The shadow of doubt

Inheritance tax and trusts | OMB

01 January 2019

Anthony Nixon considers recent cases involving business relief for investment businesses

Key Points

What is the issue?

A case about livery stables last year cast doubt on the assumption that holiday lettings are an investment business. A recent case raises further questions about HMRC's approach.

What does it mean for me?

It is not correct to say that holiday lettings do not qualify for inheritance tax business relief. Each case must be analysed on its facts.

What can I take away?

In any land-based business, where business relief may be challenged, ensure that you have collated details of all activities and effort put into the business.

Some readers will remember my article, 'The Turn of the Tide?' in the January 2018 issue of *Tax Adviser*. I looked at HMRC's challenges to business relief for land-based businesses and was much encouraged by the First Tier Tribunal (FTT) decision in *Vigne's Executors v HMRC* [2017] UKFTT 632(TC). That case was about livery stables. The tribunal agreed with the taxpayer that the business did not consist 'wholly or mainly of making or holding investments' (Inheritance Tax Act 1984 s 105(3)) so relief was available.

We now have the report of the FTT hearing (a hearing I was able to attend) in *The Personal Representatives of Grace Joyce Graham (Deceased) v HMRC* [2018] UKFTT 0306 (TC). This tribunal also ruled against HMRC's argument that s 105(3) precluded business relief. The case was about a holiday business in the Scilly Islands of St Mary's, which earned almost all of its income from letting self-catering units.

Carnwethers was a family-run guest house until 2004. As the holiday market changed, and the demand for small hotels receded, it was converted to become four self-catering units while retaining almost all of the guest house facilities:

- A swimming pool and sauna, both cleaned daily, were freely available to all the self-catering guests;
- An acre of maintained gardens included croquet, badminton and other facilities, as well as a barbecue for guests to make use of;
- Guests could rent (golf style) buggies to get about in the surrounding country lanes.

HMRC argued that the Carnwethers business consisted mainly in the holding of an investment and therefore was not relevant business property by virtue of section 105(3).
HMRC seem to have applied this argument to all holiday lettings since the *Upper Tribunal (UT) decision in HMRC v Pawson's Executors* [2013] UKUT 050 (TCC). From

what I have heard, HMRC's approach has been to refuse relief, unless a business could demonstrate 'non-investment' activities on an exceptional scale.

My firm acted in obtaining the late Mrs Graham's probate and we submitted the IHT return on her death, which claimed the relief that the FTT judgment has granted. While the family took on the running of the appeal to the FTT themselves, I have maintained a close interest in the case.

I was surprised that the judgment did not come down more strongly in favour of relief:

> *Overall we conclude that Carnwethers was an exceptional case which does, just, fall on the non-mainly-investment side of the line. The pool, the sauna, the bikes, and in particular the personal care lavished upon guests by Louise Graham [the late Mrs Graham's daughter who had worked with her mother in the business and presented the case to the FTT] distinguished it from other 'normal' actively managed holiday letting businesses; and the services provided in the package more than balanced the mere provision of a place to stay. An intelligent businessman would in our view regard it as more like a family run hotel than a second home let out in the holidays.* (paragraph 93)

One of the witnesses at the FTT hearing, Mr Guthrie, runs a letting agency in the Scilly Isles. He described how he arranges lettings of, exactly, 'second homes let out in the holidays.' No doubt some of the owners of those properties qualify for the special income tax and capital gains treatment available to holiday lettings, but I suspect that many are indeed investments, in the IHT sense. Indeed, this seems to have been exactly the kind of business which Henderson J ruled did not qualify for relief in *Pawson*.

To my eyes, it is the different businesses described by Mr Guthrie that demonstrate where the line between businesses mainly holding investments and the opposite should lie. And, as it happens, this exactly matches the approach once taken by HMRC. Their IHT manual used to say that significant activity by the owner of a self-catering business would indicate that it was not a business mainly of holding investments.

The *Graham* judgment did not find it necessary to disagree with *Pawson*:

> *Louise Graham takes issue with Henderson J's statement at [42] that he took as his starting point that the owning and holding of land in order to obtain an income from it is generally to be characterised as an investment activity. She says that this is inconsistent with Carnwath LJ's statement in George [George and another (executors of Stedman) v HMRC [2003] EWCA Civ 1763] at [12] that although the exploitation of a proprietary interest is 'in principle' an investment activity, there is a wide spectrum involved. She says that Henderson J fails to recognise that the spectrum is of equal if not more importance as 'in principle'.* (paragraph 60)

The *Graham* judgment continues:

> *We do not think that the appellants have any need to seek to dilute the effect of Henderson J's statement.... Nevertheless we accept that we must be vigilant in having in mind the spectrum and assessing where [a] business lies on that spectrum; and we agree that there is no presumption which requires rebuttal that a business which involves the exploitation of land for profit is mainly an investment business: the facts must be looked at in the round.* (paragraph 61)

If there is no presumption that a land-based business is investment, was it correct for Henderson J to take it as his 'starting point'?

I find another part of Henderson J's *Pawson* judgment unsatisfactory:

> *I am unable to accept...that a holiday letting business is inherently of such a nature that it falls outside the scope of a 'normal' property letting business, of the kind envisaged by Carnwath LJ in George at paragraph [27]. On the contrary, I consider such a business to be a typical example of a property letting business, albeit one of a fairly specialist nature.* (paragraph 46)

Why does its 'fairly specialist nature' not take a holiday letting 'outside the scope of 'normal''? And, , if such businesses are normal property letting businesses, why has Parliament created special income tax and capital gains tax rules for them?

I also question the assumption, present in both the Pawson and Graham judgments, that selling holiday weeks in self-catering accommodation is an investment activity. Traditionally, seaside hotels and boarding houses would always let rooms a week at a time. While this is rarer today, would this be treated as investment activity? Of course not. What is different about letting weeks of self-catering accommodation?

Surely, to treat letting holiday weeks as an investment activity presupposes that there is an investment business? And, as I have already quoted from the *Graham* judgment:

> *'We agree that there is no presumption which requires rebuttal that a business which involves the exploitation of land for profit is mainly an investment business: the facts must be looked at in the round.'* (paragraph 61)

The assumption that selling self-catering weeks is an investment activity seems to derive from *Martin v IRC* [1995] STC (SCD) 5. *Martin* was about a business park granting leases of, usually, three years. The Court of Appeal, in George, expressly agreed, '*on its own facts*' with the Special Commissioner's finding that arranging lettings was part of the investment. Is it right to transfer that conclusion, where the facts were that three years leases were being granted, to holiday lettings of a week or so? I do not think it is.

HMRC have appealed both the *Vigne* and Graham FTT decisions to the Upper Tribunal. Indeed the hearing on the *Vigne* case has already taken place and we can expect to read the judgment soon – perhaps even before this article is published. A lot of IHT will be at stake, now and in the future, on the correct approach to land-based businesses, so I am expecting that one if not both of these cases will be appealed further.

In both these reported cases a family member has led the appeal to the FTT and has been able to put before the tribunal their detailed knowledge of the business concerned. It is hard to be confident that many appeals of this kind will succeed without an enormous investment of time and energy by family members. How can these family members find the time to challenge HMRC while continuing to grow, or even keep afloat, the business? Surely this is one of the principal reasons that businesses are given relief against IHT?