Exceptional case?

Jacquelyn Kimber reviews a recent First-tier Tribunal decision concerning business property relief on furnished holiday lettings.


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There can be few greyer areas than the application of business property relief (BPR) under IHTA 1984, s 104 to a business involving the letting of land or property. For owners of furnished holiday lettings businesses in particular, the position seems anomalous given that the carrying on of the business is treated as a trade for various purposes under specific income tax and capital gains tax provisions – for example, loss relief (ITA 2007, s 127) and capital gains tax (TCGA 1992, s 241(3)). Inheritance tax operates independently of income tax and capital gains tax so, when determining whether BPR is due, reference must be made only to the provisions of s 103 to s 114 (all references are to IHTA 1984 unless otherwise stated).

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Historically, most BPR cases have gone against the taxpayer, although there has at last been a positive decision in *Personal representatives of Grace Joyce Graham (decd)* (TC6536). But, however tempting it may be to see this as opening the door to BPR claims by lettings businesses, the reality might be quite different.

Requirements

BPR is available for the value attributable to a transfer when:

- there is a qualifying business – this includes a business carried on in the exercise of a profession or vocation, but excludes one carried on otherwise than for gain (s 103(3));
- the asset is 'relevant business property' (s 105); and
- the (broadly) two-year minimum period of ownership is met (s 106).

Key points

- Furnished holidays lettings rarely succeed in claiming business property relief.
- Similarities between *Graham* and the Upper Tribunal's decision in *Pawson*.
- Property business is usually considered an investment rather than a trade.
- Additional services provided to guests must be high to make the activity a trade.

In most cases, the first and third conditions are relatively unproblematic. Section 105 specifies that a business or interest in a business (or shares in a company) are not relevant business property if the business consists *wholly or mainly* of dealing in securities, stocks or shares, land or buildings or making or holding investments (s 105(3)). There are exceptions, such as for market makers and holding companies, but these need not be considered further here. On land dealing, the exclusion from relief relates to dealing or speculative trading rather than active development or building on the land (*DWC Piercy's Executors* [2008] STC SCD 858 (SpC 687).

The crux for property businesses is the interpretation of whether this consists wholly or mainly of making or holding investments. Many businesses hold property as an investment, but there is a significant difference between the property as the source of the profit and the activities that take place on it. Property letting is problematic because it undoubtedly involves the exploitation of land for profit, but the provision of additional facilities or services blurs the boundary.

HMRC's stance – as set out in its *Inheritance Tax Manual* at IHTM25278 – is clear:

> 'HMRC's view is that furnished holiday lets will in general not qualify for business property relief. The income derived from such businesses will largely consist of rent in return for the occupation of property. There may, however, be cases where the level of additional services provided is so high that the activity can be considered as non-investment, and each case needs to be treated on its own facts.'

Graham – the facts

Returning to the *Graham* case, the taxpayer operated four self-catering holiday flats and occasional bed and breakfast accommodation from part of the family home, 'Carnwethers'. Guests had use of a solar-heated outdoor pool, extensive well-maintained gardens, a sauna, games room, laundry

and barbecue area. A separate guest lounge with books was also available. As well as bed linen and towels, each flat was supplied with fresh flowers, homemade goods, toiletries and cleaning materials. A golf buggy and bicycles could be hired.

On arrival, guests were provided with refreshments and a welcome pack. The owners were on hand to help with taking in shopping, organising birthday and other celebrations and suggestions on walks and other activities. The flats were thoroughly cleaned between lettings, and there was regular maintenance of the pool, gardens and other facilities. As well as providing services to guests, time was spent advertising for tenants, collecting payments and general maintenance.

It was common ground that the activities amounted to a business: the points at dispute were how much of the overall holiday letting business related to the use of land and how much related to other components, such as services provided or onsite facilities.

Past decisions

There are clear similarities with the facts in *CRC v Pawson (decd)* [2013] STC 976 in which the Upper Tribunal found for HMRC, overturning the First-tier Tribunal's decision for the taxpayer. In that case, the taxpayer let a fully furnished bungalow on the Suffolk coast. In between lettings, the property was cleaned and inspected and any necessary repairs made. The owner was also on call to deal with queries or emergencies.

In reaching its decision to allow the claim, the tribunal had drawn extensively on the Court of Appeal decision in *George v CIR* [2004] STC 147. In this, the taxpayers ran a campsite and provided additional services to guests leasing pitches in a static caravan holiday park. Upholding the decision of the Special Commissioners in favour of the taxpayer, Lord Justice Carnwath said:

> 'There is nothing ... to support the view that, merely because services or facilities are required by the lease, and their cost is included in the rent, they lose their character as services, and become part of the "holding" of the investment.'

Until then, case law had generally supported the view that the provision of land – the investment element – largely predominated against any service element. *George* recognised the fact that a necessary component of the business was the use of land should not disavow business property relief for the activity.

The First-tier Tribunal in *Pawson* said: 'There are clearly significant services provided to the occupiers of the property. Those services are part of the reason why the occupiers are prepared to pay for the package of benefits they receive when they book to use the property as a holiday destination. The fact, even if it is a fact, that the appellants can provide the services at a relatively low cost to themselves compared with the amount they can charge for the package appears to us to be irrelevant.' The tribunal therefore had little trouble finding that 'an intelligent businessman would not regard the ownership of a holiday letting property as an investment as such'.

However, the Upper Tribunal in *Pawson* found that, although the level of services provided on a caravan park was enough to outweigh the investment aspect of holding land, this was not the case for a holiday cottage lettings business, where the services provided were of a 'relatively standard nature, and they were all aimed at maximising the income which the family could obtain from the short-term holiday letting of the property'.

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Additional services

For a property lettings business to fall outside one of mainly holding investments, the level of services provided must therefore be over and above those of a 'relatively standard nature'. It was the presence of these additional services in *Graham* which allowed the tribunal to distinguish the case from the Upper Tribunal tribunal decision in *Pawson* and allow the claim for business property relief.

The factors that tipped the balance in favour of the taxpayer in *Graham* were the extent of the additional services offered, such as homemade food and drink, bikes, a games room, the provision of a pool, sauna and gardens, together with the 'personal care lavished upon guests by Louise Graham'. These services and the hours required to provide them, enabled the tribunal to draw a distinction between a 'normal' lettings business, such as that in *Pawson*, and the situation in *Graham* in which 'an intelligent businessman would view it more like a family-run hotel than a second home let out in the holidays'.

The judge in *Graham* emphasised: 'It will only be an exceptional letting business which falls on the non-investment side of the line.' He said the services provided to guests at Carnwethers 'just' predominated. When services fall short of this very high level, HMRC can therefore be expected to challenge claims for BPR – assuming it does not appeal against this decision. The taxpayer rightfully won the battle on this occasion, but one has the feeling that HMRC is very much still winning the war. ●

Planning point

If claiming business property relief on a furnished holiday lettings business make sure to emphasise any additional services provided to guests to maximise the likelihood of success.

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