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FHLs - Abolition of Capital Allowances

Property Tax Update:

ALUN OLIVER FRICS, Managing Director of property taxation specialists E³ Consulting, explains the recently confirmed withdrawal of the Furnish Holiday Lettings (FHL) tax incentives. The proposals were first announced by Jeremy Hunt MP in his Budget Statement on 06 March 2024 and now confirmed by the new Labour Government with publication on 29 July 2024 of draft legislation.



These measures were proposed to ‘normalise’ the property tax treatment of dwellings so that FHLs are treated the same way as Assured Shorthold Tenancies (ASTs) - thus bringing ‘fairness’ to all residential property landlords. Given the income and tax advantages of FHLs, it has been widely commented on that the significant growth in FHLs - driven by the various holiday apps now available (AirBnB/Vrbo/Booking.com et al) - has been detrimental to the current housing shortage and ‘levelling up the playing field’ would potentially boost housing by freeing up more residential stock.

Others see the move more cynically as an attempt to simply raise more tax from a sector perceived as affluent. Additionally, many rural or coastal communities that have significant tourism demands will struggle to see a shift from FHL to AST - thus potentially limited impact on housing numbers and in turn rents! The added tax costs being passed on to the consumer.

The FHL tax regime was first introduced in 1984 and currently applies to properties which are available for holiday letting for at least 210 days a year, and which are actually let for at least 105 days per tax year. There is a restriction to bar long-term lets (those over 31 days). These tax benefits are now to be abolished from April 2025. According to HM Treasury, it is thought scrapping the holiday lettings relief is expected to raise about £600m by 2028-29 for the Exchequer.

There is a wider socio-economic impact too to withdrawing these value tax breaks which was eloquently explained by Victoria Vyvan, President of the Country Land and Business Association (CLA), where the CLA had campaigned against the measures, stating that *“for many farmers and landowners, diversification into the holiday lettings market is a business necessity. The short-term rental and holiday let sector contributes billions to the wider economy, supporting local shops and restaurants and creating tens of thousands of jobs. Abolishing the Furnished Holiday Lets regime will only punish people who are helping to grow local economies. It is far from a tax loophole, providing a crucial support mechanism, strengthening the resilience and viability of many rural businesses that in turn enables them to invest in their work looking after the environment and feeding the nation.”*

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Key Measures

From April 2025, the specific tax treatment and separate reporting requirements for FHLs will be removed, such that all property rents (ASTs and FHLs) will be treated the same in the tax return as property income.

The key tax benefits being removed include:

- The availability of capital allowances on qualifying expenditure;
- Access to tax reliefs on chargeable gains for trading business assets, including gift holdover relief, business asset disposal relief (10% tax rate) as well as rollover relief;
- Income from FHLs included as relevant UK earnings for the purposes of making pension contributions;
- Exemption from finance cost restriction rules (which allows loan interest to be offset above the otherwise restricted 20% basic rate, if higher rate or additional rate applies for income tax purposes);
- The operative dates will be from 6 April 2025 for Income and Capital Gains Tax and from 1 April 2025 for Corporation Tax.

Transitional rules

Thankfully, the Government has also set out some transitional rules to ease the changes into place:

- Capital allowances - those owning FHL properties will no longer be eligible for beneficial capital allowance treatment but will instead be eligible for 'replacement of domestic items relief' in line with other property letting businesses. Where an existing business has an ongoing capital allowance pool they can continue to claim writing down allowances on that pool. Any new expenditure from the operative date must be considered under the wider property business rules. ***This is excellent news for those FHL owners that were concerned in relation to capital allowances either being stopped entirely, or clawed back, and provides on going tax savings to expenditure incurred prior to April changes, where a valid claim is made.***
- Under current rules a loss generated from a FHL property business can only be carried forward and utilised against future profits of that same FHL business – after the changes, former FHL properties will be part of the person's UK or overseas property business, as applicable – that property business will then include the amalgamated profits and losses of all the properties in that business. ***These provisions enable FHL losses to be used much more flexibly going forwards against other property profits.***
- Capital gains reliefs - under the current rules, FHL properties are eligible for rollover relief, business asset disposal relief (10% tax rate), gift relief, relief for loans to traders and exemptions for disposals by companies with substantial shareholdings. After the changes the eligibility for the reliefs will cease. However, 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. ***This enables taxpayers to have some clarity of the current position being maintained where appropriate.***

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- In relation to business asset disposal relief, where the FHL conditions are satisfied in relation to a business that ceased prior to the change in rules, relief may continue to apply to a disposal that occurs within the normal three-year period following cessation. ***Again, this measure ensures taxpayers to have some clarity of the current position being maintained following cessation of the FHL activity.***
- There is also an anti-forestalling rule. This prevents the obtaining of a tax advantage through the use of unconditional contracts to obtain capital gains reliefs by selling to a connected party. This rule applies where exchange was on or after 6 March 2024 (i.e. the date of the Spring Budget). ***This is a reasonable preventative measure and ensures taxpayers do not attempt to 'game the system' by adjusting the base costs and avoid any Capital Gains Tax.***

Tax Planning Areas to consider

Rachel Reeves MP, Chancellor of the Exchequer, clearly saw an opportunity to gather in some much-needed tax receipts from an area unrestricted by manifesto promises, building upon the Spring Budget proposals of her predecessor. FHL owners should carefully consider the impact of these changes from April 2025 to them and their property landlord activities.

We regularly see taxpayers underclaiming their available capital allowances on FHLs - or worse not claiming at all! **If you have or own FHLs - whether in UK or the European Economic Area (EEA) - and have not full optimised your tax allowances - NOW is the time to act!**

New claims can be backdated to the prior two tax periods, for old expenditure where the FHL criteria have previously been achieved; potentially yielding significant tax rebates from prior year tax payments that failed to take account of capital allowances and so overstated. Furthermore, new claims up to April 2025 (01 for Corporation Tax and 05 for Income Tax) are still possible where the FHL criteria are met, resulting in valuable tax savings in that last period of FHLs. This also means that tax claims can be made up until 31 January 2027 or 31 March 2027 for Income or Corporation Tax respectively, within the 'normal' two-year tax window.

But don't leave it until the last minute! Timely claims often yield higher tax savings, as project information and evidence, such as contractor's quotes or invoices, etc., are more readily available as the work is completed or soon after. So, please get in touch with Alun, or one of our property taxation surveyors, to schedule a meeting to explore the available tax savings your FHL could unlock... before it's too late!

If you already operate FHLs and had contemplated making some capital improvements to your properties in the next year or so, you might want to bring those costs forward (subject to funding and affordability) to complete the works before the rules change and thereby locking in the tax relief. All owners should carefully consider their options to comply with, or mitigate any costs of, the changes coming into force from April 2025. To make the most of these existing FHL tax reliefs - please get in touch with one of the E³ Consulting team to see how we might assist you in optimising the capital allowances available within your property expenditure.

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In May, E³ Consulting won the *Best Independent Tax Consultancy Firm* at the Tolleys Taxation Awards 2024.

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Image: E³ Consulting own image of Luxury FHL in Hampshire.

HM Revenue & Customs webpage: >>>> [Furnished holiday lettings tax regime abolition - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/furnished-holiday-lettings-tax-regime-abolition)