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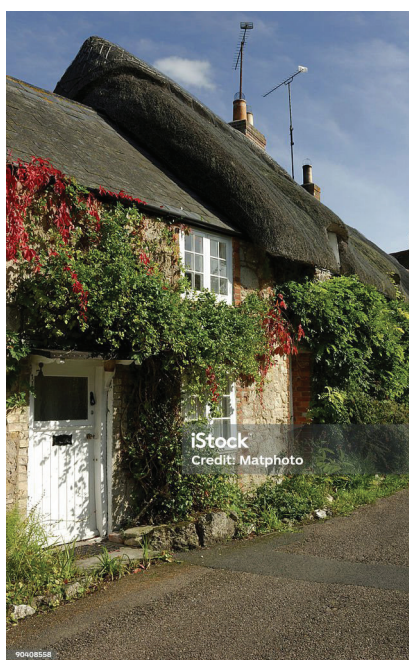
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Goodbye to furnished holiday lets

Since first being introduced over forty years ago, furnished holiday let (FHL) tax breaks have been very beneficial to those owning qualifying properties. With the spread of Airbnb and years of low interest rates, it seems that more and more people have been buying properties to let short-term to holiday makers. This has distorted the normal residential lettings market and perhaps, too, reduced the supply of properties on the market for first-time buyers.

At the March 2024 Budget, the then Chancellor (Jeremy Hunt) announced that these tax breaks will end after 5 April 2025. This has been confirmed by the new Chancellor, Rachel Reeves. The change will have major consequences for those affected.

In this guide, we outline the current rules, how they will change next April and what the main tax consequences will be for those owning such properties.

The current position

To qualify for FHL treatment in any tax year, a property must:

- be available for letting for at least 210 days;
- be let for at least 105 days; and
- lettings for over 31 days must not total more than 155 days.

Owners of multiple FHLs may elect for the 105-day letting provisions to be averaged across two or more properties. However, the properties must still be available for letting for at least 210 days each; no averaging can apply to this condition.

There is also the possibility of claiming a 'year of grace' where the letting conditions are not met for a year but were met previously, as long as the intention is to let the property in a way that would meet all the conditions. This allows the property to be treated as a FHL in a year when it doesn't actually qualify and was particularly useful where COVID-19 prevented the 105-day letting condition from being met.

Main advantages of FHL status

- Finance costs (such as mortgage interest and arrangement fees) are fully deductible when calculating property business profits for tax purposes; this is not the case for normal residential lettings (see example below).
- FHL income counts as pensionable income (unlike normal letting income); this may enable larger pension contributions to be made than would otherwise be the case.
- Capital allowances can be claimed on fixtures and fittings (e.g. beds, tables) for use in the property; normally, you cannot get capital allowances on assets for use in a dwelling house.

- Business asset disposal relief (BADR) may be available on the sale of a FHL property, assuming all the relevant BADR conditions are met; this means that the rate of tax on any gain is 10%, rather than the 18% or 24% rates that normally apply to residential property gains.
- Gift relief and rollover relief are available, again subject to meeting all the relevant conditions for these reliefs. Gift relief (or 'holdover relief') enables gifts to be made (e.g. to a family member) without triggering any immediate CGT charge; instead, the recipient takes over the donor's CGT cost, such that, on eventual sale of the asset, the gain or loss that the recipient makes will reflect the combined ownership period. Rollover relief enables a similar deferral of tax, where a FHL property is sold and the proceeds reinvested in another qualifying property up to 3 years from when the first property is sold. These reliefs will not be available after FHL status is abolished.

Note that shares in a company investing in FHLs rather than normal let properties may attract BADR or gift relief, again subject to various conditions.

The new rules

The new provisions will apply

- from 6 April 2025 for individuals; and
- from 1 April 2025 for companies.

The big change is that there will no longer be a separate category of FHLs with special treatment. Existing FHLs will be absorbed into (or become, if no other property is rented out) an 'ordinary' property business.

Despite Brexit, property within the European Economic Area (EEA) can currently qualify as a FHL if the conditions are met. Such property would become part of an overseas property business. UK and overseas property businesses are treated separately.

Restriction on finance costs

Since April 2021, no finance costs of residential landlords have been deductible against property business profits. Instead, a 'tax reducer' equal to 20% of the disallowed finance costs is given when calculating the taxpayer's final tax liability (although this deduction can be subject to restrictions). These finance cost rules have not previously applied to FHLs but will do so from 6 April 2025.

Just as when this measure was introduced for normal residential letting, it may increase the rate of tax paid by landlords, unless all income falls within and (after the disallowance of finance costs) remains within the basic rate band.

Note the following:

Example

Damian's only income is from his FHL business. Gross rents are £160,000 and mortgage interest on the let properties is £85,000. Non-finance tax-allowable costs (such as advertising for tenants and repairs and maintenance) are £25,000. He is not a Scottish taxpayer.

The tax-free personal allowance (PA) is £12,570, the higher rate threshold is £50,270 and the top rate tax threshold is £125,140. These are all unchanged for 2025/26.

Example – continued

Damian's tax position: 2024/25

As it is a FHL business, the mortgage interest is fully deductible against the rental income.

- Taxable rent:
 $£160,000 - 85,000 - 25,000 = \text{£}50,000$
- Tax:
 $(12,570 @ \text{nil}) + (37,430 @ 20\%) = \text{£}7,486$

Damian's tax position: 2025/26

Due to the abolition of FHL status, the interest is not deductible against rental profits, but a 20% tax reducer is available, as follows:

- Taxable rent $£160,000 - 25,000 = \text{£}135,000$
- No PA is due because his income is too high (i.e. above £125,140); the higher rate threshold is therefore £37,700
- Tax: $(37,700 @ 20\%) + (87,440 @ 40\%) + (9,860 @ 45\%) = \text{£}46,953$
- Tax reducer $(£85,000 @ 20\%) = \text{£}17,000$
- The final tax figure is therefore **£29,953**

Due to the change in the tax rules, there is an increase in his tax bill of $(29,953 - 7,486) = \text{£}22,467$.

1. The higher tax liability each year will also impact payments on accounts under self-assessment.
2. The disallowance of finance costs each year may unexpectedly cause extra tax liabilities, due to:
 - Restriction on PA (as in our example), which begins when income goes above £100,000; or
 - High-Income Child Benefit Charge, where income of the higher earner of a household is above £60,000.
3. Capital gains tax (CGT) bills may be higher if there is no longer any basic rate band to allocate against gains.

Capital allowances

The Annual Investment Allowance (AIA), which in recent years has given 100% relief on up to £1million p.a. of qualifying expenditure, will not be available for qualifying fixtures and fittings. Instead, relief will be available only under the replacement of domestic items relief rules. These latter rules are less generous, as they:

- only allow a replaced item to be claimed; and
- only to the extent that there is no improvement element.

Although capital allowances (CAs) such as the AIA are not normally available for assets within residential properties, there is a special transitional rule applying from 6 April 2025, when FHL status disappears. If there is any unrelieved capital allowance expenditure at the implementation date, the business will be able to continue claiming writing down allowances (at either 18% or 6% p.a. of unrelieved expenditure, depending on the type of asset) until the expenditure has all been relieved. Given that AIA at 100% has been available for many years, there may not be many businesses where this applies.

Landlords of FHL property may wish to consider accelerating expenditure which might qualify for CAs to a date before the rules change, particularly if it involves any enhancement of what is already installed.

Losses

Under current rules, losses arising from FHL businesses can only be carried forward and set off against future profits of that same FHL business. Once the FHL property has become part of the ordinary property business, the profits and losses from all properties will be reported as a single figure (but with UK and overseas property business treated as separate businesses).

In addition, any losses which have arisen in the FHL business before the status is repealed will be carried forward and be available to offset against total property business profits arising after the change.

CGT reliefs

Unlike normal rental properties, those that are FHLs can currently qualify for BADR, rollover relief and gift relief (as mentioned previously).

For BADR, there is a general ability to claim the relief up to 3 years after cessation of the business, as long as the qualifying conditions have been met for the two years up to cessation. Where the FHL business ceased before commencement of the new rules, the relief will be available for a disposal within the normal 3-year post-cessation period.

HMRC has confirmed that where legislation refers to the cessation of business, it means an actual cessation of business activity. HMRC does not consider that the repeal of the FHL tax rules in April 2025 means that an FHL business has ceased. It says that the date of cessation is the date from which there are no longer any bookings or lettings, nor any intention to resume such activity in future. To benefit from CGT reliefs beyond 5 April 2025, the business has to cease before then.

Anti-forestalling

The government is concerned that owners of FHLs will enter unconditional contracts before the rules change that will complete sometime after they change, purely to 'bank' BADR or one of the other reliefs. (It is the contract date rather than the completion date that determines the CGT disposal date for an unconditional contract.) This would very likely involve contracting with a connected person, such as a child or sibling. HMRC is introducing anti-forestalling legislation to counter this.

HMRC's guidance explains that where a contract is made on or after 6 March 2024 (the date on which Jeremy Hunt announced the intended abolition of FHLs) and the completion takes place on or after 6 April 2025, CGT relief will not apply unless the claim includes a statement confirming that all the conditions for relief are met.

In simple terms, the legislation will require that either:

- the purpose of entering the contract was other than to avoid the changes made in connection with the abolition of the FHL regime; or
- the contract was entered into by unconnected parties wholly for commercial reasons.

Business rates

The ability to pay business rates rather than council tax on holiday lettings has nothing to do with the FHL definition. There seem to be no changes to the rules in this area, which you can find at:

<https://www.gov.uk/introduction-to-business-rates/self-catering-and-holiday-let-accommodation>

The rules apply to self-catering and holiday let accommodation, available for (and actually let for) the minimum specified number of days. Note the different limits for Wales.

VAT

VAT at the standard rate is charged on holiday lets, regardless of the type of accommodation or the length of stay, if business turnover exceeds £90,000 pa.

Accommodation advertised or held out as suitable for holiday or leisure is treated as holiday accommodation; this includes houses, flats, chalets, villas, beach huts, tents, caravans, houseboats.

However, holiday accommodation which is let out of season is exempt from VAT (like residential letting normally is), if it is let as residential accommodation for more than 28 days and the area clearly has seasonal holiday trade.

Again, these rules are distinct from the FHL rules and are not changing.

Jointly-held FHLs

Where spouses or civil partners own assets jointly, the default position is that any income arising is automatically split 50:50, unless the couple have filed a Form 17 with HMRC indicating that the right to the income falls in a different ratio (e.g. because their capital contributions towards the purchase of the asset have not been equal). However, income from jointly-owned FHLs is not governed by these rules, meaning that a couple may be used to splitting such income in a different ratio. Once FHL status is abolished, couples will need to consider filing a Form 17 (where this can be justified) if they want the income split other than equally.

Conclusion

If you own one or more FHLs, it is important to understand how these changes will affect you and to plan for any extra tax that may become due. In particular:

- The changes to tax relief on finance costs may mean some FHL businesses are no longer economic, particularly with, it seems, the days of ultra-low interest rates now over.
- If your intention is to eventually gift your FHL properties to a child, it may be worth advancing this gift to the current tax year, so that a gift relief claim may be made to defer any capital gain that arises.

Please contact us if you need help in quantifying how these changes will affect your letting business, or if you have any other questions.