Technical Connection

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BUSINESS PROPERTY RELIEF & FURNISHED HOLIDAY LETTINGS

The issue of whether inheritance tax business property relief is available on a business consisting of furnished holiday lettings has been a thorny issue over the years.

The big question is whether such a business is trading (business property relief available) or an investment (no business property relief available). Frequently a furnished holiday letting business may fall somewhere in between! The dividing line will frequently be the level of services the business supplies to tenants of the holiday let – ie. bed linen, food and drink etc. But what level of service is needed to secure the relief?

The relevant issues on this were examined in the case of Pawson v HMRC (2013) UK UT 50 which examined Mrs Pawson's claim to business property relief on her deceased husband's furnished holiday letting business.

The case was first heard by the First-tier Tribunal (FTT). The FTT held that the deceased's letting of holiday accommodation was a trading business. The FTT ruled that a property used for holiday lettings was not 'wholly or mainly' an investment because an 'intelligent businessman' would have regarded it as a business which involved a fairly high level of owner activity. Most intelligent businessmen would therefore regard a furnished holiday letting business as a trade involving the provision of a reasonably high level of services.

On appeal by HMRC, the Upper Tribunal (UT) decided that the Pawson letting operation was, in fact, an investment business. The UT felt that it was necessary to look at the business "in the round". On this basis, there was nothing to distinguish it from any other actively managed furnished letting business of a holiday property. There was therefore no basis for concluding that the services provided were to such an extent that the business had more attributes of a trade rather than an investment business.

The executors sought to take the case to the Court of Appeal, and launched a fighting fund to help them pay the legal fees. However, the final oral application for leave to appeal has now been denied by the Court of Appeal on the grounds that there would be no realistic prospect of the appeal succeeding, as the services provided were clearly insufficient to place the business at the business property relief end of the investment/non-investment spectrum.

It is not yet clear to what extent HMRC is now likely to use this case as a precedent to deny business property relief to any furnished holiday lettings but it is clear that only those providing significant ancillary services will have any chance of securing relief. While each case will continue to be judged on its own facts, this creates a great deal of uncertainty for owners of furnished holiday lettings who are already providing services which they consider to be sufficient for relief to apply.

COMMENT

From the Tribunal judgments it would seem to be the case that in order to be regarded as trading, owners of furnished holiday lettings need to provide services that go beyond what customers want and, indeed, what owners might be prepared to provide. If individuals wish to secure inheritance tax business property relief on their furnished holiday lettings business they should therefore:

- *provide/offer a high level of services. For example, they should, if possible, supply typical hotel facilities, such as the provision of newspapers, early morning calls, daily cleaning, breakfast and other meals and transport facilities;*

- *if the furnished holiday lettings are on a farm, it would be appropriate to ensure holiday lettings are part of a mixed farm or farming operation which may be treated as a subsidiary part of a wider business; and*

- *in all cases it is appropriate to ensure the holiday letting becomes part of a wider holiday/leisure experience (e.g. riding holidays and woodland etc).*

It should also not be forgotten that income from furnished holiday lettings will normally count as relevant UK earnings for the purposes of registered pension plans and can therefore be used to support a payment to a personal pension plan or other registered pension.

EMPLOYER-FINANCED RETIREMENT BENEFITS SCHEMES

HMRC enquiries into certain arrangements
Opportunity to settle an enquiry by agreement

From 6 April 2006 (Pensions "A" Day) unapproved schemes [the prime example of which was the Funded Unapproved Retirement Benefits Schemes (FURBS)], which did not choose to satisfy the conditions needed to be registered, were recategorised as non-registered schemes and renamed Employer-Financed Retirement Benefits Schemes (EFRBS).

Under the relevant legislation, introduced in 2006, contributions made by an employer to an EFRBS from 6 April 2006 to 5 April 2011 were not deductible for corporation tax purposes until benefits had started to be paid and taxed. As far as the employee was concerned, there was no assessment or NICs on the employer's contributions but the benefits were subject to income tax, and NICs in certain circumstances, when received.

HMRC is aware that some EFRBS have been established which are designed to trigger a corporation tax deduction for the employer without any corresponding taxable benefit arising on the employees under the scheme.

HMRC strongly believes these arrangements do not work and has opened enquiries with employers who it believes have established such arrangements. However, in order to streamline the settlement of these cases, HMRC is now writing to those employers offering to settle the open enquiry by agreement which will minimise costs for employers and HMRC. The letter from HMRC puts forward two options and states that it expects the employer to agree that one of two options is applicable to them. The options are:

> **Option 1**
>
> No corporation tax deduction is due until benefits are paid out by the EFRBS.
>
> **Option 2**
>
> PAYE and NICs are payable on the contributions in which case a corporation tax deduction can be made on those contributions.

If an employer considers neither option applies they need to state they do not wish to take advantage of the opportunity to settle the enquiry by agreement. The opportunity to settle in this way remains open until 31 December 2013, and any settlement with HMRC will be concluded by 30 June 2014.

THE TRANSFERABLE NIL RATE BAND AND THE IMPACT ON LIFETIME TRANSFERS

As readers are no doubt aware many people die without using all or part of their inheritance tax nil rate band (NRB). However, where the deceased was married, the surviving spouse's estate can claim some or all of the unused NRB – known as the transferable nil rate band (TNRB).

In this situation there is often confusion as to whether it is possible to offset the TNRB against lifetime transfers that have become chargeable on the surviving spouse's death.

Consider the following example:

A husband died in 2012 without having made any prior chargeable lifetime transfers (CLTs) and leaving all of his estate to his wife.

On the wife's subsequent death, her personal representatives can make a claim for a TNRB from her husband. Can the TNRB be offset against chargeable lifetime transfers the wife had made in the 7 years before her death?

It is helpful to consider some figures. Let's call the wife A, and let's assume she makes PETs of, in total, £1,500,000 to three donees on 1 May 2014. A dies in May 2019. The PETs fail and tax on the failed PETs will be calculated (taking account of any CLTs made by A in the 7 years preceding her PETs).

Any TNRB claimed by A's personal representatives will enhance A's nil rate band available on her death.

As there is additional tax due on the PETs by virtue of the death of A, any TNRB can be used to reduce or eliminate the additional tax due on A's death as all it has done is increase the nil rate band available to A's estate. In other words, the usual rules apply but A's nil rate band is bigger.

It should, however, be noted that a TNRB cannot be used to reduce **lifetime** tax due on a gift (i.e. had the PETs, when made, instead been chargeable lifetime transfers on which immediate IHT was payable) although it could be taken into account in reducing any additional IHT payable on death if a person dies within 7 years of a CLT (which would include failed PETs).

A's personal representatives would need to have claimed the TNRB within 2 years of A's death and they must include the PETs (now CLTs) on the IHT return. It would be prudent for them to make all three donees fully aware of their potential additional tax liability unless the donees are already aware of the position.

COMMENT

Whilst in this case the TNRB can help to reduce the IHT on the failed PETs it does not eliminate it. For that reason it would have made sense for the three donees to effect decreasing term assurance on the life of A to provide for the payment of the IHT in the event of A's failure to survive the gifts by 7 years.

I'LL HAVE 30% MORE, PLEASE

The Association of British Insurers (ABI) has issued an 'annuity window' - it is worth looking through.

The financial services industry is awash with league tables – just think of all those comparison websites – so the news that the ABI has launched its own annuity rate table may not seem that noteworthy. Add in the fact that the rates are deliberately out of date and the ABI's efforts sound a waste of time.

In terms of telling you who to go to to buy an annuity, the ABI's table is not much use as it only covers one age (65) and two different types of non-increasing annuity. However, what it does do is include a range of annuity providers that do not normally appear in other annuity league tables because they only offer annuities to a captive audience – their existing pension policyholders.

The ABI's broader collection of annuity providers highlights the differences between the best and worst rates in a dramatic way. For example, the table below shows the top and bottom income levels, based on a 65 year old Wimbledon resident wanting to invest £18,000 in a single life level annuity.

	No health issues	Smoked for 10+ years and overweight
Best annuity	£1,099.92	£1,277.76
Worst annuity	£839.52	£979.52
Best-worst gap	31.0%	30.4%

The 30% gap between the best and worst rates is one reason why both the Financial Conduct Authority and the Department for Work and Pensions have expressed concerns about the way in which the annuity market operates. At the top end there is undoubtedly competition between providers, with rates regularly moving in response to relatively small changes in long-term interest rates. On the bottom rungs, where often there are companies that only sell to their own policyholders, competition seems rarely to be an issue.

COMMENT

This reinforces the message that for those considering turning their pension pot into a retirement income, the chances are their pension provider will not offer the best annuity deal.

EVIDENCE TO SUPPORT 'DISTINCT BREAK' CLAIMS VITAL IN DETERMINING RESIDENCE STATUS

The First-tier Tribunal has recently found that the taxpayers (Mr and Mrs Rumbelow), who could produce no evidence to suggest they had made a 'distinct break' with the UK, had failed to show that they had taken up permanent residence elsewhere.

Mr and Mrs Rumbelow moved to Belgium from the UK in April 2001. Shortly after having been granted Belgian residency, they sold or gifted a number of properties, bought for the purposes of investment, on the basis that they would not be subject to capital gains tax (CGT) in the UK on disposals in 2001/02 and subsequent tax years.

Following the opening of an enquiry by HMRC into their CGT liabilities, Mr and Mrs Rumbelow were asked to substantiate their alleged movements during the relevant period. While it was undisputed that they had made several visits to the UK during the 2001/2002 tax year, including visits to their children (one of whom was still a minor), evidence of cash withdrawals, debit card purchases and business transactions contradicted their claims that the return visits stayed within the limits set for non-residency at the time.

Accordingly (and perhaps, unsurprisingly) the Tribunal decided that the Rumbelows' settled and usual abode remained their fully-furnished house in Cheshire at which their 15-year old daughter still resided for some of the time. HMRC's decision to levy CGT was therefore upheld.

COMMENT

Although this case involved a review of the law in force prior to the introduction of the Statutory Residence Test (SRT) in April 2013, it highlights the fact that proper evidence and record-keeping are crucial to establishing non-residence status - even after the introduction of the SRT.

SHORT-TERM OCCUPATION DOES NOT AMOUNT TO RESIDENCE FOR CGT PURPOSES

The capital gains tax principal private residence relief will provide a total exemption from CGT when a gain is realised by an individual on the disposal of a property that has been their sole or main residence throughout the whole period of ownership (but ignoring the last 3 years). The relief is complex and restricted in a number of circumstances, for example where the residence has been let for a period or where the purchase was made wholly or partly for the purpose of realising a gain. This latter point is illustrated by the Paul Gibson case.

In Paul Gibson v HMRC [2013], Mr Gibson was denied capital gains tax private residence relief on the sale of a house which he had demolished and rebuilt – even though it was occupied by him as his main residence for a short period.

The facts of the case were that Mr Gibson bought the house, with the financial assistance of a friend, and lived in it as his only home before applying for planning permission. The house was subsequently demolished and a substantially larger house built in its place. Although Mr Gibson stayed in the new house for four months finishing off works, HMRC denied him capital gains tax private residence relief on the gain on the sale on the basis that the house had been acquired wholly or partly for the purpose of realising a gain.

The First-tier Tax Tribunal were split in making a decision, so the Judge's view – which accorded with that of HMRC – prevailed: the house had been acquired wholly or partly for the purpose of realising a gain on disposal and, as such, private residence relief was denied. The Tribunal did not accept that Mr Gibson had ever intended to occupy the property permanently despite his assertions and despite the fact that he had resided in it for a period.

COMMENT

Principal private residence relief will never be allowed if a property is purchased for the express purpose of selling it on for a profit (s224(3) Taxation of Chargeable Gains Act 1992). It is therefore important to try to avoid selling a property soon after purchase, especially if renovation work has been carried out.

LAW COMMISSION LAUNCHES FIDUCIARY DUTY CONSULTATION

Following the outcome of the Kay Review on Equity Markets and Long Term Decision Making in 2012, the Law Commission has been investigating the duty of financial intermediaries to act in the best interest of beneficiaries when considering an investment strategy.

Kay criticised FCA rules as materially falling below the standards necessary to establish trust, confidence and respect; and recommended that the Law Commission should be asked to review the legal concept of fiduciary duty as it applies to investment.

The Law Commission consultation document, which was published last October, highlights the fact that fiduciary duty is used differently within the market and attempts to evaluate whether the law works in the interests of end investors. Using pensions as an example (by tracing a chain of intermediaries from the prospective pensioner/saver to the registered shareholder of a UK company), the consultation addresses four main issues:

- the extent to which trustees are required to maximise financial return over a short time-scale to the exclusion of other factors;

- whether the duties on contract-based pension providers to act in the interests of scheme members need to be clarified and strengthened;

- problems with the practical application of fiduciary duties in workplace defined contribution schemes; and

- the extent to which fiduciary duties apply to others in the investment chain and, in particular, whether regulation needs to be strengthened in relation to investment intermediaries and custodians.

The consultation is open until 22 January 2014, with a final report expected in June next year.

COMMENT

Although the consultation paper uses duties owed in respect of trust-based and contract-based pension schemes as an example, the principles will be relevant to all investment intermediaries and their advisers. An appreciation of the implications of such duties and the consequences of breaching them will be essential.

COMPANY CAR ADVISORY FUEL RATES

HMRC has published revised advisory fuel rates which took effect from 1 December 2013. The new rates may be used to negotiate dispensations for mileage payments for business travel in company cars, or where employees are required to repay the cost of fuel used for private travel.

For one month from the date of change, employers may use either the previous or new current rates as they choose. Employers may therefore make or require supplementary payments if they so wish, but are under no obligation to do either.

Engine Size	Petrol	LPG
1400cc or less	14p	9p
1401cc – 2000 cc	16p	11p
Over 2000 cc	24p	16p

Engine Size	Diesel
1600cc or less	12p
1601cc – 2000 cc	14p
Over 2000 cc	17p

Hybrid cars are treated as petrol or diesel cars for this purpose.

HIGHER RATE TAX RELIEF ON PENSIONS

The Prudential recently published a survey highlighting the fact that many higher rate taxpayers do not claim higher rate tax relief on their pension contributions.

The main results of the survey concluded:

- 26% of employees earning more than £41,451 do not claim the higher rate income tax relief on their pension contributions. This equates to an estimated 185,000 higher rate taxpayers failing to maximise their tax relief.
- The average loss to a higher rate taxpayer as a result of not claiming this higher rate tax relief is £1,255 a year.
- The total "lost" tax relief amounts to £229 million.
- There is a further 15% (over 100,000) higher rate taxpayers who are unsure if they are claiming the higher rate tax relief to which they are entitled.
- The majority of higher rate taxpayers are making personal contributions of 10% of their salary, the average of which is a little over £62,000, making the potential tax loss over £100 a month.

COMMENT

One of the key benefits of contributions to a registered pension plan is tax relief on those contributions. For most contributions, basic rate tax relief is given at source. It is then down to the taxpayer to claim any higher rate tax relief in their tax return. Advisers should check that any clients who are higher rate taxpayers are claiming.

INCOME WITHDRAWAL RATE FOR DECEMBER 2013

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in December 2013 is 3.0%, the same yield as for November.

We would like to take this opportunity to wish all our readers a happy Christmas and prosperous New Year