fail this test)
- The property must be available for letting as an FHL for at least 210 days in a year
- It must actually be let as an FHL for at least 105 days (the 'occupancy threshold')
- It must not normally be let to the same person for a continuous period exceeding 31 days

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If the owner is unable to let the property for at least 105 days then, if they own more than one FHL, they may be able to average the occupancy threshold across all properties. There is also a ‘period of grace’ rule which allows for a grace period of two consecutive years where the occupancy threshold has not been met. For either of these conditions to apply, the owner must have been thwarted in letting the property for at least 105 days for reasons beyond their control.

What income tax breaks are associated with furnished holiday lets?

Owners of FHLs can deduct the full amount of their finance costs (e.g. mortgage interest) from their turnover to arrive at taxable rental profits. This stands in sharp contrast to the rules for buy-to-let landlords (where rules were recently changed, meaning that tax relief for finance costs is only available as a tax credit, restricted to 20% of the cost incurred). In a further divergence from the tax rules surrounding buy-to-let properties, profits from a FHL may be apportioned between spouses for tax purposes with reference to the actual work done in letting the property. It is therefore possible for spouses (including civil partners) to own a property in joint names, but to have all of the FHL profits to be taxed in the name of the spouse who is actively involved in running the FHL business.

FHL profits also count as ‘relevant earnings’ for the purposes of contributing to a personal pension; since personal pension contributions extend the basic rate tax band, this could potentially reduce the tax bill on FHL rental profits.

What capital gains tax breaks are associated with furnished holiday lets?

When it comes to capital gains tax (CGT), the sale of a FHL business could qualify for Business Assets Disposal Relief (formerly Entrepreneurs’ Relief). This would give the owner the chance to pay CGT at the 10% rate, subject to the availability of their £1 million allowance.

It might also be possible for a FHL owner to gift their property outright to another individual, and claim to ‘holdover’ any arising capital gain through the ‘gift of business assets’ relief rules. The recipient would receive the property with a CGT base cost that is reduced by the capital gain held over by the original owner. Alternatively, if an owner chose to sell their FHL and to reinvest the sale proceeds into another FHL (or indeed any other qualifying business asset) then it could be possible to claim CGT rollover relief and defer the capital gain arising until the replacement FHL is sold. Of course, we always recommend seeking professional tax advice to ensure that qualifying conditions are met by the owners, and CGT reliefs correctly claimed.

Are there any inheritance tax breaks for furnished holiday lets?

Unfortunately, FHLs do not generally benefit from inheritance tax relief. To revisit our point about the hybrid nature of FHLs in tax terms, they are extremely unlikely to qualify for Business Property Relief (BPR).

The reason for this is that HMRC considers that the underlying rental return is that of a passive investment activity rather than that of an active trade. Any FHLs that do qualify for BPR will very much be the exception rather than the rule, and probably much more akin to a ‘bed and breakfast’ business than a holiday property rental.

How about more casual holiday lets?

So far, we have focussed on FHLs. However, some clients may decide to occasionally rent out their home under an Airbnb arrangement.

The ‘property allowance’ exempts from income tax up to £1,000 of rental income per year. If gross annual property income is £1,000 or less then it will not be taxable and there is no need to report it to HMRC. If clients live in an area already popular with tourists, or perhaps close to a sporting venue, then they could consider renting out their home for a day or two and make up to £1,000, tax free, in the process.

Mark Collins
Head of Tax

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