When holidays mean business

The Upper Tribunal has overruled the *Pawson* verdict. But this U-turn is not as bad as it seems, explains *Julie Butler*

Holiday lets were not investments for tax purposes. They should be considered a trade and their owners could claim business property relief (BPR) on those properties. So found the judges in 2012 case *Pawson v HMRC*.

But many owners of furnished holiday-home lets (FHL) could now be hit with inheritance tax (IHT) bills after the Upper Tribunal quashed the ruling in January 2013. It is expected that many FHLs will now revert to simple lettings after the *Pawson* decision was overturned.

Nicolette Pawson's property in Thorpeness, Suffolk, known as Fairhaven, was let fully furnished as a holiday home. It was jointly owned by the deceased, who held a 25 per cent share, and members of her family.

The First-Tier Tribunal (FTT) accepted that the property had been run as a business for more than two years before Pawson's death. The FTT also accepted that the family's use of the property for three weeks a year did not prevent it from being run as a holiday letting business.

Family members' use of the property reduced the level of activity and profit, but it was 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

HMRC has 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 who provide a substantial number of services to holidaymakers qualifying for the relief. (Another example of this strict interpretation is the grazing agreement as in *McCall v IRC [2009] STC 990*.)

The Upper Tribunal found there was no clear evidence that Pawson had 'substantial involvement' in managing Fairhaven for holidaymakers. Now, only those who are considered to be providing a substantial number of services to holidaymakers will be eligible for BPR on their FHLs.

The key evidence is about the active involvement in the FHL. The decision is not the depressing 'U-turn' it is perceived to be; the importance is substantial involvement.

Mr Justice Henderson said: "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 inate character of a holiday letting business rendered it outside the scope of a normal property letting business. The judge said it was typical example of a property letting business: the property was held mainly as an investment not as a trade.

Investment v trade

The activities generally deemed to relate to a letting activity are: finding holiday customers, keeping the property insured, rent collection, maintaining the property including repairs, and sorting out the booking arrangements.

The services that are part of the trading holiday operation are: providing welcome packs, including a 'meet and greet'; cleaning; being on call for problems; and making food and refreshments, such as breakfast, available. It is generally understood that these duties must be substantial to stop the business from being "mainly one of property investment".

Therefore, FHLs should be reviewed in regard to how they are run and whether there is potential for HMRC to deem involvement in the trading tasks substantial. Consider whether the mode of the operation should be changed as well as what further services could be provided and by whom. ■

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