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Abolition of furnished holiday lettings regime – draft legislation for consultation

Comments by the Chartered Institute of Taxation

1. Introduction

1.1. On 29 July 2024[1] the government published draft legislation for consultation to remove the specific tax treatment for income and gains from furnished holiday lets (FHLs) from April 2025[2]. Legislation will be introduced in the next Finance Bill.

1.2. Our stated objective for the tax systems include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- Responsive and competent tax administration, with a minimum of bureaucracy.

2. Uncertainty in relation to the status of furnished holiday letting income post- abolition

2.1 Formal clarification would be helpful on the policy intent in relation to the tax status of furnished holiday lettings going forward. We note that explanatory note 84 states:

84. This measure removes the specific tax treatment and separate reporting requirements for furnished holiday lettings (FHLs). Income and gains from a FHL will then form part of the person's UK or overseas property business and be treated in line with all other property income and gains.

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

[2] For income and capital gains tax, the abolition takes effect from 6 April 2025. For corporation tax, the abolition is from 1 April 2025.

However following abolition there is likely to be uncertainty leading to the possibility of costly disputes and litigation in relation to claims for trading status. This uncertainty may arise where there is a letting business with a high level of services and management and/or similarity to holiday accommodation currently accepted as trading by HMRC. The First-tier Tribunal in *Julian Nott v HMRC [2016]*[3] acknowledged the difficulties in analysing and reconciling the statutory framework. These difficulties are now exacerbated by the repeal of ITTOIA 2005 Part 3 Chapter 6 potentially leaving the status of former FHLs open to uncertainty that may need to be determined ultimately through litigation.

2.2 The *Julian Nott* case demonstrated that subtle distinctions in the type of accommodation, the services provided and owner occupation can affect the treatment of property income. The tribunal also noted that dividing lines between various types of rental accommodation were increasingly fluid and observed (see paragraph 89) that HMRC's practice of treating all hotels and bed and breakfasts as trades may be unduly simplistic.

2.3 HMRC's guidance at BIM22001 and PIM4300 sets out HMRC's view that income from furnished lettings is rarely trading income.

BIM22001
It is only treated as a trade when the landlord remains in occupation of the property and provides services substantially beyond those normally provided by a landlord. This will be the case, for example, where the activity consists of providing bed and breakfast, or running a hotel or guesthouse. See PIM4300

PIM4300
Whole activity a trade
The whole letting activity will only constitute a trade where the owner remains in occupation of the property and provides services over and above those usually provided by a landlord. The provision of bed and breakfast, for example, is clearly trading. 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.

2.4 The traditional divide between hotels, B&Bs and guesthouses as trades versus furnished holiday lets as property income as set out in HMRC's manual guidance seems outdated and difficult to apply to the current holiday accommodation market. For example 'aparthotels' are relatively common, these vary in levels of facilities but usually involve self-contained apartments with access to a range of facilities.

2.5 One of the important factors HMRC notes at PIM4300 in distinguishing between a hotel (trade) and the provider of furnished accommodation (property income) is that in a hotel the occupier does not acquire any legal interest in the property. The same would be true however of self-contained apartments in an aparthotel or, in fact, in most furnished holiday lets as guests will usually have a mere contractual licence to occupy. This factor does not appear to help in drawing a line between trading and property income.

2.6 We note that HMRC have not accepted the suggestion by the Office of Tax Simplification (OTS) for a statutory test to provide certainty by demarking the boundary between a trade and rental businesses, a suggestion we support. HMRC'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

[3] https://www.bailii.org/uk/cases/UKFTT/TC/2016/TC04897.html

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.

2.7 We observe that 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.

2.8 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.

3. Business asset disposal relief (BADR): disposals relating to pre-commencement businesses (paragraph 19)

3.1. On the disposal of a qualifying FHL property following cessation within TCGA 1992 section 169I(2)(b), it is clear that paragraph 19(1)(a) retains the period of three years ending with the date of actual cessation despite that period extending beyond 1 April / 6 April 2025. Therefore, following an actual cessation before April 2025, BADR will apply to a disposal of the FHL property within a period of three years subject to meeting the other qualifying conditions[4]. Case law applies to determine what constitutes a cessation.

3.2. We also note that currently the deemed trade is treated as carried on throughout the 'chargeable period' (the tax year) if the property was an FHL for any part of the year (TCGA 1992 section 241(4)[5]). This appears to mean if someone has had an FHL for a few years and decides during 2024/25 that they will take in a long-term tenant going forward, their 'trade' is therefore treated as carrying on until 5 April 2025 and therefore benefits from the three year period from that date. Is that the intention?

3.3. It is also not clear from the drafting whether there is a deemed cessation as at 5 April 2025 for the purposes of BADR as a consequence of the repeal of TCGA 1992 section 241. That section provides that the FHL element of any UK property business is treated as a trade for the purposes of BADR. Without a deemed trade, the 'business' no longer exists for BADR as 'business' is defined in section 169S (1) as 'a trade, profession or vocation' and section 169I(2)(b) defines a disposal of business assets as 'a disposal of…one or more assets in use, at the time at which a business ceases to be carried on , for the purposes of the business..'. One interpretation, absent an earlier actual cessation, is therefore that FHL businesses (that meets the two year qualifying ownership period) will cease the deemed trade as at 5 April 2025 and BADR will therefore apply to a disposal of the FHL property or other business assets in use at that time within the three year period. An alternative interpretation might be that deemed trade only takes effect for the limited purpose for which they are intended[6] and therefore a deemed cessation does not necessarily follow from the repeal of section 241.

3.4. The position is unclear. We suggest the draft legislation should be amended to clarify the position for the purposes of paragraph 19.

[4] This includes the requirement that the business has been owned throughout the preceding two year period ending with the date of disposal.

[5] The exception is where the property is neither let commercially nor available to be so let unless this is due to construction/repairs (section 241(5).)

[6] Fowler v HMRC [2020] UKSC 22 see the dicta at paragraph 27

4. 'Relevant period' for FHL business starting in 2024/25 (ITTOIA 2005 section 324)

4.1 ITTOIA 2005 section 324 is omitted by paragraph 2(8) with effect from the tax year 2025/26. However for a new FHL that starts in 2024/25 the relevant period of twelve months begins on the first day in the tax year (or accounting period) on which it is let and may therefore extend into 2025/26. Please confirm whether the relevant period in these circumstances will include any part of the twelve months period that falls within 2025/26.

5. Commencement: Part 4 roll-over relief (paragraph 13(2)(a))

5.1 Under current rules FHL properties are eligible for roll-over relief. After the changes eligibility ceases. However, the policy paper indicates that where the criteria for relief includes conditions that apply in a future year those rules will not be disturbed. It is not clear therefore whether acquisitions of qualifying assets post 6 April 2025 (that are not FHLs) are qualifying replacement assets or not. 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 (within three years of the above disposal, but after the commencement date) for £600,000. Can the landlord claim under section 152 to roll-over the gain?

5.2 Is paragraph 13(2)(a) referring only to acquisitions of FHLs (see the explanatory note 66)? If so, it is not clear why paragraph 13(2)(a) is needed at all as FHLs will no longer exist.

6. Anti-forestalling: disposals under conditional contracts – paragraph 14

6.1 One of the filters of the anti-forestalling measure is that 'no purpose of entering the contract was to avoid the amendments made by Part 4 having effect in relation to the disposal.' Those amendments were only known once the draft legislation was published on 29 July. However we understand that the intention is the anti-forestalling measure applies from the date of the original announcement (6 March 2024).

7. Form 17 (ITA 2007 sections 836, 837)

7.1. We are concerned that taxpayers will be unaware of the practical consequences of repeal of the exceptions to section 836. While a property is in the FHL rules, the 50:50 rule in ITA 2007 section 836 is not in point because of the exception D and DA. Therefore normally income is attributed between spouses /civil partners based on actual entitlement. The carve out will fall away immediately on 6 April 2025, so jointly held FHLs will immediately be within the 50:50 rule unless a valid form 17 (section 837 election) is made. If income and capital shares do not match, it is not possible to make the election. It is not uncommon for one spouse to be able to justify a higher share of income due to doing more work (arranging bookings, changing beds etc). These sorts of splits will not be possible unless they change capital shares to match (or they are trading) – however, changing capital shares may not be practical, for example if there is a mortgage on the property any transfer may trigger an SDLT charge even if nothing is paid for the transfer. Even if capital and income shares do correspond, there is a practical problem. Section 837 elections cannot be backdated. They are only effective from the date they are made. Strictly speaking, those who want their tax treatment to be undisturbed would therefore need to sign the form on 6 April 2025. Otherwise income from 6 April to the date of the election will need to be split 50:50.

7.2. As we said in our response to the Office of Tax Simplification's (OTS) Property Income Review, it is not clear there is still a need for the section 836 deeming provision for income tax purposes; we suggest its retention should be evaluated as it gives rise to complexities. We note also the OTS recommendation[7] in their final report that '*the government should consider removing the anachronistic 50:50 rule for spouses and civil partners and aligning treatment to that of other joint owners and to the position for spouses under Capital Gains Tax and Inheritance Tax*.'

7.3. In the short term, we suggest providing the ability to backdate a section 837 election to the start of the preceding tax year would allow taxpayers to fix the position when they only find out about the existence of the provision when preparing their tax returns. For example, a couple with a former FHL owned 75:25 who discover in October 2026 that the 50:50 rule exists should be able to make their section 837 election with effect from 6 April 2025.

7.4. It would be helpful in any case if new guidance relating to abolition/ transitional measures highlighted the need to consider a section 837 election.

8. Capital allowances

8.1 We suggest it would be helpful to remind taxpayers of the CA 2001 section 56A small pool allowance allowing for write off where there is £1,000 or less in the capital allowance pool, perhaps through a nudge in the SA return. This will help to remove any legacy complexity in respect of small balances.

8.2 We note that the small pool limit of £1,000 was prescribed in 2008. We suggest consideration should be given to uprating the £1,000 limit as part of the FHL changes (although with wider application). The failure to uprate reduces the value and intended impact of this measure.

8.3 We suggest guidance should confirm that it is possible to make a section 198 election where an existing FHL business is sold after the commencement date and the FHL business has an ongoing capital allowances pool.

9. Cash basis

9.1 We note that amendments to the draft legislation for the property cash basis (ITTOIA 2005 section 307B onwards) do not provide for any 'clawback' of expense deductions for purchases of furniture, appliances etc under ITTOIA 2005 section 307B only by reason of the withdrawal of the FHL regime for a continuing UK property business (unless assets are sold or removed from the business).

10. Other points that arise in the context of withdrawal of the FHL regime.

10.1 We suggest that as part of the guidance relating to the abolition of the FHL regime the opportunity should be taken to confirm the VAT treatment, that is the provision of holiday accommodation as standard rated regardless of whether it is an FHL. We think otherwise there may be some uncertainty. Taxpayers may incorrectly assume rents from holiday lets will be exempt post abolition.

[7] https://www.gov.uk/government/publications/ots-review-of-residential-property-income

10.2 As the policy paper references, one of the consequences of withdrawal of the FHL tax regime is the removal of the ability to count profits as 'relevant earnings' for pension purposes. In this context we note the maximum pension contribution without net relevant earnings has remained unchanged at £3,600 (the basic amount) for over twenty years (FA 2004 section 190) . We suggest it may be timely to consider whether that threshold should be evaluated to establish whether the current amount is consistent with the policy intent. If the current level had been adjusted by CPI, it would be over £6,500.

10.3 It would be helpful to confirm that the current criteria for liability to business rates will remain (that is, available to let for short periods commercially for at least 140 nights in total and actually let for at least 70 nights).

11. About us

11.1. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

11.2. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

11.3. 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.

11.4. Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

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