Big changes are coming for holiday rental properties

The tax rules around 'furnished holiday lets' are set to change significantly on 6 April 2025.

Why is this happening, and what does it mean for their owners?

What were the previous rules?

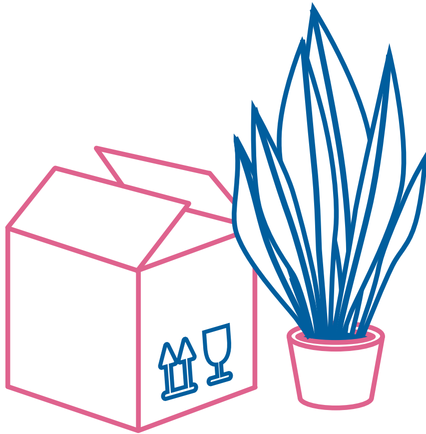
The previous rules around 'furnished holiday lets' (short-term holiday rental properties) were first introduced in the early 1980s. The rules included more favourable treatment of holiday lets versus ordinary property rental businesses, particularly when it came to income tax and capital gains tax.

Over the intervening years, these tax rules have been repeatedly tweaked, eroding some of the previous tax benefits of short-term holiday lets, and making it more difficult for properties to qualify for this special treatment. From April next year, holiday lets will effectively receive the same tax treatment as any other property rental business, such as 'buy to let' properties.

Why are the rules changing?

Free up holiday properties for local use

Short-term holiday lets are being blamed for local distortions in housing markets around the UK, due to a shortage of long-term rental properties for local use in areas popular among holidaymakers. Changing the rules around the taxation of holiday lets could encourage owners to rent out their properties for long-term residential use instead.



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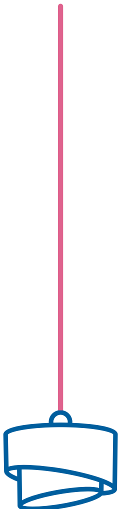

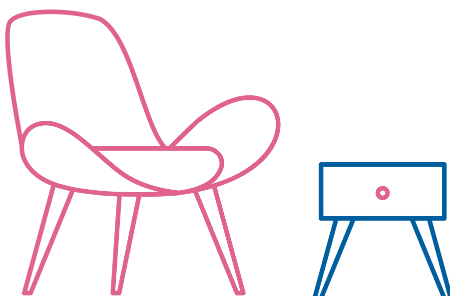

Raise funds for the UK government

An estimated £300 million will be raised by abolishing the special tax treatment of short-term holiday lets. This could help to plug the gap created by recent cuts to National Insurance contributions.

Untangle messy tax rules

Changes to the tax rules for short-term holiday lets also represents another step in the move to simplify UK tax regulations.

Five things that will change for owners

The planned changes are all designed to bring tax rules for holiday lets into line with tax rules for other residential property lettings. As with all tax issues, we would strongly recommend taking professional advice to better understand how these rules will apply to your own situation. However, in broad terms, the new rules will mean:

1. Basic tax relief on mortgages and borrowing

Interest on borrowings (mortgage interest and associated financing costs) will no longer be fully deductible when calculating taxable profits from a rental property. Instead, tax relief will only be available at the basic rate of 20%.

2. No more special rules around capital gains tax

Various capital gains tax reliefs will no longer be available to the owners of holiday lets. These include:

'Business asset disposal relief' – a reduction in capital gains tax for the sale of a qualifying business asset (such as a property). In future, gains on the sale of short-term holiday lets will likely be taxable at 24%, rather than a potential rate as low as 10% in the past.

'Gifts holdover relief' – where capital gains tax is essentially deferred when giving away certain business assets. This will no longer be applicable to short-term holiday lets when they are passed on as gifts.

'Business assets rollover relief' – a reduction in capital gains tax when the proceeds from the sale of a business asset (such as a property) are used to purchase certain replacement assets. This will no longer be applicable when proceeds from the sale of short-term holiday let is used to purchase other business assets.

3. Reduced tax relief on the way into pensions pots

Profits from holiday lets will no longer count as 'earnings' for pension contribution purposes. This means that they will not be eligible for the same tax relief as earnings if they are paid into a pension pot.

If profits from short-term holiday lets are someone's only source of earnings, then their ability to make personal pension contributions will therefore be limited to the standard £3,600 (gross) per annum. Tax relief for higher rate and additional rate taxpayers would be significantly limited, further increasing the property owner's personal income tax burden.

4. No tax relief on original cost of items purchased for use in the property

The owners of short-term holiday lets will no longer be able to claim tax relief on the original cost of domestic items purchased for use in the property. Instead, tax relief will only be available when these items break or wear out and need replacing. With owners unable to deduct financial costs in full to arrive at taxable profits, they could see their marginal tax rate increase and/or push other sources of income (for example from investments, interest, or dividends) into higher tax brackets.

5. **Property income split equally between spouses/civil partners for tax purposes**

   Under the new rules, where a holiday let is owned jointly by spouses or civil partners, by default each partner will be liable for tax on 50% of the rental profits. This could have significant consequences for anyone whose income is close to the threshold of a higher income tax bracket, increasing their personal income tax burden.

Generally speaking, expenses incurred 'wholly and exclusively' through running a rental business are deductible for income tax purposes.

Three things that won't change

Despite changes to the rules around short-term holiday lets, some tax issues will remain broadly consistent, including:

1. Rules around deducting running costs for income tax purposes

Generally speaking, expenses incurred 'wholly and exclusively' through running a rental business are deductible for income tax purposes such as estate agents' fees, insurance and repairs. This is generally the same for 'buy to let' properties and short-term holiday lets alike. However, under the new rules owners of holiday lets will no longer be able to deduct their finance costs in full or claim 'capital allowances' to write off the original cost of domestic items used in their letting business.

2. Rules around VAT on rental properties

The rent charged on holiday lets may be subject to VAT, while rent on residential lets is typically exempt. This will not change under the new rules. So, if a short-term holiday let has turnover above the VAT registration threshold (currently £90,000) then the owner must charge VAT under the new rules.

However, if the property owner decides to stop renting out the property as a holiday let (for example, leasing it out as longer-term residential accommodation instead) they should de-register for VAT, and not charge VAT to their tenants. Owners should contact their local council to check whether they should continue to be registered for business rates, or de-register and re-register for Council Tax.

3. No inheritance tax business relief

It will no longer be possible to claim inheritance tax business relief for leased properties (though this was already rarely available for holiday lets under the previous rules).

Can you avoid the impact of these changes?

There's no getting away from the changes being made to tax rules around holiday lets, and at the risk of repeating ourselves, we would strongly recommend taking professional advice before making any big decisions on your assets. However, in general terms, there are some changes that you could make between now and 5 April 2025 to sidestep some of the impact of the new rules:

Submit a formal application with your partner to avoid being taxed equally

To avoid automatic '50:50' taxation, spouses/civil partners could consider altering the beneficial ownership of their property to unequal shares. To effect this, in addition, you would also need to submit a formal application to HMRC to change the split of income from the property for tax purposes.

Sell up to make the most of current 'business asset disposal relief' rules

If reducing capital gains tax is a priority, owners could consider selling their holiday let before the next tax year to secure business asset disposal relief at the current 10% capital gains tax rate. Please note that other conditions apply.

Give away the property to claim the current 'gift holdover relief'

Giving the property away to a family member before the coming tax year would allow owners to claim capital gains tax 'gifts holdover relief'.

However, the amount of gain that may be 'held over' may need to be time-apportioned if the property has not qualified as a short-term holiday let throughout your ownership. There may also be stamp duty issues to consider. If you occupy the property personally then you must pay an open market rent to ensure the gift is effective for inheritance tax purposes.

Maximise tax relief by topping up your pension during this tax year

If short-term holiday lets provide your only source of earnings, you could consider maximising your personal pension contributions this tax year. You may find that you are eligible to bring forward extra tax relief from the previous three tax years. before the next tax year to secure business asset disposal relief at the current 10% capital gains tax rate. Please note that other conditions apply.

Taking drastic steps to avoid becoming subject to the new rules around short-term holiday lets could create as many financial problems as it solves.

We would strongly encourage you to take good, professional financial advice before committing to any course of action.

If you have questions about taxation, or our wealth planning services, please contact the Marketing team:

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