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Furnished Holiday Lettings (FHL)

Following Labour's Autumn Budget in October 2024, the new government announced that they would continue to pursue the Conservative Party's plans to abolish the Furnished Holiday Let (FHL) status.

Background

Properties under the current regime that meet the FHL conditions can receive favourable tax treatments.

The conditions for a property to be treated as a FHL are as follows:

- The property must be let in the UK or European Economic Area (EEA);
- The property must be furnished;
- The property must be available to let for at least 210 days in the tax year (or first 12 months if commencing trading);
- The property must actually be let for at least 105 days in the tax year (or first 12 months if commencing trading);
- Periods of occupation exceeding 31 days must not exceed 155 days in total in any tax year.

The favourable tax treatments include:

- The ability to claim capital allowances on qualifying expenditure such as furniture and fixtures.
- There is no restriction to any finance costs associated with the property, such as mortgage interest. This cost can be deducted in full from any income received.
- Earnings from a FHL business count as relevant earnings for pension contribution purposes.
- On the disposal of a qualifying FHL, it may be possible to claim certain Capital Gains Tax reliefs, such as Gift Relief, Rollover Relief and Business Asset Disposal Relief;
- Where a property is held jointly by spouse or civil partners, it can be possible to alter profit sharing arrangements based on the work actually undertaken by the relevant individuals without a formal election.

A FHL is treated as a separate trade from any other standard residential lets. As a result, any losses made from an FHL business can only be set against profits from the same FHL business with any excess carried forward. EEA FHLs are also treated separately from FHLs operating in the UK.

Changes to rules from April 2025

On the basis draft legislation is enacted, from 6 April 2025 (1 April 2025 for companies), it will no longer be possible for a property to be classified as a FHL for UK tax purposes.

Instead, the treatment of any rental income will be dependent on whether HMRC view the income as deriving from a trade or investment activity.

Historically, it has proven to be very difficult for the taxpayer to argue that they are operating a trade whilst running a FHL. To gain trading status, a high level of services would require to be provided, and essentially an individual would be required to show that they are running a full-time business to argue that they are running a trade.

If, instead, HMRC view that the FHL is an investment activity, then any property previously let as a FHL will be taxed in the same way as a standard residential let. This would mean:

- It will no longer be possible to claim capital allowances on new qualifying expenditure. Instead, it will only be possible to claim relief on the replacement of domestic items.
- Relief for any mortgage interest costs will be restricted to the basic rate of tax, currently 20%.
- Income will no longer count as relevant earnings for pension contribution purposes.

- On disposal, no Capital Gains Tax reliefs will be available.
- For FHL businesses in existence prior to the rule changes, there are some transitional rules that will apply based on the draft legislation. These include:
 - Where capital allowances have previously been claimed and that expenditure has been 'pooled', it will still be possible to claim capital allowances on the qualifying expenditure up until the point of sale. Any future sale would then create an allowance or charge based on allowances claimed up to the point of disposal.
 - FHL losses brought forward as at 6 April 2025 (1 April 2025 for companies) will be available to set against all other types of rental income. However, losses between UK and non-UK businesses will continue to be treated separately.

Changes for jointly owned FHL's

Currently where a property is owned jointly by spouses or civil partners, FHL profits may be split between them based on actual entitlement. This differs from the treatment of the profits of other rental property owned jointly by spouses which is automatically split 50/50 unless a Form 17 declaration has been made for the profit-sharing ratio to reflect the actual ownership of the property.

From 6 April 2025, the exemption from the automatic 50/50 split for FHL profits will no longer be available and, where a FHL property is owned by spouses in varying proportions e.g., 60/40, a 50/50 split will be applied for Income Tax purposes unless a Form 17 declaration has been made.

The Form 17 declaration must be made jointly by the owners and a separate declaration is required for each property. The declaration cannot be backdated, therefore for a declaration to be effective from 6th April 2025, when the rules change, it would need to be signed by 5th April 2025 and submitted to HMRC within 60 days of being made.

Where property is currently owned 50/50 by spouses and there is a desire for the rental profits to be apportioned in a different ratio there must first be a change in beneficial ownership to reflect the proportions required and a Form 17 declaration must then be made. Where there is a mortgage or loan outstanding on the property, a change in beneficial ownership may result in a Stamp Duty Land Tax or Land Based Transaction Tax liability. It should also be noted that where there is a change in beneficial ownership, the proceeds on a subsequent disposal of the property will also follow the new ownership ratio for Capital Gains Tax purposes.

Anti-forestalling measures

These will be in place, primarily to prevent any attempts to mitigate the withdrawal of the Capital Gains Tax reliefs, by entering into a contract to sell their property prior to 6 April 2025 (1 April 2025 for companies), with completion after the 6 April 2025 (1 April 2025 for companies). Genuine disposals that straddle the tax year end may still be able to qualify for Capital Gains Tax reliefs, under certain circumstances.

Summary

The changes to the tax treatment of FHLs could have a significant impact, dependent on individual circumstances.

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They have been prepared in accordance with legislation in force or proposed at March 2025.

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