Holiday homes on the range

Inheritance tax and trusts | Management of taxes

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Keith Gordon discusses a recent case which revisits the question as to when holiday accommodation can qualify as Business Property for the purposes of inheritance tax

Key Points

What is the issue?

Much of the case law on business property relief has turned on the part of the legislation which excludes businesses which consist ‘wholly or mainly of … making or holding of investments’. One of the key factors as to whether a property qualifies for the relief has been the level of services provided.

What does it mean for me?

In the case of Ross the business expenses were analysed over three years with the ‘hotel’ service costs amounting to about two-thirds. The Tribunal considered the evidence, viewed the business in the round and concluded that the business failed to qualify for BPR as it consisted mainly of holding investments.

What can I take away?

If you are already in a similar dispute with HMRC, then you should point out the Tribunal's errors in Ross and be prepared to carry on regardless. You should take the opportunity to contact clients with similar property businesses and advise them of the latest setback. In some cases, it might be possible to ensure that even more services are provided.

Business Property Relief is a particularly valuable relief in the context of inheritance tax. In many cases, qualifying assets can (in effect) be simply ignored for inheritance tax purposes, allowing individuals to pass considerably more wealth than the standard £325,000 to the next generation without triggering an inheritance tax charge.

In the case of an unincorporated entity, and leaving aside other matters such as length of ownership, the basic condition is no more than it should constitute a business (a relatively low threshold, provided that there is enough activity to evidence more than a mere passive income stream). As most readers will know, however, the statute then excludes certain businesses from the relief (Inheritance Tax Act 1984, section 105(3)). Much case law has turned on the part of that subsection which excludes businesses which consist 'wholly or mainly of … making or holding of investments', with particular emphasis on the words 'holding … of investments'.

As the case law has consistently shown, the principal stumbling block when it comes to businesses that rent land is that the land is an investment and, therefore, a mere rental activity generally constitutes the holding of an investment (or investments). However, equally, it is wrong to treat all land-based business activity as definitely outside the scope of Business Property Relief. As was said by the Special Commissioner in *Stedman's Executors v Inland Revenue Commissioners* (sometimes also known as *George*, Mr George being one of the Executors), it is necessary to consider the business in the round and to consider what the overall picture reveals. This test was expressly approved of by the Court of Appeal ([2003] EWCA (Civ) 1763) when the case progressed. Consequently, BPR is precluded only if the business (when viewed holistically) amounts to more than 50% investment activity.

In reality, there is of course a range of different types of land-based activity: in some cases, the investment side of the business will prevail, but in others, the non-investment side will dominate. In the latter cases, there should be no bar to BPR (provided that the other statutory conditions are met, of course). As the Special Commissioner said in *George* and as was again expressly endorsed by the Court of Appeal: 'There is a spectrum at one end of which is the exploitation of land by granting a tenancy coupled with sufficient activity to make it a business, which may be activity in granting tenancies rather than activity in relation to the tenancy once granted. At the other end of the spectrum, while land is still being exploited, the element of services means that there is a trade, such as running a hotel, or a shop from premises owned by the trader.'

It was with this background that the case of *Executors of Marjorie Ross v HMRC* [2017] UKFTT 507 (TC) came to the First-tier Tribunal.

Facts of the case

The late Mrs Ross was a partner in a business known as The Green Door Cottages Partnership. The Partnership ran and managed eight holiday cottages and two staff flats in Cornwall, as well as a house in Weymouth. Before acquiring the cottages in 1985, Mrs Ross and her husband owned a hotel across the road and the cottages were operated in conjunction with the hotel business. When Mrs Ross became too ill to run the hotel part of the business, she sold the hotel but retained the cottages. However, arrangements were entered into by which the hotel continued to provide services to the cottage guests. Indeed, the transition was so smooth that many guests were unaware of the split in ownership between the hotel and the cottages.

HMRC considered that the business did not qualify for BPR and the matter was referred to the First-tier Tribunal. In preparation for the hearing, Mrs Ross's executors obtained evidence which made reference to the following services available to guests: meals in the hotel dining room or brought over from the hotel, cleaning, use of internet, parking, arranging babysitters, on-site handyman, laundry facilities, fishing nets etc. One former guest described the stay at the cottages as 'so much more than other self-catering houses' and 'certainly appreciated the difference compared with other holiday lets'. Another likened the experience to 'checking into a hotel with the ability to self-cater'. Although the on-site handyman was strictly employed on a 9-5 basis, he regularly helps guests outside those hours

and sees part of his role as ‘making this a stress-free holiday for guests ... making sure their stay is as pleasant as possible’. He listed some of the tasks he had undertaken for guests as including arranging car repairs, fishing trips and taxis.

The business’s website listed a number of services provided to guests including wi-fi, newspapers and milk deliveries, sports and leisure equipment.

The business expenses were analysed over three years with the ‘hotel’ service costs exceeding 65% in two of the years under review and 64.7% in the third.

The Tribunal’s decision

The Tribunal (Judge Rachel Short) considered the evidence and viewed the business in the round. She concluded that the business failed to qualify for BPR as, in her view, it consisted mainly of holding investments.

Commentary

When reading the facts of the case as summarised by the Tribunal, I could not help but thinking that, if this business does not qualify for BPR then there is no way that any other furnished lettings business would. Having read the Tribunal’s ultimate decision, it therefore occurred to me that, if the Tribunal’s view were right, then there is definitely no way that any furnished lettings business can ever qualify for BPR. So this then leads to the question as to whether the decision is indeed right?

Of course, I can do no more than read the facts as summarised by the Tribunal but, as I have said, they do seem to demonstrate a considerable amount of service (and, crucially, services representing far more than 50% of the overall business, at least when expressed in terms of expenditure). Furthermore and perhaps more importantly, there appear to be a number of errors of approach taken by the Judge in reaching her decision.

First, the Judge appears to have started with the notion that the business is a property-based business (and therefore on the wrong side of the line) and that, from this starting point, the Executors were required to show that enough services were provided so as to take the business to the 50% mark (or beyond). This approach is not consistent with the idea that one should consider the business in the round.

More importantly, despite making a number of references to the spectrum, it appears that the Judge has misunderstood or at least misapplied the test. The essence of the Judge's reasoning is that the business was not that of a hotel, no matter how similar the services were to those provided in a hotel. However, the case law does not require a business to be a hotel (or a shop) – such businesses are merely those that lie at the far extreme of the range. All that the Executors needed to show was that they were 'more hotel than not'.

About the only consolation is the fact that the Tribunal accepted that it did not matter who provided the additional services – i.e. it was possible for some services to be contracted out – as they were nevertheless provided to guests by the business.

HMRC are no doubt going to cite this case in other instances where BPR is being claimed in relation to holiday accommodation and it will not surprise me if they make comments similar to those I have already expressed being that no case will pass the test if this case does not. However, given the apparent errors of approach taken by the Tribunal, it is my view that the case should be of little persuasive authority in other appeals.

Finally, what to do next

If you are already in a similar dispute with HMRC, then you should point out the Tribunal's errors in Ross and be prepared to carry on regardless.

In other situations, you should take the opportunity to contact clients with similar businesses and advise them of the latest setback. In some cases, it might be possible to ensure that even more services are provided so as to ensure that the business falls on the right side of the 50% line. However, it might be advisable to start talking about other estate planning options, just in case BPR proves to be unavailable.

Update on previous case analyses

In my article in the April 2016 issue, I discussed another inheritance tax case, *Hood v HMRC*, which concerns gifts with reservation of benefit. The First-tier's decision has since been upheld by the Upper Tribunal ([2017] UKUT 276 (TCC)).

In my article in the February 2016 issue, I discussed a case concerning fairness (*R oao Hely-Hutchinson v HMRC*). The Court of Appeal has since allowed HMRC's appeal against that decision ([2017] EWCA Civ 1075).

In my article in the May 2016 issue, I discussed the Court of Appeal's decision to uphold a direction which debarred HMRC from future participation in the appeal by BPP Holdings Ltd. The Supreme Court has recently upheld the decision, albeit for slightly different reasons ([2017] UKSC 55).

In my article in the April 2017 issue, I discussed the Court of Appeal's decision in the construction industry scheme case of *JP Whitter (Waterwell Engineers) Ltd v HMRC*. The Supreme Court has recently given permission to the taxpayer to appeal.