The turn of the tide?

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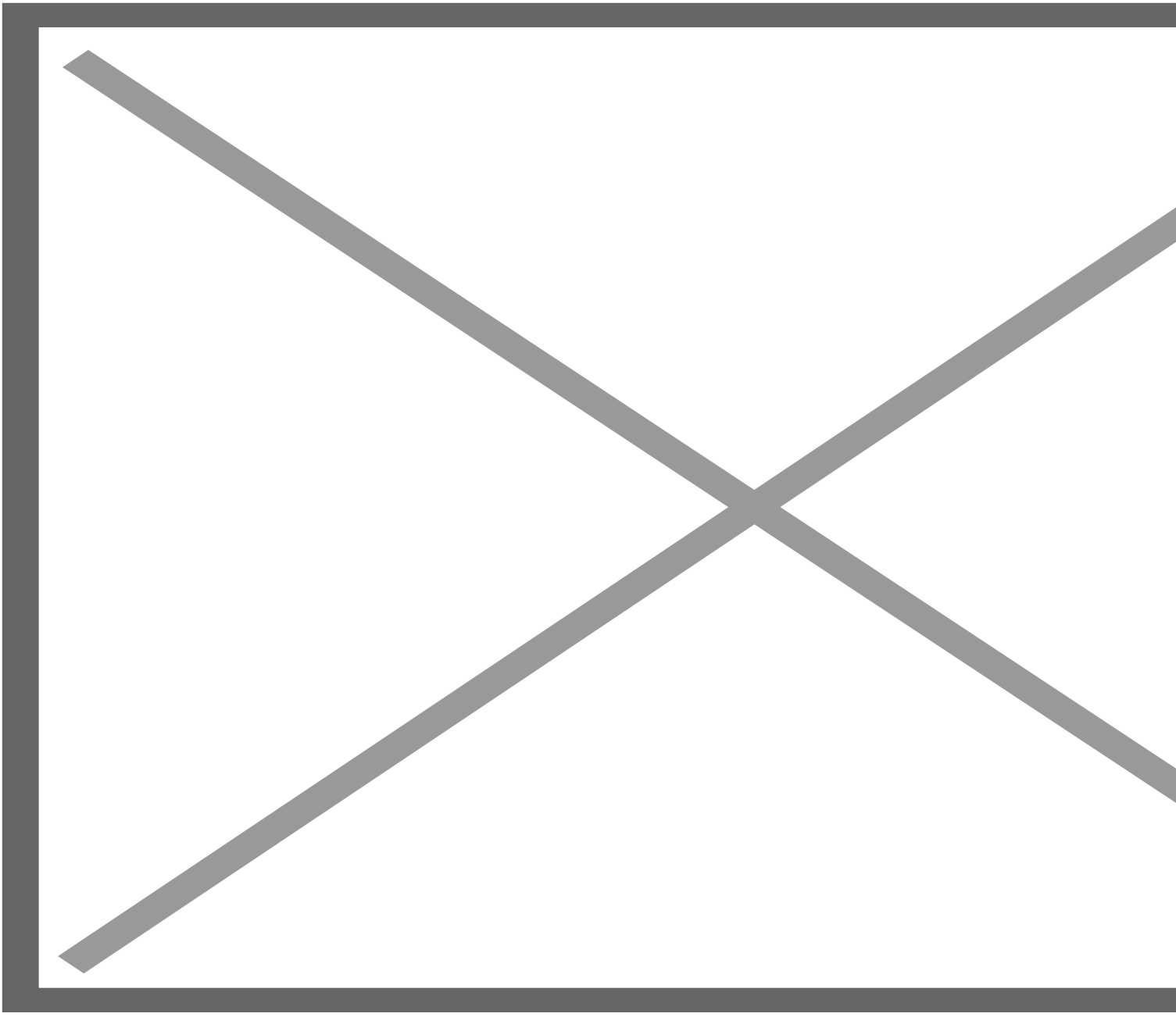

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Anthony Nixon examines the cases on business relief and investment

Key Points

What is the issue?

The view has arisen in recent years that holiday lettings are investment, for inheritance tax purposes, so that business relief is not available. A recent case, about livery stables, casts doubt on this approach.

What does it mean to me?

The correct approach is to consider every business on its own facts, and not to accept generic descriptions suggesting that some kinds of business are investment and that others are not.

What can I take away?

In any case where business relief may be an issue, analyse all the facts and all the activities in which the business is engaged.

Many tax practitioners will deal with holiday lettings in the context of income tax and capital gains tax (CGT). Provided the business meets the threshold for minimum weeks available for letting and actually let, it is taxed as if it was a trade, so that, for example, the profits can support pension contributions and disposal of the business is eligible for CGT entrepreneurs' relief.

Logically, one would expect similar rules to apply to inheritance tax (IHT) business relief, perhaps subject to a threshold such as satisfying the income tax rules for at least five of the seven years before any transfer of value. But we do not have a 'joined-up' tax system. While most sole trader or partnership businesses get 100% relief from inheritance tax (IHT), investment businesses do not (see Inheritance Tax Act 1984 s 105(3)). And HMRC seem to be determined to argue that holiday lettings are, invariably, investments.

In his article in the September 2017 edition of *Tax Adviser*, Keith Gordon pointed out that there have been more reported decisions on what is and is not an investment business than on any other aspect of IHT business relief. Since Mr Justice Henderson's 2013 judgment in *HMRC v Pawson's Executors* [2013] UKUT 050 (TCC), most of the reported cases seem to have gone in favour of HMRC.

Keith's September article focused on *Ross's Executors v HMRC* [2017] UKFTT 0507 (TC), released in June 2017. Like *Pawson*, Ross related to a holiday letting business and, as in *Pawson*, HMRC persuaded the tribunal that the business was mainly investment, so did not qualify for relief. Another reported case on holiday letting, A*nne Green v HMRC* [2015] UKFTT 334 (TC), had arrived at the same result.

HMRC's successes seem largely to result from the comments of the judge in *Pawson*: 'I take as my 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.' (paragraph 42) and '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 [*George and another (executors of Stedman) v HMRC* [2003] EWCA Civ 1763] 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)

Since *Pawson*, I have seen many claims for IHT relief for businesses in which farmers have diversified from agriculture; as well as holiday lettings, these included livery stables and storage activities. HMRC seem, in every case, to have asserted that, because these activities use land, they must be mainly investment. They follow

another comment of the *Pawson* judge that additional services and facilities are 'unlikely to be material because they will not be enough to prevent the business remaining mainly one of property investment'. (paragraph 45)

I have long felt that the *Pawson* approach was not in line with the Court of Appeal's approval, in *George*, of the Special Commissioner's analysis that land-based businesses covered a wide spectrum, from those which were the mere grant of tenancies to the running of a hotel or a shop: 'Although it is common ground that the exploitation of a proprietary interest in land for profit is in principle an 'investment' activity, I would agree respectfully with the Commissioner's comment as to the wide spectrum involved'. (paragraph 12)

Where there is a 'wide spectrum' it does not seem to me to be right that *Pawson* should interpret the Court of Appeal's 'in principle' as a 'starting point' from which it is very hard to be moved, whatever other activities are involved.

I was pleased to find, when the First Tier Tribunal published its decision in *Vigne's Executors v HMRC* [2017] UKFTT 632 (TC), just a few weeks after the Ross judgment, that I am not alone.

The *Vigne* judgment begins with a summary of what can be drawn from the two Court of Appeal cases (*George* and *McCall and another (executors of McLean) v HMRC* [2009] NICA 12) and continues: 'With such guidance in mind we approach this matter by primarily having regard to the plain words of the statute, but being mindful that the outcome of this appeal is essentially fact sensitive because it is on the basis of the facts that we have to apply the statutory language...We consider it implicit that the eventual outcome cannot be dictated by simply looking at the comparative value to be attributed to the occupation of land when compared to the provisions of services but must include such things as the subjective intention of the landowner, any manifestations on the part of the landowner as to whether the relevant land is being held purely as a long or medium term investment and what, if any, components of business activity existed...before a decision is made as to whether on the facts the outcome falls one side or the other side of what, in many, instances might be a very fine dividing line.' (paragraph 16)

Only towards the end of the *Vigne* judgment is *Pawson* considered, even though it is clear that HMRC put forward exactly the line of argument I have already described. The *Pawson* judge's comments about services not being sufficient to prevent the business of being one of holding an investment are quoted, followed by: 'With respect to the learned judge, that it is to transpose the statutory test. The essential question requires us to begin by asking the simple question: was the deceased carrying on a business, wholly or mainly, of holding investments. It is not correct to start with the preconceived idea that in any given situation, the business is wholly or mainly one of holding investments and then to ask whether there are factors that result in that preliminary view being altered. The proper starting point is to make no assumption one way or the other, but to establish the facts and then to determine whether, taken together, they indicate that the business is wholly or mainly one of holding investments.' (paragraph 44)

Vigne reminds us that most of the cases on what is and is not investment ask what a reasonable business owner would think: 'We are satisfied that any objective observer who had visited the site would have concluded that a business was being run from and on the land which did provide services to those who kept their horses on the land and that no properly informed observer could or would have said that the deceased was in the business of "holding investments"'. (paragraph 45)

I have seen it suggested that *Vigne* arrived at a different conclusion from *Pawson* because horses are less able to look after themselves than human holidaymakers, and that this is why holiday lettings are investments, but horse livery, with just a few services, is not. I do not think this is right.

I believe that the *Vigne* judgment was right to emphasise that 'the proper starting point is to make no assumption one way or the other' and to focus on the facts. I think the *Pawson* judge was probably right, on the facts, that

the business was mainly investment.

Where I think *Pawson* went too far was in giving too much weight to the approval, in *George*, of *Martin v IRC* [1995] STC (SCD) 5. The Court of Appeal had 'no doubt as to the correctness of the *Martin* decision on its own facts' (paragraph 26). Among other things, the Appeal Court approved the *Martin* case's analysis of activities 'directed at "making" the investment (finding tenants, negotiations over rent, granting leases, taking surrenders and the like)' as 'clearly activities of or attributable to the making or holding of investments' (paragraphs 19/20). On the facts of *Martin*, about a business park granting leases of, usually three years, this was no doubt correct. But can it have been right to apply this analysis to a holiday lettings business selling a week or two's occupation at a time? Surely these are sales not investments?

Vigne, like *George*, reminds us that the statutory wording is very simple. In commenting on the High Court decision in favour of HMRC, which they reversed, the Court of Appeal said, in *George*: 'I think, with respect to the Judge, that he placed too much reliance on the particular formulations used in [two other cases] instead of concentrating on the language of the statute. As I have said, the most important point about each of those decisions is that the Court was upholding the decision of the fact-finding tribunal.' (paragraph 58). 'Nor is it necessary to determine whether or not investment is "the very business" of the Company. The statutory language does not require such a definitive categorisation' (paragraph 60).

In my view we cannot say that a holiday lettings business is or is not an investment business, any more than we can say that a storage business or equine livery is or is not investment. Exactly the same is true of the various 'caravan park' cases that preceded *George*. They all depend on their specific facts, not on a generic description of the kind of business.

It will be interesting to see whether either *Vigne* or *Ross* is appealed and with what result. Let us hope the Court of Appeal has another opportunity, before long, to comment on whether I am right in thinking the *Pawson* 'starting point' was the wrong one.

In the meantime, when I am involved in cases in this area, I shall continue to direct HMRC's attention to the facts in each.