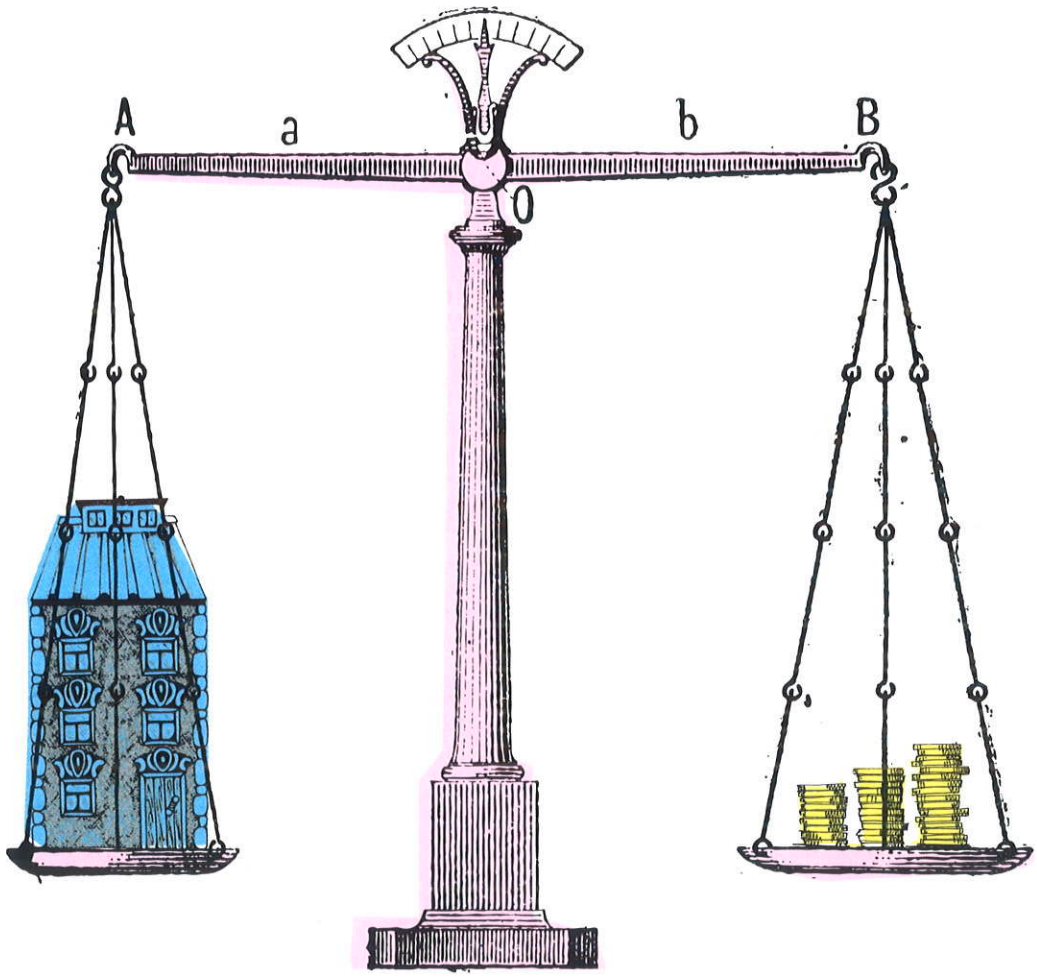
Tipping the balance

How many extra services must a property-letting business provide to be deemed 'mainly' a trading business, and therefore qualify for inheritance tax business property relief? **Julie Butler** weighs up a recent case



"In *HMRC* v *Personal Representatives of Nicolette Pawson*, it was held that the additional services associated with a furnished holiday let did not change the nature of the business from investment to trading"

The importance of meeting the inheritance tax (IHT) business property relief (BPR) criteria has been emphasised in the recent case of *Trustees of David Zetland Settlement* v *HMRC* [2013] UKFTT 284 (TC). One of the planning points that has to be considered is the whole structure and operation of services provided by the taxpayer.

Active management

David Zetland was an entrepreneur who transferred company shares into a discretionary settlement. The trustees contended that no anniversary charge was due because the business (an actively managed office block, Zetland House) qualified for BPR. HMRC argued that relief was not available as a result of the fact that the business of the company was one of holding investments.

The question raised was: how 'actively managed' was the office block at the core of the business? This ties into many trades operating in the UK. There is a need for detailed guidance from HMRC on the definition of active management when the investment business activities have become a large part of the overall operation.

The trustees of the David Zetland settlement operated a commercial model offering flexible office space for businesses involved with computers, media and hi-tech. Such a business model required major changes to the property, physically and in terms of use and type of occupant. The trustees provided short leases, which made rentals more attractive, and reconfigured the offices as and when required. The gross rent and service charges in 2007 amounted to slightly under GBP2.4 million.

Provision of services

The trustees hired staff to assist with the running of the building, and provide more services and facilities to tenants. The whole building was run in a community spirit, with regular barbecues and social events. A key factor in the case was the availability of the additional services provided by the trustees and the impact on the commercial nature of the business as a result of these services.

The services provided by the trustees were as follows:

- conference rooms;
- a mail room, reception and porters;
- seven to eight full-time and four part-time staff working on the Zetland House business (including general administration, dealing with tenants, organising events, marketing and branding of the building, security, property management, legal matters, and taking conference room bookings);
- a café operated independently but supported by the trustees;
- communal events (barbecues in summer, computer courses, carol singing and Christmas parties);
- internet services;
- bicycle stands;
- project management;
- cleaning services;
- 24-hour security; and
- a gym and hair salon, also operated independently but supported by the trustees.

Was there trading activity?

But were the services enough to tip the balance from investment business to trading business?

The trustees claimed that the extensive services provided to tenants meant that Zetland House ought not to be classified as an investment business. The services provided went beyond those normally involved in letting property (maintenance, finding tenants, etc). It is argued that the services would certainly tip the balance when compared with the services offered in *HMRC* v *Personal Representatives of Nicolette Pawson* (2013) UKUT 50, where it was held that the additional services associated with that particular furnished holiday let did not change the nature of the business from investment to trading.

HMRC argued that the purpose of the additional services was to increase occupancy and increase the rent collected under the lease. The services were incidental to the core business of collecting rent and service charges – the core investment business of letting.

Services 'unlikely to be material'

The First-tier Tribunal (FTT) referred to the remark of Carnwarth LJ, quoted in *Pawson*, that, in the case of a business letting a building, the provision of such services is 'unlikely to be material' because it will not be enough to prevent the business remaining 'mainly' one of property investments. The implication, the FTT said, is that, in any normal case, an actively managed property-letting business will fall within the exception in s105 *Inheritance Tax Act 1984* because the 'mainly' condition will be satisfied.

The trustees argued there was no case law that says that, if 50 per cent of a business relates to investments, that would satisfy the 'mainly' test. The FTT's view was that it stands to reason that, if one starts with 100 per cent, then more than half would be considered 'mainly' and 50 per cent is the benchmark.

What is the core business?

The FTT argued that the non-investment side was incidental to the core letting business and the services were insufficient to make the business of a mainly non-investment nature. The purpose of the activities was largely to improve the building and its fabric, keep the tenants there and keep the occupancy rates high.

The FTT found that: 'The reality is that most of these activities generate rental income. The income from the cycle rack and gym is all rental income. The tenants rent office space in a large building. There are some services that are provided over and above that which is required to be provided. This includes cleaning of the common parts, post sorting and delivery, reception, free food and drink at socials, and gift vouchers. It would be difficult to classify security as something that is over and above a landlord's responsibility, especially in London and where a building is open late at night and early morning. However, these do not tip the balance in favour of the settlement nor are they sufficient to challenge the "mainly" investments argument.'

Erroneous assumption

One very useful point was made in this case with regard to eligibility for BPR and the 'starting point' for consideration of relief. HMRC stated that, in its view, there should be an assumption that a property business will not qualify for BPR, and the taxpayer must show that sufficient additional services and facilities are provided in order to rebut this assumption. The FTT dismissed that stance, confirming that HMRC should keep an open mind and not start from any assumption that property-based businesses will not qualify for relief. ■

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