Representation from the Chartered Institute of Taxation
for Finance Bill 2024-25 Public Bill Committee

Property Taxes

Furnished holiday lettings: clause 25 and Schedule 5
Alternative finance: diminishing shared ownership refinancing arrangements: clause 35 and Schedule 7
Annual tax on enveloped dwellings: clauses 54 and 55

Executive Summary

Clause 25 and Schedule 5 - Our overriding concern is that abolition of the furnished holiday lettings regime reopens the complexity of a dividing line between a trading and an investment (letting) business and may lead to costly disputes and litigation about where the line is drawn. We support a statutory 'bright line' test to remove uncertainty. We make a request for further guidance **before** April 2025 and an administrative easement to backdate an election for joint property owners.

Clause 35 and Schedule 7 - We support this clause but note that it is not retrospective so a taxpayer using alternative finance to re-finance an investment property may have already incurred a CGT liability in circumstances that appear contrary to successive governments' policy. We therefore suggest amending the Bill to extend the capital gains tax exemption to pre-October 2024 transactions.

Clauses 54-55 - We support this change. However, there are other areas of the tax code that do not provide a level playing field for alternative finance arrangements, we suggest these are also addressed in legislation.

1. Furnished Holiday Lettings: Clause 25 and Schedule 5

1.1 Clause 25 and Schedule 5 provide for the abolition of the furnished holiday lettings (FHL) regime with effect from 1 April 2025 for companies and 6 April 2025 for other businesses. The current FHL regime means that qualifying holiday lets are treated as a trade for certain tax purposes giving them a tax advantage over non-FHL property businesses. These advantages include the availability of capital allowances and capital gains tax reliefs.

1.2 *Uncertainty – the boundary between trading and property letting.*

We recognise that removing the complexities of the FHL regime brings some benefits in terms of simplification of the taxation of rental properties. However, our overriding concern is that abolition reopens the dividing line between a trading and an investment (letting) business, that turns on fine distinctions in case law. This was demonstrated in a number of tax cases and was one of the reasons for the introduction of the FHL regime for 1982/83 that deems the letting business to be a trade for certain purposes. It therefore removed disputes about whether the FHL business constitutes a trade. Renewed uncertainty following abolition may lead to costly disputes for both taxpayers and HMRC and litigation in relation to taxpayer claims for more favourable trading status.

1.3 We are aware of the suggestion by the Office of Tax Simplification (OTS) for a 'bright-line' statutory test to provide certainty by demarking the boundary between a trade and rental businesses. We agree with this proposal.

1.4 The then government's response to the ICAEW indicates the basis for their rejection:

The suggestion by the Office for Tax Simplification (OTS) for a brightline test would have some downsides. For example, it could create potential preferential tax treatment for those able to afford to buy more properties, as opposed to considering whether the overall nature of the activity constitutes trading or property letting on its merits. The OTS suggestions could also potentially mean more activities would be considered trades. As a result, the Government decided not to take that suggestion forward but keeps all aspects of tax policy under review.

1.5 However, the OTS suggestion was to consider a number of factors, not simply number of units, but potentially other characteristics such as the nature of lettings (short term lettings only), no private use and the level of personal time devoted and/or provision of services.

1.6 In the absence of the certainty of a statutory test, consideration might be given to a Hansard statement during the passage of the Finance Bill setting out the government's policy intention in relation to the status of furnished holiday accommodation. Together with enhanced and updated guidance this action would go some way to reducing the likelihood of challenge and provide greater certainty for the holiday letting sector of the policy intent.

1.7 *Schedule 5 Part 4 Amendments relating to chargeable gains and Part 5 Commencement and transitional provision.*

The policy intent in relation to FHLs and eligibility for capital gains tax reliefs post abolition is set out in the Tax Information and Impact Note[1] issued at the Autumn Budget.

1.8 Under current rules FHL properties are eligible for roll-over relief, business asset disposal relief (formerly entrepreneurs' relief), gift relief, relief for loans to traders, and exemptions for disposals by companies with substantial shareholdings.

1.9 Following abolition eligibility for these reliefs will cease. However, the Note indicates that

- '*… where criteria for relief includes conditions that apply in a future year these specific rules will not be disturbed where the FHL conditions are satisfied before repeal*' and
- specifically in relation to business asset disposal relief *'…where the FHL conditions are satisfied in relation to a business that ceased prior to the commencement date, relief may continue to apply to a disposal that occurs within the normal three-year period following cessation'*.

1.10 There are some technical uncertainties as to how this policy is to be applied, as detailed below, that require confirmation.

1.11 *Commencement: Part 4 roll-over relief (paragraph 13(2)(a))*

Under current rules FHL properties are eligible for roll-over relief. After the changes eligibility ceases. However, as noted, the policy paper indicates that where the criteria for relief includes conditions that apply in a future year those rules will not be disturbed.

1.12 We understand that an acquisition of a qualifying asset post 6 April 2025 (that is not and cannot be an FHL) can be a qualifying replacement asset in relation to a disposal of an FHL before 6 April. For example, a FHL property is disposed of on 1 September 2024 for £500,000 giving rise to a chargeable gain of £200,000. A hotel is acquired on 1 June 2025

[1] https://www.gov.uk/government/publications/furnished-holiday-lettings-tax-regime-abolition

(within three years of the above disposal, but after the commencement date) for £600,000. Subject to fulfilling the other conditions, the landlord can make a claim to roll-over the gain.

1.13 On the other hand, although the rollover rules provide that it is possible to acquire a qualifying replacement asset in the period twelve months before to three years following the disposal, we understand that the disposal of the FHL must be made before 6 April 2025. For example, assume a replacement asset is acquired on 1 September 2024. The disposal of the FHL is not until after abolition on 1 June 2025. We understand that rollover relief would not be available in these circumstances.

1.14 Assuming our understanding is correct, and this needs to be confirmed in guidance, it will be important that taxpayers thinking of disposing of their FHL business are made fully aware of the time limits in which they are operating as action may need to be taken **before** 6 April 2025. We suggest the guidance issued to date by HMRC[2] might be helpfully supplemented on this point ideally with examples.

1.15 *Business asset disposal relief (BADR)*

A further area where there is some uncertainty relates to the availability of BADR. Where an FHL business ceases prior to 6 April 2025, a disposal of a previously qualifying business within three years of the cessation date will attract BADR, subject to satisfying other conditions. The question is what is meant by cessation.

1.16 HMRC issued guidance[3] on 7 November 2024. The guidance indicates that:

'Where legislation refers to the cessation of business, it means an actual cessation of business activity. The date of cessation is not the date that further bookings stop being taken, it is the date from which there are no longer any bookings or lettings (CIOT underlining) nor any intention to resume such activity in future'.

1.17 This statement has caused some uncertainty as it suggests that cessation requires that property is no longer let at all – and HMRC indicates that by "lettings" they mean all lettings, not just holiday lettings. This gives quite an odd and uncertain outcome, as intuitively it might be expected to mean only be holiday bookings that are relevant. For example, assume an individual has an established FHL business. The last booking as holiday accommodation runs until 4 April 2025. From 5 April 2025 a long-term tenant starts renting the property on an unfurnished basis. We understand that because the property is rented out, albeit now to a long-term tenant instead of as short-term holiday accommodation, this means that BADR would not be available for a disposal within three years because there has not been a cessation of all letting.

1.18 It would add certainty if cessation of an FHL business is defined in the legislation rather than left to guidance.

1.19 We also suggest that the guidance could be helpfully updated with examples so FHL businesses are fully aware that lettings need to cease altogether **before** 6 April if a disposal within three years is to attract BADR.

1.20 *Schedule 5 para 20 Post-commencement disposals by companies with substantial shareholding*

[2] Clarification on abolition of the furnished holiday lettings tax regime
[3] Clarification on abolition of the furnished holiday lettings tax regime

In broad terms the main substantial shareholding exemption (SSE) exempts companies from corporation tax on a capital gain (or disallows a capital loss) arising on the disposal of shares in a trading company or group. There is a "subsidiary exemption" that is available where not all the conditions for the main exemption are met at the time of disposal but were met at some time during the previous two years. This exemption could be relevant, for example, where a holding company has a subsidiary that held FHL properties, and the holding company is selling that subsidiary on or after 1 April 2025.

1.21 Paragraph 20 provides that no account is taken of the provisions that deem an FHL to be a trade when considering whether this subsidiary exemption applies to a disposal made on or after 1 April 2025.

1.22 The policy statement that "*where criteria for relief includes conditions that apply in a future year these specific rules will not be disturbed where the FHL conditions are satisfied before repeal*" appears to support the availability of the subsidiary exemption where the conditions for the main SSE were satisfied pre-1 April 2025. However, paragraph 20 is unclear.

1.23 Assume a holding company has a 100% subsidiary that owns FHL properties. The holding company sells the shares in its subsidiary on 30 April 2025. Does paragraph 20 mean:

a) that the post 1 April period (in the event of a 30 April disposal, the 2 April to 30 April period) is ignored in which case a gain may be relieved (or a capital loss disallowed) by the subsidiary exemption potentially for actual disposals up to 2 years post abolition, **or**
b) that the subsidiary exemption is not available at all for post 1 April disposals

Interpretation a) seems to accord more closely with the policy statement that relief is preserved post repeal of the FHL regime where the conditions were satisfied before repeal.

Clarification is requested.

1.24 *Schedule 5 Part 1 Amendments relating to income tax paragraph 3(7) Jointly held property.*

A married couple or civil partners who jointly own an FHL may currently allocate profits between them to take advantage of lower marginal tax rates and/or reflect uneven effort in running the holiday let activity. Post abolition jointly held FHLs will be within the normal '50:50 rule' for income tax purposes. This means that spouses/civil partners will be taxed equally on the rental income unless they make an election to split the income unequally - provided the underlying ownership of the property reflects the split and a declaration[4] is made to HMRC. The declaration cannot be back dated so it is only effective from the date made. This means that a declaration must be made by 6 April 2025 in order to apply this treatment for the 2025/26 tax year.

1.25 We are concerned that taxpayers may be unaware of this practical consequence and potentially only realise when they prepare their tax return for 2025/26 at which point it will be too late to make a declaration to apply from the beginning of the tax year. We think that providing the ability to backdate a declaration at least for the tax year 2025/26 (or, perhaps preferably, as long as the election is made prior to 31 January 2027 – allowing for the last date on which a taxpayer may identify the issue when completing their 2025/2026 return) would allow taxpayers to fix their position. It is a relatively small administrative easement that would assist taxpayers.

[4] https://www.gov.uk/government/publications/income-tax-declaration-of-beneficial-interests-in-joint-property-and-income-17

1.26 *Schedule 5 Amendments relating to income tax paragraph 3: ITA 2007*

A further uncertainty relates to the question of whether a former FHL business with losses due to capital allowances may claim relief for the loss against general income under ITA section 120(2)(b) for 2025/26. We understand that a claim should be possible. However this point needs to be confirmed by HMRC in updated guidance.

2 Clause 35 and Schedule 7: Diminishing shared ownership refinancing arrangements

2.1 This clause changes the tax rules relating to the taxation of gains for capital gains tax and corporation tax and ensures there is no income tax/ corporation tax liability on revenue receipts as a result of entering sharia – compliant ('alternative') re-financing. Currently the refinancing of a residential or commercial property using alternative finance triggers a potential capital gains tax liability on any inherent gain. By contrast no potential capital gains tax liability arises when a conventional mortgage is used. The policy objective of this measure is to ensure a level playing field across conventional and alternative forms of finance.

2.2 This issue affects properties that do not qualify for capital gains tax private residence relief, such as rental properties, second homes and commercial properties.

2.3 The new measures apply to re-financing entered into on or after 30 October 2024.

2.4 We support the measure. However, we suggest the clause is amended to exempt taxpayers from a CGT liability on inherent gains realised on alternative finance transactions **before 30 October 2024** on the basis that:

- successive governments have supported and legislated for a level playing field between conventional finance and Islamic finance, such that Islamic finance transactions are taxed no more heavily (and no more lightly) than conventional finance transactions,
- the policy objective to level the playing field can only be fully realised if it applies retrospectively,
- taxpayers adversely affected are likely to include people with a protected characteristic (religion or belief) under the Equality Act 2010.

2.5 We acknowledge that any retrospective legislation needs to be fully justified as retrospection typically undermines the principles of certainty and stability. However, we suggest retrospective change in circumstances where there is an anomaly in the legislation that is both inconsistent with government policy during the time the anomaly exists and adversely affects taxpayers, particularly those with protected characteristics, meets this high bar.

2.6 The equalities impacts[5] recognises the benefit to individuals and businesses who wish to use alternative finance to raise funding going forward. There is no reference to arrangements before the commencement date. The benefits would appear to apply equally to pre-commencement date transactions.

[5] https://www.gov.uk/government/publications/changes-to-alternative-finance-tax-rules-refinancing/fdfcbaa0-b447-423b-9ddb-361460669d0a#monitoring-and-evaluation

2.7 In the absence of a change to the commencement date, what approach will be taken by HMRC to taxpayers who have already incurred a capital gains liability using an alternative finance structure implemented before 30 October 2024?

3 Clause 54 Alternative finance: land in England, Scotland or Northern Ireland
Clause 55 Alternative finance: land in Wales

3.1 These clauses make changes to the Annual Tax on Enveloped Dwellings (ATED) legislation to ensure that in the context of alternative property finance arrangements an ATED charge arises only where the client is a person within the scope of ATED. This reflects wider government policy of ensuring a level playing field between conventional finance and Islamic finance transactions. We support this change.

3.2 However there are parts of the Stamp Duty Land Tax code that still do not provide a level playing field for alternative finance arrangements compared to conventional financing, for example the current legislation does not provide for a look through to the underlying buyer for SDLT reliefs such as charities relief, group relief and relief for acquisition by a housebuilder from an individual acquiring a new dwelling. The effect is that relief is denied when alternative finance arrangements are in place. This is inconsistent with a policy of providing parity of treatment between alternative finance and conventional financing and should also be addressed.

4 The Chartered Institute of Taxation

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4.2 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

4.3 The CIOT's 20,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

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The Chartered Institute of Taxation
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