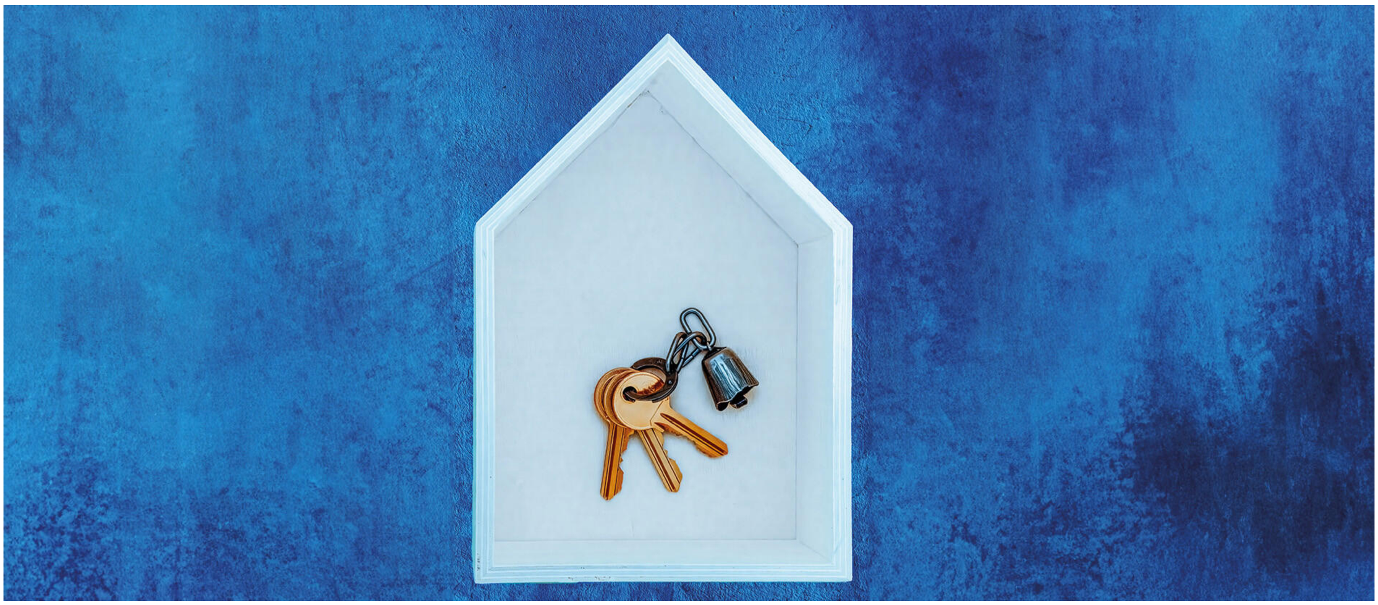
Furnished holiday lets: the end of an era

Property Tax OMB



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We consider what the 2025 tax changes will mean for married joint owners of furnished holiday lets.

Key Points

What is the issue?

From April 2025, the furnished holiday let regime will be abolished. Without any action being taken, most married or civil partnered joint owners of furnished holiday let properties will become subject to the usual rules around joint property profit allocations – a default 50:50 split.

What does it mean for me?

In most cases, married and civil partnered joint owners who currently allocate profits unequally will need to be proactive if they wish to preserve this arrangement for tax purposes. A Form 17 declaration can be used to achieve unequal profit allocations, but the rules are not straightforward and adjustments to the underlying beneficial ownership might be required ahead of time.

What can I take away?

Preparations will need to take place in advance of the abolition of the furnished holiday let regime. Advisers need to be talking to clients about this early on to ensure the necessary arrangements are in place from the beginning of the next tax year.

As we know, from 6 April 2025, furnished holiday let properties will, for the most part, be treated as normal property rental units. No more bells, no more whistles. Consequently, there are many changes that the owners of furnished holiday let properties, and their advisers, need to get up to speed with as we approach the abolition of the regime from April 2025. Aside from the ‘big ticket’ changes, such as the availability of capital allowances and business asset disposal relief, there is another, slightly more subtle, consequence of the end of the furnished holiday let regime: the ability to flexibly allocate profits between individual joint owners who are married or in a civil partnership.

This flexibility has allowed married couples and civil partners to take advantage of lower marginal tax rates or to reflect uneven effort in running the holiday let activity. The purpose of this article is to highlight the need for married furnished holiday let joint owners and their advisers to consider whether they need to take action – in time for the start of the 2025/26 tax year – particularly if they wish to preserve an unequal profit allocation.

We are only considering the position for joint owners who are married or in a civil partnership and ‘living together’. For ease, we simply refer to ‘married couples’ and ‘spouses’ throughout. We are not considering partnership property.

The current position: before the abolition of the furnished holiday let regime

Most advisers will be familiar with the two different forms of beneficial co-ownership for land and buildings under English law:

- as joint tenants, where each owns an indivisible share of the whole property, and their notional interest automatically passes to the co-owner on death by law; and
- as tenants in common, where each owns a distinct share of the property, not necessarily equally, and ownership of a share can be passed by will or intestacy.

(Note: The position and terminology under Scottish law and in Northern Ireland may differ slightly and should be checked.)

For non-furnished holiday let properties, the default position – absent any Form 17 declaration (more on that later) – is that spouses are taxed equally on income arising, under Income Taxes Act (ITA) 2007 s 836 (2), regardless of the underlying beneficial ownership.

In the case of furnished holiday let properties, exception D and exception DA within ITA 2007 s 836(3) currently provide an important automatic 'let out' from the 50:50 rule, providing the ability to take a more flexible approach to profit allocation for income tax purposes between married joint owners. There are some points to bear in mind on flexible furnished holiday let profit allocations:

- If a furnished holiday let is held by co-owners **as joint tenants**, then they are taxable on income from their property according to their actual indivisible beneficial interests in a 50:50 split.
- If a furnished holiday let is jointly held **as tenants in common**, they are taxable on income from the property according to their actual beneficial ownership share which may not be in equal; for example, if one spouse has contributed 60% of the funds to acquire the property and the other spouse 40%, and the beneficial ownership is agreed in those proportions (and supported with evidence).
- However, the furnished holiday let co-owners might wish to agree a different, more favourable allocation of the profits, not necessarily in line with their actual beneficial (capital) ownership. This might be desirable to take account of their differing marginal tax rates, for instance if one spouse is a higher or additional rate taxpayer while the other is a basic rate or a non-taxpayer.

HMRC guidance at Property Income Manual PIM1030 indicates its view that *unmarried* joint owners can agree a different profit split for income tax purposes – independent of their underlying beneficial ownership.

Where *married* joint owners are excluded from ITA 2007 s 836(2) under exception D or exception DA, they fall to be treated in the same way as unmarried co-owners. This in turn appears to mean that in HMRC's view, they are able to split profits in a different manner to their underlying beneficial ownership, if they wish.

Although there is no reference at PIM1030 to the settlements legislation, care needs to be taken that the allocation does not fall foul of those rules. Provided that it is commercially justifiable, however, they should be taxed on their agreed income tax split. This might be because more work is done by one non-working spouse (taking bookings, attending to guests, handling changeover and laundry arrangements, etc.) than the other spouse.

What changes from 6 April 2025?

From 6 April 2025, exception D and exception DA in ITA 2007 s 836(2) will fall away.

Married couples who co-own a furnished holiday let property will no longer have an 'automatic let out' from ITA 2007 s 836(2) on the basis that the property is a qualifying furnished holiday let. Consequently, they will be taxed on the former furnished holiday let income on a 50:50 basis for income tax purposes, regardless of their actual beneficial interests – unless specific action is taken.

Time for action

Where the deemed 50:50 income split for tax purposes applies from 6 April 2025 under ITA 2007 s 836(2), married joint owners will have the same options available to them as are currently available in respect of 'normal' (i.e. non-furnished holiday let) rental properties.

As such, readers will be familiar that it is possible to depart from the 50:50 rule by making use of a further exception under s 836(3): exception B. This exception provides that the default 50:50 does not apply where the couple has made a valid declaration of unequal beneficial interests under ITA 2007 s 837.

In brief, a declaration under s 837 allows joint property income to be split unequally between spouses provided that:

- the underlying ownership of the property is in fact unequal between the married joint owners;
- the income allocation follows that same unequal ownership split; and
- a Form 17 declaration has been validly made (see tinyurl.com/4n5uzfts).

In such circumstances, the property income will be taxed in accordance with the **actual beneficial ownership** shares instead of a deemed 50:50 split.

Of course, due to the legal construct of two methods of joint ownership (joint tenants and tenants in common), it is not possible to make a Form 17 declaration where spouses own the property as joint tenants, unless they first take steps to end or sever the joint tenancy to achieve an unequal ownership split.

Furthermore, the Form 17 method still might not put the joint owners in the same position as under the furnished holiday let rules for splitting profits flexibly under exception D. There is no ability under ITA 2007 s 837 to allocate profits based on the 'effort' by the individual owner or any other reasonable justification. The profit split can only reflect the underlying beneficial interests of the owners in respect of both the capital and income entitlement (which must be the same).

This might mean that adjustments to the capital beneficial interests are required now, ahead of 6 April 2025, for properties held as tenants in common if the current underlying ownership split does not match the desired income split. See ***Example: Ali and Mary*** for an illustration of how this might look in practice.

In all cases where there is a change to the underlying beneficial ownership, consideration will need to be given to the wider tax consequences of changing the capital shares. For example, if there is a mortgage on the property, any transfer may trigger a stamp duty land tax charge (or the equivalent in Scotland or Wales), even if nothing is paid for the transfer. Further, in cases where a severance is required to convert the ownership from joint tenants to tenants in common, it is necessary to also update the Land Registry to show a 'Form A Restriction' on the title.

Example: Ali and Mary

Ali and Mary are married. They own a UK furnished holiday let as tenants in common, in equal shares. Ali oversees the management of the furnished holiday let, such as dealing with bookings, cleaning and welcoming the guests. They have always split the rental profit as 80% to Ali and 20% to Mary, to reflect Ali's contribution to running the furnished holiday let. This is also beneficial to the couple as Mary is a higher rate taxpayer, whereas Ali has no other income. Ali and Mary intend to continue with this arrangement after 6 April 2025.

Pre-6 April 2025: Ali and Mary fall within exception D in ITA 2007 s 836(3), and are therefore not necessarily required to declare the rental income on a 50:50 basis. However, beneficially, the property is owned 50:50, so on what basis are they able to depart from that? In this case, given Ali's higher contribution to running the furnished holiday let, the couple's tax adviser felt the 80:20 split was justifiable and HMRC has not raised any objection.
As such, Ali and Mary have always been taxed on the income in accordance with the agreed 80:20 split.

Post-6 April 2025: From 6 April 2025, exception D within s 836(3) will no longer exist. Ali and Mary will be taxable on a 50:50 basis, regardless of Ali's contribution to running the furnished holiday let.

Planning steps: If Ali and Mary wish to continue to be taxed on an 80:20 basis, they would need to take the following steps before 6 April 2025:

- The underlying ownership of the property would need to be altered. This effectively means that Mary would need to 'gift' 30% of the property to Ali, bringing his share up to 80%.
- To be effective, this gift would need to be in writing (as set out in the Law of Property Act 1925 s 53(1)(b)). In making the gift, Ali and Mary would need to be mindful of any potential exposure to stamp duty land tax, land transaction tax or land and buildings transaction tax if there are outstanding borrowings on the property, and any other tax consequences or legal requirements such as lender's consent.
- They would need to make a joint declaration to be taxed on their actual ownership share using Form 17. The form should be signed on 6 April 2025 and submitted to HMRC within 60 days.

The timing of the Form 17 declaration

It is understood that HMRC generally enforces the 60 day time limit strictly. The CIOT has suggested that it should be possible to backdate Form 17 to the start of the preceding tax year at least (see www.tax.org.uk/ref1353). This would allow taxpayers to adopt their preferred allocation from the start of the preceding tax year if they only became aware of the 50:50 rule when they start preparing their tax return. The Office of Tax Simplification recommended the abolition of the 'anachronistic' 50:50 rule altogether.

However, as the rules stand, time is running short for furnished holiday let joint owners to ensure that their beneficial ownership of the property is understood, varied if necessary (with legal advice), and a valid Form 17 is ready to be signed by both joint owners on the 6 April 2025. It is not clear if HMRC would reject a Form 17 declaration signed *before* 6 April 2025. However, in the interests of safety, it would seem a risk not worth taking – particularly since the rejection would require a new declaration to be made, without any possibility of backdating to the beginning of the tax year.

The authors' view is that Form 17 declarations for furnished holiday let properties should be jointly made on 6 April 2025 (and received by HMRC within 60 days) if the owners wish to ensure that the desired income split is achieved from the first day of the new tax year.

Practical points: Form 17

These are some issues for the furnished holiday let co-owners to bear in mind when considering a Form 17 declaration:

- The declaration must be made jointly by the joint owners.
- A separate declaration must be made for each property (it does not apply to the combined 'property business').
- HMRC will require evidence that the unequal beneficial interests are in the proportion set out in the declaration – normally, a deed of trust or a deed of assignment.
- Once the Form 17 declaration has been made, it is permanent. The joint owners cannot go back to being taxed 50:50 on that property, unless there is a later

change in the beneficial interests to own the property equally.

- Changing the allocation of beneficial ownership may have other tax implications, including for capital gains tax, stamp duty land tax (or for the land and buildings transaction tax in Scotland or the land transaction tax in Wales) and inheritance tax.
- Form 17 only takes effect for income tax. However, HMRC takes the Form 17 declaration as evidence of the existence of an express agreement concerning the ownership of the assets and will follow that split in assessing the gains on disposal (see the Capital Gains Manual CG22020).
- The declaration only takes effect from the date it is signed (not from the date of any change to the beneficial interests) and cannot be backdated.
- The declaration must reach HMRC within 60 days of being signed and dated by both parties.
- If the form does not reach HMRC within 60 days, it is invalid and a fresh declaration will need to be made.
- A Form 17 declaration is not required where a property is legally owned by one spouse only, even if each spouse has an underlying beneficial interest in the property (a bare trust scenario). In this case the default 50:50 income split does not apply.