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FURNISHED HOLIDAY LETTING CONSULTATION

The Tourism Alliance was established in 2001 as the voice of the UK tourism industry. It comprises 50 tourism industry trade and marketing associations that together represent some 200,000 businesses of all sizes throughout the UK (see Appendix 1 for membership list). The Tourism Alliance's mandate is to work with government on issues relevant to the growth and development of tourism and its contribution to the economy. It is therefore responding to this consultation in that capacity.

Britain's tourism industry has been one of the largest and fastest growing sectors of the British economy over the past 20 years. It is now worth £86bn and accounts for over 7% of the UK workforce. Most tourism in the UK is domestic. Almost 80% of tourism revenue is domestic tourism with British residents taking well over 1bn overnight trips and day visits each year (an average of 17 per person). This travel results in the circulation of over £67bn around the UK economy, with 58% of overnight tourism expenditure being revenue redistributed from large towns and cities to rural and seaside communities.

Tourism is therefore an important component in achieving the Government's policy of rural-proofing. The importance of tourism to the rural economy was highlighted during the Foot and Mouth outbreak of 2001 when the loss to rural economies when the countryside was "closed" to visitors was calculated to be over £5bn – greater than the agricultural cost of the outbreak.

The Treatment of Self-Catering Properties

The Tourism Alliance recognises that there have always been 'shades of grey' in tax law on the distinction between property and trading businesses. It is noted in the Standard Note BT/5250 that in the 1970s Inland Revenue informally regarded the provision of holiday accommodation as a trading activity for tax purposes. However, this practice changed in the early 1980s when Inland Revenue started to enforce a more rigid distinction that treated self-catering as a property, rather than trading business. This change in approach caused considerable unrest within the sector, and in 1984, the Furnished Holiday Lettings Rules were introduced in recognition that these businesses are an important component of the tourism sector and that should be treated as a trading business activity for tax purposes, subject to reaching qualifying criteria designed to prevent abuse of the system by second homes owners.

Since the 1980s the self catering sector has grown significantly to the stage where it accounts for almost 20% of all domestic leisure holiday expenditure (£1.8bn per annum). Around 70% of this expenditure occurs in seaside and rural locations and employs 15,600 people directly and a further 24,900 in associated services such as country pubs, attractions and village shops. With the downturn in the UK economy, it is increasingly important that the jobs in these rural and seaside communities are protected.

The Financial Secretary, Stephen Timms has reiterated many times in Parliament and privately that the only reason that the FHL Rules are to be repealed is because of legal advice that had been received that said that the Rules may not be compliant with European law.

The Tourism Alliance has always accepted this position. We have also been confident that, rather than following the simplistic approach of repealing the Rules and therefore jeopardising the viability of these businesses, the Government could take a more sophisticated approach and develop a solution that would protect rural and seaside jobs while still complying with EU requirements and protecting tax revenue. On this basis, we have continued to request that the Government enter into a meaningful consultation with the industry and officials from affected departments such as DCMS, DEFRA and their counterparts in Scotland and Wales, to develop such as solution.

It has been deeply disappointing throughout this process that, while the Government has agreed that it is being forced to make a change that it wouldn't otherwise have contemplated, it has not put forward an alternative proposal as to how self-catering properties could retain their status as trading businesses while complying with EU law.

Unfortunately, the response of the Government through the consultation period has simply been to find reasons why solutions put forward by the industry are unworkable. Indeed, the industry's favoured proposal, to raise the FHL Rules threshold for occupancy from 10 weeks to 15 weeks has not even been included in the Impact Assessment despite it being supported by groups such as the Institute of Chartered Accountants for England and Wales and the Central Association of Agricultural Valuers.

FHL Rules Repeal Guidance

One of the rationales that has been used to reject the proposals put forward by the industry is that retaining the FHL Rules would be unfair to other businesses that are taxed as property investment companies. The Alliance finds this argument spurious in that

- the Government recognised this issue and did not consider the treatment unfair when the Rules were introduced.
- there is no evidence that other sectors have specifically complained that self-catering businesses have an unfair advantage over the businesses
- the market for self-catering properties (holiday makers) is totally separate from the residential lettings market (permanent residents). As there is no competition, there can hardly be an unfair playing field.
- repealing the FHL rules would create unfairness between self-catering businesses and other holiday accommodation providers such as B&Bs, Guesthouses and hotels.
- it would create unfairness in that FHLs would be considered property businesses but still be required to pay business rates and charge customers VAT.

Most significantly, there seems to be little fairness in treating a self-catering tourism business differently to a budget hotel or apart-hotel where there is very little difference in the level of

services provided, yet they are competing in the same market. Indeed many self-catering operators would attest that they provide a higher degree of service than budget hotels.

In discussing where a business should be defined as trading or not, the current guidance states that;

“Essentially the distinction lies between the hotelier (who is carrying on a trade) and the provider of furnished accommodation (who is not). An important difference is that in a hotel etc. The occupier of the room does not acquire any legal interest in the property”

This clearly provides a starting point for considering self-catering properties to be trading as the customer does not acquire any legal interest in the property. It goes on to state that, to be considered trading;

“the taxpayer needs to show that what they offer goes well beyond the services normally provided by a landlord”

Following from the general principle above, this gives self-catering operators the opportunity to demonstrate that the services provided constitute trading activity.

However, the proposed new guidance is retrogressive in that the general principle of the customer not acquiring a legal interest in the property is removed and replaced with a new general principle that;

- “a person who is in legal occupation of the premises, retains control over them, and provides services or facilities to a third party is trading; and”
- “a person who allows a third party into occupation or possession of the premises for payment is carrying on a property business.”

As, by definition, the operator of a self-catering business does not occupy the premises, the new guidance makes it virtually impossible for any self-catering business to now be deemed to be trading.

The Tourism Alliance therefore requests that the Guidance be revised so that the current general principle is retained and that the guidance then goes on to describe the types of services an operator would have to supply to be deemed to be trading.

The Impact of the Repeal

Although demand for self-catering holidays is increasing, start-up costs are high due to the price of suitable properties and the need to undertake refurbishment to the high quality expected by today's customers. The availability of capital allowances and loss reliefs can reduce the set-up costs of a business by up to 40%, encouraging new entrants into the market. Reducing these benefits will lessen the attractiveness of the sector for further investment and, consequently, lead to a reduction in the number of new entrants.

If Capital Gains Tax was applied at the full rate, the attractiveness of the sector to new entrants would be further eroded and many people already operating self-catering businesses penalised. As a consequence, there will be a reduction in the number of self-catering businesses, which would negatively impact upon local economies dependent upon tourists who use this form of holiday accommodation.

The net result would be that, due to the reduced viability of the sector the number of new entrants to the sector will not match the number of people leaving the sector and revenue and jobs in rural and coastal areas will shrink as self-catering properties revert to second homes. It is worth noting at this point that research conducted by the BH&HPA found that rural economies lost £10,000 per annum for each caravan that converted from self-catering holiday letting to second home ownership.

The Tourism Alliance analysis indicates that if just 10% reduction on the number of self-catering properties as a result of repealing the FHL Rules would result in over £200m in tourism spend and over 4,500 jobs being lost from rural and seaside economies.

An Alternative Solution

UK self-catering businesses could be protected, and compliance with the EU requirement to apply the FHL Rules without discrimination to owners of commercial self-catering properties in Europe maintained, through simply increasing the number of weeks that a property had to be occupied by customers.

The Tourism Alliance has conducted an analysis of 1,600 cottages in the UK and 900 cottages located in Europe that are managed by one of the UK's largest self-catering management companies. The analysis shows that UK properties have a much longer season than properties in Europe – an average of 18 weeks for UK properties versus 11 weeks for European properties.

- if the occupancy threshold is increased from 10 to 15 weeks, then:
 - 79% of UK properties would still comply*
 - 76% of European properties would **NOT** comply

- if the occupancy threshold is increased from 10 to 20 weeks, then:
 - 60% of UK properties would still comply*
 - 88% of European properties would **NOT** comply

* The figures from this analysis on the number of UK properties that would comply if the occupancy threshold is increased have been confirmed through an independent analysis undertaken by the English Association of Self catering Operators.

The Impact Assessment states that the FHL Rules provide UK self-catering businesses with £20m pa of benefit and that if the rules were permanently extended to include EEA properties this would increase by £5m to £25m pa. Therefore, combining these figures with the results of the above analysis, we arrive at the following:

If the occupancy threshold was increased to 15 weeks:
the total cost would be **£16.7m** (£15.5m for UK properties and £1.2m for EU properties)

If the occupancy threshold was increased to 20 weeks:
the total cost would be **£12.6m** (£12m for UK properties and £600k for overseas properties)

Raising the occupancy threshold for self-catering properties would therefore concentrate the tax treatment benefits on the, as it happens predominantly UK rather than other EEA, self-catering businesses managed commercially while, as the same time, reducing the total cost to the Government from £20m per annum to either £16.7m or £12.6m depending upon the level to which the threshold is raised.

This solution also has the added benefits of:

- Ensuring that owners of second homes do not take advantage of tax rules that are aimed at supporting genuinely commercial rural and seaside tourism businesses which support their local economy.

- Encouraging businesses operating at around the 10 weeks occupancy level to increase the size of their business, thereby adding further benefits to their local economies
- Preventing self-catering businesses turning into seldom-visited second homes, thereby exacerbating the problem of “ghost villages”.
- Avoiding the many court cases that will inevitably follow the repeal of the FHL Rules as self-catering business seek to demonstrate that they are trading businesses while HMRC seeks to tax them as property businesses.

The Tourism Alliance therefore requests rather than repealing the FHL Rules, the Government raise the occupancy threshold at which the Rules apply to 15 weeks per annum from 5 April 2010 for a trial period of at least one year so that a proper analysis of the impact of the proposal and the impact of repealing the FHL Rules can be undertaken

If the Tourism Alliance, or its members, can be of any assistance in providing further evidence or expanding or clarifying tourism-related issues, please feel free to contact our Policy Director, Kurt Janson, at the address below.

Yours sincerely

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Appendix 1: **Tourism Alliance Members**

Members

Association for Tourism in Higher Education
Association of British Travel Agents
Association of Leading Visitor Attractions
Bed and Breakfast Association
British Association of Leisure Parks, Piers & Attractions
British Beer & Pub Association
British Educational Travel Association
British Hospitality Association
British Holiday & Home Parks Association
British Marine Federation
British Resorts and Destinations Association
Business In Sport and Leisure
Business Visits and Events Partnership
Camping and Caravanning Club
Confederation of British Industry
Confederation of Passenger Transport UK
Country Land and Business Association
Cumbria Tourism
Destination Performance UK
East of England Tourism
English Association of Self Catering Operators
English UK
European Tour Operators Association
Events Industry Alliance
Farm Stay UK
Guild of Registered Tourist Guides
Heart of England Tourist Board
Heritage Railway Association
Historic Houses Association
Historic Royal Palaces
Holiday Centres Association
Holiday Cottages Group
National Caravan Council
National Trust
South West Tourism
The Caravan Club
Tourism for All
Tourism Management Institute
Tourism Network North East
Tourism Society
Tourism South East
UKinbound
Visit London
Visitor Attractions Forum
Welcome to Yorkshire

Associate Members

Local Government Association
SouthWest RDA (representing the RDAs in England)
VisitBritain
VisitEngland