

BPR ON FURNISHED HOLIDAY LETS



Background

Many rural landowners looking to diversify their business interests have considered converting property for use as furnished holiday lets.

In addition to potentially increasing the property's yield, particularly if located in a tourist hotspot, there are potentially valuable tax advantages if the business is sufficiently engaged with the customer experience and goes significantly above that of simply letting a property.

This note focusses on the availability of Business Property Relief for such businesses for inheritance tax purposes.

What is Business Property Relief?

Business Property Relief ('BPR') is a valuable inheritance tax ('IHT') relief for qualifying business assets. In the context of a furnished holiday business, BPR may be available on the value of a business held by an individual, partnership or trustees, or on shares in an unquoted company carrying out a furnished holiday business.

If BPR applies, relief for inheritance tax is usually available on the whole value, which can include the land and property forming part of the furnished holiday business.

This contrasts with the usual situation for let property where BPR would not ordinarily be available and the full value of the property would be subject to IHT unless other reliefs apply.

Conditions for BPR

The first prerequisite is that there must be a genuine business being operated. The business does not necessarily need to be profitable but it must be carried out with a view to profit.

This means that there must be an earnest endeavour to carry out the business on commercial terms, rather than simply running a property as a hobby or pastime.

The business must also be 'wholly or mainly' a trading business rather than an investment business. 'Wholly or mainly' in this context means greater than 50%. It can be difficult to distinguish between investment and trading activities, particularly in the context of furnished holiday lets, and a body of case law has developed on the matter.

The courts over a number of years have established five indicia that should be considered in the context of whether the business is wholly or mainly trading, which are as follows:

- Time spent by owners and staff on investment and trading activities
- How the capital of the business is employed as between investment and trading activities

- Turnover by activity
- Profit by activity
- Overall context of the business

When considering each of these indicia, it is important not to place too much emphasis on any one; the courts will ultimately examine the position of the business 'in the round'.

Trading vs investment

It is not always easy, for furnished holiday businesses, to distinguish between investment and trading activities. In simplistic terms, a property investment business consists mainly in collecting rent and maintaining the property, which is passive exploitation of the asset. On the other hand, assets held by a trading business are used in a more active sense, where the property serves as a setting or location in which a trade is carried on.

Historically HMRC took the view that any furnished holiday letting business where lettings were short term and where there was substantial involvement by the owner or an agent qualified for BPR. However, in 2013, HMRC published a change in their view as to the availability of BPR on furnished holiday lettings and now more closely scrutinise claims for BPR. In particular, HMRC are looking more closely at the level and type of services rather than who provided them.

Pawson vs Revenue and Customs Commissioners

The 'Pawson' case followed the change in the interpretation of the BPR rules by HMRC. The case was ultimately won by HMRC in the Court of Appeal and relief was denied to the taxpayer.

In this case, an analysis of the activities carried out at the holiday home on the coast in Suffolk indicated that the extra services provided were both relatively minor and ancillary to the provision of accommodation. Such services included cleaning, the provision of a welcome pack, television and telephone. Although these were viewed as non-investment activities, they were insufficient to demonstrate that the business was more of an active trade than an investment business.

Following this highly publicised case, BPR on furnished holiday lettings became a contentious area and the quality of trade required to achieve relief is much higher.

Executors of the Estate of Ross (deceased) vs HMRC (2017)

Further doubt as to the availability of BPR on furnished holiday lets has been raised following a recent case which was won by HMRC. In this particular case, HMRC accepted that the level of services provided to guests was above the standard level of services for self-catering cottages. In particular the claimant was able to evidence the presence of a resident on-site caretaker, a member of staff to welcome guests and ensure their holiday ran smoothly and guests were provided with access to a hotel which offered additional services including meals and laundry.

The courts also considered the percentage of direct property costs incurred by the business and found that more than half of the costs related to the provision of holiday services.

Surprisingly, the level of services and cost of activities were still insufficient to overturn the view that the business was essentially one of owning and holding land to earn rental income. The main focus of the appellants' argument was that they provided a "holiday experience". However HMRC argued that advertising material did not describe the cottages as anything other than self-catering accommodation. Ultimately, what guests were paying for was access to the property for a specific period, that is an activity which consists mainly of the investment in property.

This decision may be appealed by the taxpayer, but if not, or if that is unsuccessful, it appears that the bar has again been raised for furnished holiday let businesses seeking valuable IHT reliefs.

Qualities of a trade

In view of these cases, taxpayers claiming relief will need to be able to demonstrate that there are significant additional services provided to customers. There are no hard and fast guidelines, but some additional services that might indicate a more active trade are:

- Provision of at least some meals
- A website
- Personal welcome on arrival
- Swimming pool and maintenance
- BBQ and other entertainment facilities

- Arranging for the delivery of a daily newspaper
- Organising car hire

It is not essential for all customers to enjoy all of the additional facilities, but it is the making them available which will improve the claim. Ultimately HMRC will be looking for the business to provide services more in line with what one might expect from a hotel.

Documentation

HMRC have made it clear that substantial claims for BPR on furnished holiday let businesses are almost certain to face scrutiny. Therefore, it is important to retain documentation that might be helpful in this context.

When reviewing the trading status of a business, the historic financial statements, statutory or internal accounts are important and can be helpful in showing that the additional services provided represent over 50% of the activity of the business. Turnover should distinguish between the basic rent received and income from other, value added services. Similarly, expenses should also be split between the general upkeep of the buildings and those relating to additional services. HMRC will also consider the percentage of property management costs out of total expenses as an indication of whether the business is 'wholly or mainly' an investment business.

Other documentation should be retained, and may be particularly helpful in demonstrating that management time is spent attending mainly to customer relations and additional services, rather than simply to collecting rents and maintaining the building.

Conclusion

In light of recent cases, owners of furnished holiday lets should consider their position more carefully. For claims for BPR on furnished holiday lets to succeed, the business must provide guests with an experience or holiday rather than simply a place to stay. HMRC expects the services offered to be more similar to that of a B&B or a hotel where there is provision of significant other services as well as basic accommodation.

It may be possible to make changes to existing businesses to increase the likelihood of success and to help demonstrate more clearly that a particular business is a trading one. Furthermore, appropriate record keeping and documentation will be important to help prove the case, as any substantial claim is likely to attract scrutiny from HMRC.

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