

Pawson “reversed”



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Holiday home owners who let their properties have been delivered a blow from the Upper Tribunal which has quashed a landmark ruling that allowed relief from inheritance tax (IHT) for holiday homes being run as a business.

Pawson “not an investment”

The latest decision reverses a tribunal ruling from last year which favoured holiday home owners. In the case of HMRC v Pawson judges found that holiday lets should NOT be considered investments for tax purposes. This meant that they should NOT be treated in the same way as other investment or rental properties are viewed ie, that they should be considered a trade.

A large number of owners of furnished holiday home lets (FHL) could now be hit with IHT bills after the ruling, which overturns the previous verdict allowing owners to claim business property tax relief (BPR) on the FHL. It is considered that a large number of FHLs will revert to simple lettings following this ruling.

What were the Pawson facts?

The property, located in Thorpeness in Suffolk, was let fully furnished as a holiday home, and was jointly owned by the deceased and members of her family. The deceased held a 25% share in the FHL property. The First-tier tribunal (FTT) accepted that the property had been run as a business for more than two years before the deceased’s death. The FTT also accepted the fact that the family’s use of the property for three weeks a year did not prevent it from being run as a holiday let business.

The use of the property by family members reduced the level of activity and profit but it was considered not enough to prevent the property being run on sound principles. The business had been profitable for two of the three years before the taxpayer died and was running profitably in the year of her death. The FTT concluded that the business was being run with a view to gain which satisfied section 103(1) of the Inheritance Tax Act 1984 (IHTA 1984).

Substantial involvement

HM Revenue & Customs (HMRC) have generally sought to apply a stricter interpretation of where BPR can be available for IHT purposes. For example, treating holiday home lets as other investments, with only those providing a substantial amount of services to holiday makers able to achieve the relief. Another example of this strict interpretation is a grazing agreement (*McCall v IRC* [2009] STC 990).

The upper tribunal found that there was no clear evidence that the holiday home owner in question, Nicolette Pawson, had 'substantial involvement' in managing the property in Fairhaven, Sussex, for holiday makers.

Now, only those who are considered to be providing a substantial amount of services to holiday makers will be eligible for the BPR on their FHLs.

The key is evidence of the active involvement in the FHL. The reversal is not such a depressing "u turn" as at first perceived. The importance is substantial involvement.

Overall, Mr Justice Henderson concluded that the FTT should have found that "the business... did indeed remain one which was mainly that of holding the property as an investment. The services provided were all 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".

The judge did not accept the taxpayer's argument that the innate character of a holiday letting business rendered it outside the scope of a normal property letting business. The judge stated it was typical example of a property letting business ie, the property was held mainly as an investment NOT as a trade.

Investment activities

What activities are generally deemed to relate to a letting activity?

It is considered that activities which are part of the investment business ie, which enhance the capital value of property and are part of obtaining an income from the property are:

- Finding holiday customers
- Keeping the property insured

- Rent collection
- Maintaining the property including repairs
- Sorting out the booking arrangements.

Services part of the trading operation

What tasks are generally deemed to relate to a trading activity?

Services which are part of the trading holiday operation are:

- Providing welcome packs, including a “meet and greet”
- Cleaning
- Being on call for problems
- Making food and refreshment available eg, breakfast.

It is generally understood that the duties mentioned above must be substantial to stop the business from being “mainly one of property investment”.

Action plan

You should review all FHLs with regard to how they are run and the potential for HMRC to consider the involvement in the trading tasks substantial. Also, consider whether the mode of the operation should be changed and what further services could be provided and by whom.

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