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Homeowners Caught in Tax Dilemma Over Renting Spare Rooms

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A growing number of homeowners keen to rent out spare rooms for extra income are being deterred by an outdated tax threshold that hasn't kept pace with rising living costs and soaring rents.

The UK's Rent a Room Scheme, which allows homeowners to earn up to £7,500 per year tax-free by letting out a furnished room in their primary residence, has not been updated since 2016. With average rental prices climbing significantly since then, critics say the scheme no longer reflects the financial reality faced by many households.

Matt Hutchinson, director at house share platform SpareRoom, believes the stagnant threshold is a missed opportunity. “If just one in 20 of Britain’s spare rooms were rented out to lodgers, it would add the equivalent of a city the size of Birmingham to the nation’s housing stock,” he said.

The £7,500 allowance translates to £625 per month. Any rent earned above that is subject to tax and may require individuals to file a self-assessment tax return, something many find off-putting, especially given the complexity and cost of professional tax advice.

Alex Hobbs, a 29-year-old construction industry manager, found himself in exactly that position. After the pandemic, he rented out a room in his London flat to help with rising bills and mortgage payments. “I was charging £750 a month, and then he paid separately for a share of the bills. Then I realised you had to pay tax on rent over £625 a month,” Mr Hobbs said.

While the Rent a Room Scheme provided him with some short-term relief, he soon realised the financial benefit was outweighed by the tax implications and administrative burden. “I had to get an accountant and pay their fees, and it was a lot of work,” he added.

SpareRoom data shows that since the £7,500 limit was introduced, average room rents have risen 21 percent across the UK and 34 percent in London. Mr Hutchinson argues that had the allowance increased in line with the Retail Prices Index (RPI), which includes housing-related costs, it would now stand at £11,500. That figure, he says, would cover 94 percent of UK postcode areas.

The freeze comes as many homeowners grapple with higher mortgage rates and inflated household expenses. Renting out a room has become an attractive option, particularly for younger homeowners or those living alone, but the low tax threshold acts as a disincentive.

“There’s about 26 million homes in England and Wales with one or two spare rooms,” said Mr Hutchinson. “Even renting out 5 per cent of those rooms would create a city the size of Birmingham but spread out across the country.”

Another concern is how the current tax rules interact with frozen income tax thresholds more broadly. Additional rental income can push homeowners into higher tax brackets, increasing their overall liability and reducing the attractiveness of letting out a room.

Laura Suter, director of personal finance at investment platform AJ Bell, highlighted this issue: “It means that, for some, once this tax and other costs of renting a room are taken into account, there isn’t sufficient incentive for them to do it.”

Baroness Watkins of Tavistock recently raised the matter in the House of Lords, asking whether the Government would consider raising the threshold. Labour peer Lord Livermore, responding on behalf of the Treasury, acknowledged the scheme’s benefits, stating that it “reduces and simplifies the tax and administration burden for those affected and has taken some taxpayers out of self-assessment entirely.”

However, he confirmed there were no current plans to raise the threshold, saying, “At present, the Government believes that the Rent a Room Scheme threshold is set at an appropriate level.”

The Rent a Room Scheme is available to homeowners and tenants letting out furnished rooms in their primary residence. However, renters often face additional hurdles due to lease restrictions on subletting.

With calls for reform growing, many argue that an updated threshold would reflect the economic climate and help ease the country’s housing pressure if the government chooses to act.