Furnished holiday lettings: tax advantages eliminated

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The government will abolish the furnished holiday lettings tax regime from April 2025, and owners will need to move quickly to develop the appropriate action plan.

Key Points

What is the issue?

The government will abolish the furnished holiday lettings tax regime from April 2025. This will eliminate the tax advantage for landlords who let out short-term furnished holiday properties.

What does it mean for me?

In a diversified business holding a number of furnished holiday properties, it will be complex to process the tax where part of this is to be deemed non-business. It will

take some structure and planning to ‘disentangle’ the elements to ensure that there is the best commercial business structure.

What can I take away?

There is a narrow window until April 2025 in order to facilitate possible overall tax planning, including sale and transfer of property.

UPDATE:

Those following the Finance (No 2) Bill 2024 will have seen that the measures to achieve the government's policy objectives of reducing the tax attractiveness of holiday accommodation were not in the Finance Bill. It is also understood that these will not be introduced into the Finance Bill by amendment.

If this is the case, then this will not be legislated until after the general election and not much before April 2025, which is the date that the changes were due to come into force. There are those who think it will not happen at all and just shows the difficulties we are all facing as advisers, with U-turns and mixed messaging from both HMRC and government.

There is no doubt that the Treasury will need to solve the whole dilemma of property investment and trading; i.e. the 'Brightline test'. The impact on diversified tourism business still applies. The commercial 'Brightline' operation must be identified and considered in the context of the advantages of capital gains tax reliefs and inheritance tax.

As announced in the Budget 2024, the government will abolish the furnished holiday lettings tax regime from April 2025. This will eliminate the tax advantage for landlords who let out short-term furnished holiday properties over those who let out residential properties to longer-term tenants. The reasons given for the loss of furnished holiday lettings tax relief are that the government considered that the tax advantages for such properties have been at the expense of local residents getting onto the property ladder. The changes are intended to give local residents more chance of being able to rent such properties.

Draft legislation will be published later in the year and it will be very interesting to see the detail. The legislation will include an anti-forestalling rule to prevent the obtaining of a tax advantage through the use of unconditional contracts to obtain capital gains tax relief under the current furnished holiday accommodation rules – essentially removing the 10% business asset disposal relief for sales on or after Budget Day, 6 March 2024. We await the full details to be able to fully understand the possible action plan and tax planning.

Some landlords, such as farmers and landowners, are perhaps being ‘hit too hard’ as they are generally offering the accommodation as part of a tourist experience. All such operations need to be closely reviewed for tax planning, together with an action plan being put in place as soon as possible to allow time to action any sales and changes.

The ‘brightline’ test

There has been ongoing consideration about the tax treatment of long-term residential leases as opposed to shorter-term furnished holiday accommodation. The Office of Tax Simplification report in November 2022 ‘Property income review: Simplifying tax income for residential landlords’ outlined a suggested ‘brightline’ test to determine trading status. This test was to provide a clean distinction between second homes that are being let out, and where property letting activities subject to income tax should be defined as a trading business.

Some of the proposed factors for the brightline test included the minimum number of properties let, whether the letting is on a short term basis, whether there is no personal use of the property, and the level of owner management time that is devoted to the operation and the services provided.

The brightline test describes a lot of furnished holiday accommodation operations, which can merge into a larger tourist operation. There is a lack of clarity about when such operations are run as a trade in terms of claiming trading expenses. It is likely that there will be more litigation to establish whether activities should be treated as a trade. More tax will now be due, which will possibly force the landlord towards a sale or a long-term let.

Impact on diversified businesses

The reduction in the higher rate of capital gains tax on property from 28% to 24%, coupled with the abolition of the furnished holiday lettings regime, is clearly designed to bring more residential property onto the market and encourage the sale of second homes currently being treated as furnished holiday accommodation.

This is understandable when a furnished holiday let is a second home held as an investment. However, when the accommodation forms a vital part of a diversified working rural business already pressured by rising costs and uncertainty around future agricultural support, this poses more of a problem as to the next steps and there will be those pushing for answers.

A lot of rural businesses have developed diversification by holding a number of furnished holiday accommodations as part of a tourist activity or hamlet. Others are incorporated into a tourist business, including glamping, farm tours, campsites and trekking.

It will be complex to process the tax for such a holiday or tourism business, where part of this is deemed non-business. It will take some structure and planning to ‘disentangle’ the elements to ensure that there is the best commercial business structure.

Capital gains tax advantages until 5 April 2025

Many farmers and landowners who have been operating qualifying furnished holiday accommodation might want to use rollover relief from capital gains tax. This will not be possible after 6 April 2025.

The advantages of capital gains tax on furnished holiday accommodation have not been under the spotlight in the way inheritance tax has. There is therefore a window to 5 April 2025 to take advantage of all the capital gains tax reliefs, including gift holdover relief.

Such change could result in tax arising for individuals who may be looking for a change of business or to retire and pass on assets to successors.

The changes also means that these diversified businesses will lose eligibility for business asset disposal relief from 6 March 2024, which fixes capital gains tax at a 10% rate on qualifying capital gains when a furnished holiday let is sold or gifted, with an individual lifetime allowance of £1 million.

Action to take before 5 April 2025

The position of each furnished holiday property will be different, whether it be as a second home or part of a whole tourist operation. The action plan will depend on the goals of the owners linked to more detail on the tax ruling.

There is no doubt that the rise in second (and third!) homeowners profiting from websites such as Airbnb has caused housing supply problems in certain areas. Where the government was once boosting UK tourism, there now seems a change of political pressure. Many will lobby to protect the UK holiday industry by switching from furnished holiday accommodation to allowing more glamping, campsites and camping pods (see the recent First-tier Tribunal case of *Acorn Venture Ltd v HMRC* [2023] UKFTT 995 (TC), which considered capital allowances for expenditure on camping pods).

It will be possible to use the holdover relief to pass down existing furnished holiday accommodation to, for example, children before the cut-off date – this can be ‘free of tax’ with the holdover. It will also be possible for farmers to sell furnished holiday accommodation and rollover the gain into business assets such as further glamping opportunities.

It can also be used to fund farm assets and other farm improvements. In the case of *S May and Others v HMRC* [2019] UKFTT 32), the First-tier Tribunal found that a grain storage facility qualified for plant and machinery capital allowances as a ‘silo provided for temporary storage’ within the meaning of s 23 list C under the Capital Allowances Act 2001 so that it did not fall under the exclusion for buildings.

In order to be able to use the capital gains tax reliefs, there will have to be furnished holiday accommodation compliance (as noted in ***Current furnished holiday letting rules***).

Current furnished holiday letting rules

Under current rules, landlords who let properties that qualify as furnished holiday lettings can claim capital gains tax relief for traders and are entitled to plant and machinery capital allowances for items such as furniture, equipment and fixtures. Profits also count as earnings for pension purposes and interest costs are allowed in full.

To qualify as furnished holiday accommodation, the property must be available for letting for at least 210 days in the tax year. It must also be let commercially to the public for at least 105 days in the tax year, though an averaging election can be applied to landlords with more than one property.

If the total of all lettings that exceed 31 continuous days is more than 155 days during the year, the property will not qualify as a furnished holiday let for that year.

See the Help Sheet HS253 Furnished Holiday Lettings (2022) for further details.

Inheritance tax relief

Fighting to obtain inheritance tax relief on furnished holiday accommodation has proved problematic over the years, especially for investment property. The case of *HMRC v Pawson (Deceased)* [2013] UKUT 50 (TCC) found that the holiday lets in the case should be treated as investments for tax purposes.

However, in the successful case of *Grace Joyce Graham (Deceased) v HMRC* [2018] UKFTT 306, the First-tier Tribunal considered whether her four self-contained self-catering flats should be treated as ‘wholly or mainly’ for the ‘making or holding of investments’. The level of services including a pool, sauna and ‘personal care lavished upon guests’ meant that the business fell on the ‘non-mainly-investment’ side of the line and so qualified for business property relief.

There are many arguments to say that if the property is let out, then business property relief could be easier to achieve. In *HMRC v Brander* [2010] UKUT 300 (TCC), a business property relief claim was awarded on the grounds that commercially let properties in a mixed agricultural estate in Scotland, including farming and estate management, were held in a composite business. Provided that

the investments do not outweigh the trading assets of the overall farming operation, relief should be available under Inheritance Tax Act 1984 s 105(3). A review will be needed and might prompt a sale.

Interest, capital allowances and pensions

Other impacts on owner taxpayers of furnished holiday accommodation include the following:

- Owners can currently claim 100% of the mortgage interest as an expense. Finance costs will no longer be allowable when calculating taxable profits and will instead have to be claimed at a tax reducer at 20% of the mortgage interest costs.
- Under current rules, owners can claim capital allowances for 100% of the costs on fixtures and furnishings purchased within the property. This relief will no longer be available. Instead, relief may be available for the replacement of domestic items in line with long term lets. Guidance will be needed for unused balances brought forward.
- Currently, profits from furnished holiday lettings are treated as net relevant earnings for pension contributions. As this income will no longer from April 2025, this could reduce the ability for some taxpayers to make pension contributions.

VAT and incorporation

All holiday income is currently subject to standard rate VAT at 20% subject to the VAT threshold. The VAT threshold was increased to £90,000 from 1 April 2024. Some individual investors might look at moving properties into limited company structures where full interest relief is available. But any incorporation will have to be thoughtfully considered as there will be capital gains tax and stamp duty land tax on transfers. This all makes April 2025 seem very close in tax planning terms.

There has been some ‘ring fencing’ by farmers of farm furnished holiday accommodation to keep below the VAT threshold. However, that does go against the integrated tourist model.

If the furnished holiday accommodation is to lose business status from April 2025, then it should be considered whether the VAT will be exempt. If the furnished holiday accommodation property is to change to a long-term let, the supply will be exempt and there could be the *Balfour* advantage for inheritance tax. That brings us full circle to the brightline test – is the furnished holiday accommodation actually part of the trading operation?

It is clear that all tax planning around furnished holiday accommodation will have to be tailor-made and we await the full details of the Finance Act. However, there is a narrow window until April 2025 in order to facilitate possible overall tax planning including sale and transfer of property.