[2012] UKFTT 51 (TC)

TC01748

Appeal number:TC/2010/07062

INHERITANCE TAX – business property relief – holiday letting cottage – business? – yes – for gain? – yes – holding an investment? – no – appeal allowed

FIRST-TIER TRIBUNAL

TAX

NICOLETTE VIVIAN PAWSON (DECEASED)

Appellant

– and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: Judge Richard Barlow

Ms Susan Stott FCA

Sitting in public at Leeds on 7and 8 November 2011

Mr Nicholas Pawson for the Appellant

Dr Christopher McNall of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. Francesca Louise Thoresby Lockyer and Caroline Vanessa Thoresby Robertson, as the personal representatives of Nicolette Vivian Pawson, who died on 20 June 2006, appeal against a determination dated 1 October 2008, confirmed on review on 26 July 2010, by which the respondents decided that the Mrs Pawson's 25% share in a property known as Fairhaven at Thorpeness, Suffolk was subject to inheritance tax on a deemed disposal at the date of her death. The personal representatives claim that the property was entitled to relief as a "relevant business property" for the purposes of Part V Chapter 1 of the Inheritance Tax Act 1984 (the Act) as amended (ie sections 103 to 114).

2. The appellants are the daughters of Mrs Pawson and at the time of her death and for some time before that they had owned shares in the property, as they still do. The appellants were

represented by their brother Mr Nicholas Pawson who, although he is an actuary and clearly a very intelligent person as his presentation of the case demonstrated, is a layman so far as the law is concerned and so the appellants should be considered to be litigants in person. The commissioners were represented by Dr Christopher McNall of counsel.

3. At a hearing on 23 March 2011 the Tribunal had directed that the appellants were to serve a skeleton argument six weeks before the hearing of the appeal (26 September) unless they confirmed that their response to the statement of case, which they had already submitted, was to stand as their skeleton argument. They gave notice on 12 July that the response was to stand as their skeleton argument unless extra information was given by HMRC in the appeal bundles and confirmed on 23 September that as no additional information had been given the response was to stand as their skeleton argument.

4. The commissioners were directed to serve their skeleton argument by four weeks before the hearing (10 October) but failed to do so. The directions of 23 March directed the appellants to reply to the respondents' skeleton argument within one week of its being served. Mr Pawson had arranged to take two weeks holiday beginning on 10 October intending the first week to be spent considering and, if necessary replying to, the skeleton argument and the second week to be away from home. The commissioners filed their skeleton argument with the Tribunal on 14 October and claim to have sent it to Mr Pawson by email "on the evening of the 14 October" but Mr Pawson did not receive his copy before leaving for his holiday and so only came into possession of it on his return. No direct evidence was given about when the respondents' skeleton was served. Mr Pawson did not dispute that it had been emailed at the time stated and the respondents did not dispute his assertion that it had not actually come into his possession until his return from holiday.

5. Mr Pawson prepared a reply within a week of the actual receipt by him of the respondents' skeleton argument and submitted it to the Tribunal and served it on the respondents' solicitor on 31 October. We acknowledge that HMRC had applied for and had been allowed an extension of time for service of their skeleton argument so that they were not in breach of a direction when they served it on 14 October but their failure to comply with the date originally directed caused the delay in service by Mr Pawson so that he was not at fault for that.

6. Mr Pawson's skeleton argument prompted an aggressively worded four page letter from the respondents' solicitor alleging that the appellants had not been candid or straightforward with the Tribunal, had sought to secure an unfair advantage by "keeping your cards up your sleeve", had referred to documents not previously referred to, had sought to "patch holes in your appeal", had engaged in "litigation misconduct" and had acted unreasonably. The respondents also complained that the appellants had cited new authorities. *Customs and Excise Commissioners v Morrison's Academy* [1978] STC 1 was cited that had not been cited in the respondents' skeleton argument but that can hardly have come as a surprise to the respondents as it is extensively cited in *Customs and Excise Commissioners v Lord Fisher* [1981] STC 238 on which they did rely. The appellants also cited *Croft v Sywell Aerodrome* (1941) 24 TC 126 which was cited in *Webb v Conelee* [1982] STC 913 on which the respondents relied. The commissioners said they would oppose the introduction of the appellants' skeleton argument and would seek an award of costs.

7. At the hearing, the commissioners did object to the introduction of new evidence they alleged had been introduced in the skeleton argument but they had by then accepted that the arguments of law set out in the appellants' skeleton argument in response could not be objected to. As those arguments could all have been properly put forward in the appellant's closing submissions in reply to the respondents' arguments that was no concession on the part of the commissioners and was merely a recognition of the inevitable. The commissioners did object to the alleged new evidence but the Tribunal was not persuaded that any of what the appellants had said in the response was new evidence at all but rather it was simply an elaboration of what had already been disclosed which would have come out in the oral evidence of the witnesses anyway.

8. Some new documents were introduced by the appellant and the commissioners did object to their introduction but, somewhat inconsistently, during the course of the hearing Mr McNall repeatedly criticised the appellants for not producing other documents stating that they had had four years to produce documents to which Mr Pawson replied, correctly, that HMRC had had four years to ask for any they wanted to see and that those that had been produced earlier, such as accounts, effectively summarised those for the non-production of which he was being criticised, such as invoices. We directed that if the commissioners were in need of further time to consider any new documents they should apply to the Tribunal and we would rule on any such application. We did adjourn to give time for the commissioners to examine documents that were produced but, although Mr McNall continued to complain about late production of documents, he made no application for any further or extended time for examination of what were straightforward documents.

9. The commissioners' attempts to exclude evidence on what we consider to be mostly ill conceived grounds giving little if any justification for complaint and causing them no difficulty whatsoever in presenting their case, other than that caused by their delay in providing their skeleton argument that led to Mr Pawson's argument being late; was all the more unsatisfactory in light of the fact that it emerged at the end of the hearing that, unknown to the Tribunal as presently constituted, other cases have been stood over pending the result in this case. If the commissioners want to secure a decision which they will seek to rely upon in other cases the least they can do is to allow the Tribunal to reach its decision on a full consideration of the actual facts and not on some artificially restricted basis.

The issues

10. It was common ground between the parties that only two issues arose for decision and that, subject to those issues being decided, the rest was agreed and the relief would be allowed in respect of an agreed valuation. Those issues were whether, for the two years before Mrs Pawson's death, the uses to which Fairhaven had been put qualified it for treatment as a relevant business property and it was common ground that effectively that question raised the issue whether Fairhaven had been used for the operation of a business at all. The commissioners accepted that if the use of the property did amount to a business it would be a relevant business property, in principle, under section 105 of the Act and that it would fall within section 105(1)(a) as "a property consisting of a business or interest in a business" but only if it was carried on for gain. They contended that the use of the property did not constitute a business or interest in a business and that it was not carried on for gain. The second issue was whether, even if the use to which the property had been put amounted to the operation of a business or an interest in a business in principle and for gain, it was to be excluded from the term "relevant business property" by reason of section 105(3) of the Act on the basis that the business consisted wholly or mainly of "holding investments".

11. Section 103(1) of the Act provides that, for the present purposes, a business carried on otherwise than for gain is not to be regarded as a business.

Law relating to the business issue

12. Three authorities were cited to us on the question whether there was a business namely: *Commissioners v Lord Fisher*, *Morrison's Academy v Commissioners* and *McCall v IRC* [2009] STC 990 the last mentioned being a decision of the Special Commissioner that proceeded on the basis that the *Lord Fisher* criteria for deciding what amounts to a business were applicable to an inheritance tax dispute under the same statutory provisions as those applicable to this appeal.

13. In the *Lord Fisher* case Gibson J set out, at page 246, what are known as the six indicia of business. These were in fact taken from the submissions of counsel for the commissioners with which the taxpayer's counsel also agreed in general terms and were clearly endorsed by the Judge. He also stressed that the whole of an activity as it is carried out in all its aspects is to be

considered. The judge also referred to a further submission of counsel and we read the judgement as having endorsed this submission as well as the submission about the indicia. It was in the following terms:

"Fifthly and finally, in this submission, certain aspects of the activity are not to be considered as relevant for determining whether the activity is a 'business', or are not decisive of that question, namely whether the activity is pursued for profit or whether pursued for some other private purpose or motive."

That submission was considered in detail between page 251b and 252a. Gibson J drew a distinction between a case where "an activity of pleasure and social activity" was supported by contributions from friends and relations and a case where an otherwise similar activity involved making taxable supplies to consumers.

14. The Special Commissioner in the *McCall* case accurately summarised the indicia of business set out in the *Lord Fisher* case as follows and we adopt that summary:

"The six indicia were these: (a) whether the activity is a serious undertaking earnestly pursued, or a serious occupation, not necessarily confined to commercial or profit making undertakings; (b) whether the activity is an occupation or function actively pursued with reasonable or recognisable continuity; (c) whether the activity has a measure of substance as measured by the quarterly or annual value of its outputs (the original words are "taxable supplies" but they derived from a VAT case); (d) whether the activity is conducted in a regular manner and on sound and recognised business principles; (e) whether the activity is predominantly concerned with making supplies (again the original words were "taxable supplies" but that was in a VAT context) to consumers for consideration; and (f) whether the supplies are of a kind which are commonly made by those who seek to profit from them. Of these (b) to (f) derive from the judgements of the Court of Session in *Morrison's Academy Boarding Houses Association* [1978] STC 1, and I note that the reasoning of their Lordships in that case derives indicia (b), (c) (e) and (f) specifically from a consideration of the VAT legislation. Nevertheless they seem to me to be helpful criteria in the context of IHTA against which to examine an activity even if they are not conclusive".

15. Mr McNall contended in his skeleton argument that all the indicia would have to be satisfied to a meaningful degree before the activities of providing holiday accommodation could be a business. We do not agree. It is clear from the *Lord Fisher* and *Morrison's Academy* cases that some of the criteria may be irrelevant in some cases. In *Lord Fisher* Gibson J held as follows:

"As I understand their judgements, the learned judges in [*Morrison*] did not thereafter set out to lay down principles which, if satisfied, would in all cases demonstrate that an activity must be regarded as a 'business' within those provisions. Those aspects of an activity, to which their Lordships drew attention, and on which counsel for the Crown has relied in formulating the indicia listed above, plainly describe the main attributes of any activity which will be regarded as falling within the concepts of 'business' and 'trade, profession or vocation', and clearly they are useful tools, some perhaps more useful than others, for the analysis of an activity and for the comparing of it with other activities which are unarguably 'businesses'. The courts, however, cannot, by the formulation of tests and by the expounding of indicia, substitute any test or phrase different from that set out in the statutory provision and I am sure that their lordships had no intention of doing so".

Law relating to the investment issue

16. The parties cited several cases concerning the issue whether or not any business that was being operated by the exploitation of the property consisted wholly or mainly of holding an investment.

17. Paragraph [11] of the judgement of Girvan LJ in the Court of Appeal of Northern Ireland in *McCall* was cited for the proposition derived from *Weston v IRC* [2000] STC 1064that the holding of an investment is not a term of art and that it should be given the meaning that would be given by an intelligent businessman and that just because the person holding it has to take active steps that does not prevent it being an investment. Girvan LJ also held at paragraph [14] that where a landowner derives income from land he will be treated as having a business of holding an investment notwithstanding that in order to obtain the income he carries out incidental maintenance and management work, finds tenants and grants leases.

18. The case of *George* is particularly significant as it is a Court of Appeal judgement which deals with the same statutory provisions as the present appeal. In that case Carnwath LJ cited with approval the following passage from the Special Commissioner's decision in *Martin* (the emphases are those of Carnwath LJ):

> "24. Commenting on that passage [from *IRC v Fry* [2001] STC 1715] in the *Martin* case, Mr Oliver said:–
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> > "The income attributed to the rent was taxable as such: the income arising from the latter class of activities, eg cleaning, heating, and lighting provided for a separate fee came from a separate source and was potentially taxable as trading income. The distinction is I think equally applicable here. The activities which a landlord carries out *because he is obliged to under the lease* are incidents of the tenancy and *so fall on the 'holding investments' side of the equation.* The business activities, if any, carried out by the landlord for gain and which are not required by the lease fall on the other side of the equation. The activities carried on by the landlord which are *not required under the lease and for which he receives no separate consideration* will fall on the 'holding investments' side of the equation *if they are connected with and incidental to the holding of the property as an investment.*" (para 21, emphasis added)".
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> "25. I have underlined the passages most material to the argument in the present case. They were applied by another Special Commissioner, Mr Everett, when holding that a caravan park did not qualify for relief (*Powell v IRC* [1997] STC (SCD) 181). In that case the owner carried out the ordinary maintenance and security work of the caravan park, including such activities as grass cutting and painting and cleaning site vans, and helping when the electricity or gas supply broke down. The Commissioner, having cited the passage to which I have referred from *Martin*, said:
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> > "Most of the activities which she carried out were either required under the terms of the lettings or pursuant to the terms of the caravan licence which governed the lettings."

19. It is important to note, for the purposes of this appeal, that the activities which potentially need to be analysed in respect of the investment issue are of three types. First are those which a landlord is required to carry out under a lease, second are those carried out for gain and third are those which although not required by the lease are connected with and incidental to the holding of the property as an investment.

20. The reference to Slesser LJ in the following paragraphs from the judgement of Carnwath LJ in *George* are references to comments Slesser LJ made in *Fry* distinguishing services such as the supply of cleaning light and heat separately charged for by a landlord and therefore falling outside the investment category.

27. However, I would make two comments of relevance to the present case. First, I agree in general terms that property "management" is part of the business of "holding" property as an investment (cf *Webb v Conelee Properties Ltd* (1982) 56 TC 149, 157C-E). In the case of a building held for letting, management no doubt includes the activity of finding tenants and arranging leases or licences, and that of maintaining the property as an investment. But I would not extend that term

to additional services or facilities provided to the occupants (such as those referred to by Slesser LJ), whether or not they are included in the lease and covered by the rent. In the case of a building for letting, it is unlikely to be material. They will not be enough to prevent the business remaining "mainly" that of holding the property as an investment.

28. Where it does matter, in my view, the characterisation of such services depends on the nature and purpose of the activity, not on the terms of the lease (or, where relevant, a site licence). It is true that, in *Fry*, Slesser LJ noted the fact that the particular services mentioned (cleaning, heating and lighting) were optional under the lease, and that a separate charge was made. That was treated as a reason for not regarding them as "mere incidents" of the tenancy. However, the converse does not follow. There is nothing in that judgement to support the view that, merely because services or facilities are required by the lease, and their cost is included in the rent, they lose their character as services, and become part of the "holding" of the investment.

21. Carnwath LJ's conclusions include the following passages.

> "60. For the reasons I have given, I think that was the wrong approach. The section does not require the opening of an investment "bag", into which are placed all the activities linked to the caravan park, including even the supply of water, electricity, and gas, simply on the basis that they are "ancillary" to that investment business. 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. In the present context, it gives insufficient weight to the hybrid nature of a caravan site business, as I have explained. The holding of property as investment was only one component of the business, and on the findings of the Commissioner it was not the main component. In my view, the Commissioner's overall approach was correct in law, and he reached a view which was open to him on the facts.
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> 61. I would add that I am happy to be able to arrive at this conclusion. I find it difficult to see any reason why an active family business of this kind should be excluded from business property relief, merely because a necessary component of its profit-making activity is the use of land".

The evidence and findings of fact

22. Fairhaven is situated on the Suffolk Heritage Coast near Aldeburgh, Snape and the Suffolk Heaths Area of Outstanding Natural Beauty. It is therefore in a holiday area. The property, which is a large bungalow, overlooks the sea and has direct access onto the beach. The business contended for by the appellants is that of letting as a holiday cottage. Letting is the normal term used in such cases though the visitors have contractual licenses to occupy rather than leases. Typically the lettings are for two weeks at most and many are for less than a week for example long weekends. The bungalow can accommodate up to eleven people. It is set in its own grounds of about .4 of an acre.

23. The property has been owned by members of the Pawson family for some time including Mrs Pawson's husband who died in 2002. Mrs Pawson died on 20 June 2006 at the age of 81 and she had been in ill health for about 18 months before her death, suffering from cancer.

24. The income from the property in the last three financial years before Mrs Pawson's death had been 2003/04 £4,342.99, 2004/05 £6,072.51 and 2005/06 £8,120.00. That income generated profits of £680.27 in the year 2003/04, £802.32 in 2004/05 and a loss of £2,071.61 in 2005/06. The income in 2006/07, during which year Mrs Pawson died was £16,589.67 with a profit of £4,449.66.

25. In each of those years family members had occupied the property for three weeks during the holiday season. In their Statement of Case the commissioners alleged that without the family's payments for those three weeks there would have been a loss in each of the three years before

Mrs Pawson's death but that was based on an assumption that the family members who occupied the property would pay the same amount as a holiday maker would have paid. That was not the case as stated in evidence by Mrs Lockyer, Mrs Robertson and Mr Pawson which evidence was not challenged on this point. The family members who occupied the property were Mrs Pawson's two daughters and they paid amounts which they had calculated, or which had been calculated for them, from HMRC's literature for payments for private use by way of adjustments in accordance with the Notes on Land and Property. It was not contended that they had calculated that amount incorrectly.

26. The evidence of the witnesses, which we accept was truthful and accurate in this respect, was that the loss in 2005/06 was caused by a large expenditure on re-decorating and improving the property. We note that in that year the income was higher than in the two previous years in which profits had been made and so we are satisfied and find that had it not been for the expenditure on re-decorating and improvement a profit would have been achieved in 2005/06. The evidence was that the extra expenditure was decided upon to improve the attractiveness of the property and therefore to increase the income.

27. A good deal of oral evidence was given about the operation of the property as a holiday home and it is the case that Mrs Lockyer and Mrs Robertson had an imperfect recollection of when events occurred which we find unsurprising after the lapse of time. Subject to that, we found them to be accurate and truthful witnesses as was Mr Pawson. Some of the items of expenditure were not individually shown in the accounts but we are satisfied that the figures for profits and the loss are accurately reflected in the totals.

28. Mrs Robertson's evidence was that over the years the expectations of holidaymakers have increased so that, for example, it is expected that clean bedclothes will be provided and that they will not need to bring their own. Clean bedclothes are now arranged through a laundry service and by the person who is employed as the cleaner and caretaker. However, it turned out when the documents were examined again that the laundry service only started after Mrs Pawson died.

29. Television and telephone have been provided at the property for a number of years as the accounts confirm from at least 2003/04. Until June 2005 Mrs Pawson had done most of the running of the holiday letting and things like advertising had not kept up with modern developments such as advertising on the internet. At about that time Mrs Robertson became more involved and the family had discussed how things could be improved and that led to the re-decorating.

30. The cleaner cleans the property between each letting and the garden is attended to and that has been the case for all the relevant times for this appeal.

31. Mrs Robertson said that some repair or replenishment of supplies such as cleaning materials is needed after about one in three lettings and the cleaner/caretaker inspects the property regularly.

32. The property is fully furnished, heated by night storage heaters, hot water is turned on before visitors arrive, the kitchen is fully equipped and these services were provided at all material times.

33. There was some doubt raised by the respondents as to whether the insurance on the property covered letting but we are satisfied that it did, at least for some time before Mrs Pawson's death because the policy is called a 'household – commercial' policy.

34. It was put to Mr Pawson that Mrs Pawson had only allowed people she knew to rent the cottage and he denied that. We believed him.

35. Mr Pawson produced evidence from an estate agent giving it as her opinion that the property could be let at about £1,000 per month on a long let. He contrasted that with the amount

potentially available as a holiday let and indeed with the amount achieved in the year 2006/07. He argued that the difference reflected the value of the services provided with the right of occupation.

Our findings

36. We find that the exploitation of Fairhaven has amounted to the operation of a business during the years we have examined and therefore for more than two years before Mrs Pawson's death. We have taken into account all the evidence given by the witnesses and we have had regard to the documents in making that finding.

37. The operation of the property as a holiday cottage for letting to holidaymakers was a serious undertaking earnestly pursued. Mrs Robertson explained to us the inconvenience she had suffered as a result of needing to travel to the cottage from time to time when an emergency occurred and the dealings she had to have with various people and we also regard the efforts to advertise for lettings is important in this respect.

38. Clearly there is and has been reasonable continuity in the operation. There has been no year in recent years when it was not used for letting and although inevitably the main period of occupation is during the summer months that is only to be expected given the location.

39. The annual outputs are certainly not de minimis and are an activity having a measure of substance.

40. Some criticisms of the effectiveness of the operation are no doubt possible, albeit understandable given Mrs Pawson's age at the time she was running the operation, but the basic principles on which the activity is run are regular and sound. The property is not being allowed to go to ruin, there are no debts and the owners are intending to achieve what they can by advertising and by keeping the property clean and up to a reasonable standard. Clearly the use of the property by family members for three weeks a year reduces the level of activity and the profit but in our view that is not enough to prevent the property being run on sound principles. In this context we would ask whether a property in a prime location, say in Central London, lettable at a very large fee as holiday accommodation would cease to be run as a business and would, for example, escape VAT registration accordingly; just because the owner occupied it occasionally.

41. The activity is clearly intended to amount to making supplies to consumers. That is all it does except for the three weeks a year use by family members.

42. The supplies are clearly of a type that are commonly made by those seeking to profit. In fact the operation had made a profit in two of the three years before Mrs Pawson's death and was apparently running profitably in the part-year in which she died.

43. The business was being conducted with a view to gain and we hold that that satisfies the "for gain" requirement in section 103(3) of the Act. In the year when the loss was made it was only made because the owners wanted to ensure the continued profitability of the business.

44. On those findings, the question whether the business consisted of one which consisted wholly or mainly of the holding of an investment does require to be examined.

45. On the facts of this case there are clearly significant services provided to the occupiers of the property. Those services are a significant part of the reason why the occupiers are prepared to pay what they do pay for the package of benefits they receive when they book to use the property as a holiday destination. The fact, even if it is a fact, that the appellants can provide those services at a relatively low cost to themselves compared with the amount they can charge for the package appears to us to be irrelevant.

46. We note again the passages quoted from the *George* case. At paragraph 17 above we cite the passage from Carnwath LJ's judgement in which he cites with approval from the decision in the *Martin* case referring to the three types of activities.

47. The first is the activities a landlord carries out because he is obliged to do so under the lease. We note the phraseology and ask ourselves whether a holiday let is really to be equated with a landlord's obligations under a lease at all. Certainly, the right the holidaymaker has to occupy the premises is under the same contract as the provision of the services that are promised (such as cleaning heating etc.) but it is unrealistic to equate that with a formal lease typically of much longer duration and under which the services are very much secondary to the right of occupation.

48. The second type of activity is the separate provision of services carried out for gain and that is clearly not part of the holding of an investment on any view.

49. The third category is services which are not required to be carried out under the lease but which are provided without separate consideration. These only fall within the holding of investments heading if they are connected with and are incidental to the holding of the property *as an investment.* No doubt some of the services provided in this case are not specifically required to be carried out under the holiday letting contract but such services can hardly be said to be incidental to the holding of the property as in investment.

50. We have no doubt that an intelligent businessman would not regard the ownership of a holiday letting property as an investment as such and would regard it as involving far too active an operation for it to come under that heading. The need constantly to find new occupants and to provide services unconnected with and over and above those needed for the bare upkeep of the property as a property lead us to conclude that no postulated intelligent businessman would consider such a property as Fairhaven to be correctly characterised as an investment. He would consider it to be a business asset to be exploited as part of the provision of services going well beyond an investment as such.

Conclusion

51. We therefore allow the appeal.

52. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

RICHARD BARLOW

TRIBUNAL JUDGE

RELEASE DATE: 14 December 2011