[2016] UKFTT 0106 (TC)

# TC04897

**Appeal number: TC/2014/04119**

*Whether income from letting holiday cottages property or trading income – appropriate tests to be applied – meaning of "occupation" – relevance of HMRC practice in relation to hotels and bed and breakfasts – section 10 ITTOIA – furnished holiday lettings rules – income held to be property income*

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**JULIAN NOTT** **Appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS** **Respondents**

**TRIBUNAL: JUDGE THOMAS SCOTT**
**KAMAL HOSSAIN FCA FCIB**

**Sitting in public at Fox Court, London EC1 on 14 September 2015**

**The Appellant in person**

**Mr Simon Bracegirdle, HM Revenue and Customs for the Respondents**

## DECISION

### The Appeal

1. This is an appeal against a closure notice which has been issued to the Appellant, Mr Nott, for the tax year 2009-10 under sections 28A(1) and (2) of the Taxes Management Act 1970 ("**TMA 1970**").

2. The issue is whether certain income received by the Appellant in that year is property income or trading income. The technical issue in the appeal is whether losses from the activity giving rise to that income can be set against the Appellant's income for 2009-10 for the purposes of Class 4 National Insurance Contributions. The issue of greater practical significance is the ability of the Appellant to set off such losses for subsequent years against his general income for income tax purposes.

### The Legislation

3. There are various provisions relating to the taxation of income from property contained in the Income Tax (Trading and Other Income) Act 2005 ("**ITTOIA**"). Those which are relevant to the appeal are set out below. The order in which they are set out is intended to aid understanding of the statutory framework.

4. Section 5, contained in Part 2 of the Act, charges to income tax the profits of a "**trade**".

5. Section 268, contained in Part 3 of the Act, charges to income tax "the profits of a **property business**".

6. Section 264 provides:

> **264 property business**
>
> (1) A person's UK property business consists of -
>
> a) every business which the person carries on for generating income from land in the United Kingdom, and
>
> b) every transaction which the person enters into for that purpose otherwise than in the course of such a business.

7. Sections 266 and 267 provide:

> **266 Meaning of "generating income from land"**
>
> (1) In this Chapter "generating income from land" means exploiting an estate, interest or right in or over land as a source of rents or other receipts.

(2) "Rents" includes payments by a tenant for work to maintain or repair leased premises which the lease does not require the tenant to carry out.

(3) "Other receipts" includes -

a) payments in respect of a licence to occupy or otherwise use land,

b) payments in respect of the exercise of any other right over land, and

c) rentcharges and other annual payments reserved in respect of, or charged on or issuing out of, land.

(4) For the purposes of this section a right to use a caravan or houseboat at only one location is treated as a right deriving from an estate or interest in land.

**267 Activities not for generating income from land**

(1) For the purposes of this Chapter the following activities are not carried on for generating income from land -

a) farming or market gardening in the United Kingdom (but see section 9 (UK farming or market gardening treated as trade)),

b) any other occupation of land (but see section 10 (certain commercial occupation of UK land treated as trade)), and

c) activities for the purposes of a concern to which section 12 applies (profits of mines, quarries, etc).

8. Section 10 provides insofar as relevant:

**10 Commercial occupation of land other than woodlands**

(1) The commercial occupation of land in the United Kingdom is treated for income tax purposes as the carrying on of a trade or part of a trade.

(2) For this purpose the occupation of land is commercial if the land is managed -

a) on a commercial basis, and

b) with a view to the realisation of profits.

9. The relevant parts of Section 2 are as follows:

**2 Overview of priority rules**

(1) This Act contains some rules establishing an order of priority in respect of certain amounts which would otherwise -

a) fall within a charge to income tax under two or more Chapters or Parts of this Act, or

b) fall within a charge to income tax under a Chapter or Part of this Act and ITEPA 2003.

(2) See, in particular -

Section 4 (provisions which must be given priority over Part 2), ...

[remainder not relevant].

(3) But the rules in those sections need to be read with other rules of law (whether in this Act or otherwise) about the scope of particular provisions or the order of priority to be given to them.

10. Section 4 provides as follows insofar as relevant:

**4 Provisions which must be given priority over Part 2**

(1) Any receipt or other credit item, so far as it falls within -

a) Chapter 2 of this Part (receipts of trade, profession or vocation), and

b) Chapter 3 of Part 3 so far as it relates to a UK property business, dealt with under Part 3.

11. Sections 322 to 328 (in Chapter 6 of Part 3) contain provisions relating to the **commercial letting of furnished holiday accommodation**. Section 323 provides as follows:

**323 Meaning of "commercial letting of furnished holiday accommodation"**

(1) A letting is a lease or other arrangement under which a person is entitled to the use of accommodation.

(2) A letting of accommodation is commercial if the accommodation is let -

a) on a commercial basis, and

b) with a view to the realisation of profits.

(3) A letting is of furnished holiday accommodation if -

a) the person entitled to the use of the accommodation is also entitled, in connection with that use, to the use of furniture, and

b) the accommodation is qualifying holiday accommodation (see sections 325 and 326).

(4) This section applies for the purposes of this Chapter.

12. Section 127 of the Income Tax Act 2007 provides, so far as relevant, as follows:

**127 UK furnished holiday lettings business treated as trade**

(1) This section applies if, in a tax year, a person carries on a UK furnished holiday lettings business.

(2) "UK furnished holiday lettings business" means a UK property business which consists of, or so far as it includes, the commercial letting of furnished holiday accommodation (within the meaning of Chapter 6 of Part 3 of ITTOIA 2005).

(3) For the purpose of this Part (but as modified below) the person is treated instead as carrying on in the tax year a single trade -

a) which consists of every commercial letting of furnished holiday accommodation comprised in the person's UK furnished holiday lettings business, and

b) the profits of which are chargeable to income tax.

**Agreed Facts**

13. In addition to numerous documents, we were also presented with photographs, maps and a painting showing an aerial representation of the properties and surrounding land.

14. The salient agreed facts are as follows:

(1) Mr Nott was gifted the Trewinnard Estate (the "**Estate**") in October 2009.

(2) The holiday accommodation units on the Estate were an existing business when gifted to Mr Nott.

(3) The first accounts for the business, made up to 31 March 2010, showed a loss of £45,369.

(4) The Estate includes a house (the "**Manor House**"), gardens, a farmyard area which includes working farm buildings, and the holiday accommodation units.

(5) The Manor House is separate from the other buildings. The farmyard, gardens and other residential buildings are all adjacent to each other.

(6) The Manor House, including a section of gardens, is rented out by Mr Nott, such rent being taxed as property income.

(7) There are eight "units" on the Estate, six of which are holiday accommodation units. The accommodation units are described in the relevant marketing material as "cottages". One of those accommodation units is owned by Mr Nott's sister. The other five are owned by Mr Nott (the "**Units**"). It is the letting income from the Units which is the subject of this appeal.

(8) There are also two residential cottages on the Estate. One is occupied by the Estate Manager. The other is inhabited by Mr Nott.

(9) Mr Nott inhabits the cottage as his home, and is there for more than half the year, including during most weeks.

(10) The Units are business rated.

(11) The Estate Manager and his wife are employed by Mr Nott and live all year round in their cottage.

(12) The Units are not directly accessible from public footpaths or roads, but must be reached via private roads or land owned by Mr Nott.

(13) Mr Nott retains keys and rights of access to the Units.

(14) Mr Nott makes no personal use of the Units.

(15) Mr Nott is the freehold owner of all land and properties comprised in the Estate, save for the cottage owned by his sister and part of the cottage inhabited by Mr Nott.

(16) Mr Nott carries on other business on the Estate, being farming, long-term property letting and his business as a professional musician.

(17) Lettings of Units are generally for two weeks or less.

(18) Each Unit comprises one or more bedrooms, a sitting room and kitchen.

(19) Cooked breakfasts are offered, usually for an additional charge. No other meals are offered.

(20) A daily cleaning service is offered, on request and for an additional charge.

(21) The Units are cleaned at the end of the guest's stay, but not daily.

(22) Additional facilities available to guests include the recreational grounds; a "working farm" environment including guided tours for children; a "concierge" service; a pool and pool house, and a games area.

(23) For insurance purposes, each Unit is detailed separately in the insurance policy with individual valuations and separate addresses.

(24) Guests pay a 30% deposit to secure a booking and pay the balance of the total cost 60 days before the start of their stay. A booking is of an identified unit, defined in the letting terms as "the property you are booking".

(25) Guests are obliged under the letting terms to clean and tidy the property to a good standard prior to their departure.

(26) The terms and conditions of letting provide a "licence to use the property for the purposes of a holiday". They also state that they preclude the creation of a tenancy or any protection to the guest under the Housing Act.

(27) The terms and conditions state that guests "shall be entitled to use the all [sic] parts of the premises and facilities/benefits advertised as such on our website (including the pool, pool house, access over our farmland, games room, communal garden area)".

(28) The terms and conditions state that the proprietors "… shall be entitled to enter the property at any time if we deem it necessary".

**Background and Issue**

15. Mr Nott's 2009-10 tax return was received by HMRC on 28 January 2011. It included separate self-employment pages for his trades, described as musician, farming and holiday cottage complex. The tax return also included a property income page showing rents in respect of the Manor House.

16. HMRC opened an enquiry into Mr Nott's 2009-10 tax return on 19 August 2011, within the time limits permitted by section 9A TMA 1970.

17. HMRC issued a closure notice under sections 28A(1) and (2) TMA 1970 on 13 December 2011. HMRC concluded that the income from the holiday cottage complex was property income from furnished holiday lettings.

18. In their conclusion, HMRC noted that Mr Nott had offset his losses from farming and from the holiday cottage complex against his other income for income tax purposes. He had not, however, offset his losses for the purposes of Class 4 National Insurance Contributions ("**NICs**"). Class 4 NICs are payable on the profits of trades, professions and vocations. HMRC concluded that the farming losses could be set against other income for Class 4 NICs purposes, but the loss from the holiday cottage complex could not. The offset of the farming losses for Class 4 NICs purposes resulted in an over-payment of £88.72 for 2009-10.

19. The basis of HMRC's decision not to allow the offset of the loss from the holiday cottage complex was that since Class 4 NICs are only payable on the profits of trades, professions and vocations, only losses incurred in trades, professions and vocations could be set off, and the loss from the holiday cottage complex was not such a loss.

20. On 10 January 2012 Mr Nott appealed against the closure notice. The stated ground of appeal was that income from the holiday cottage complex was income from a trade, and not property income from furnished holiday lettings.

21. Mr Nott requested HMRC to carry out a statutory review, and HMRC wrote to him on 30 June 2014 upholding their decision following that review.

22. The sole issue in the appeal is whether the income from the holiday cottage complex was trading or property income.

**The Statutory Framework**

23. Before considering the arguments raised by the parties and the facts of the appeal, it is first necessary to understand the relationship between the relevant statutory provisions. Given that the question of "property versus trading (or business)" arises in many contexts, it is surprising that such an exercise is not straightforward. The current regime, summarised at [3] to [12] above, is a patchwork of provisions which appear comprehensible when looked at in isolation, but which do not fit together in any easily discernible fashion. In the absence of any useful guidance in statute or case law on the question, it is therefore helpful to start with some underlying principles and very brief background.

24. It has long been recognised that income arising from property can give rise to difficult issues of classification. Tax legislation has also long sought to grapple with those issues, by providing separate, or modified, taxing regimes for certain types of property income.

25. The search for such a division can be traced back to the Victorian era and the contrast between capital or wealth on the one hand and labour on the other. Hence, the old Schedule A was originally focused on the value of land occupied, rather than the rents or profits arising from it.

26. More modern legislation sought to impose a distinction between income from a trade (the old Schedule D Case 1) and income from property (variously Case VIII of Schedule D and Schedule A). The complications began to arise as special legislative rules were introduced for specific situations or activities, where it was thought inappropriate to rely solely on the simple property/trade distinction. Examples were furnished lettings (previously in Case VI of Schedule D) and the commercial occupation of land (formerly Schedule B).

27. Turning to the current statutory regime, contained in the ITTOIA, the basic division is drawn by section 5, which taxes the profits of a "trade", and section 268, which taxes the profits of a "property business". The phrase "property business" is defined, in section 264, largely by reference to section 266, which defines a property business as one for "generating income from land".

28. Thus far, the distinction (at least in principle) is clear enough. What if income falls potentially within both section 5 and section 268? The current regime deals with this in section 4, which has the effect that the property charge takes priority over the trading charge. Section 4 is subject to section 2(3), which provides that the rules as to priority "need to be read with other rules of law

(whether in this Act or otherwise) about the scope of particular provisions or the order of priority to be given to them."

29. The two remaining pieces of the jigsaw are section 10 (commercial occupation of land) and the rules for the commercial letting of furnished holiday accommodation. It is necessary to understand how these provisions fit into the picture. This is not an academic exercise, because, at least at first sight, activity such as that which is the subject of the appeal might in principle appear capable of falling within any or all of section 5, section 268, section 10 and the furnished holiday letting rules.

30. The definition of "generating income from land" in section 266 which forms the basis of the definition of "property business" must be read with section 267, which specifies activities which are not carried on for generating income from land. Section 267(1)(b) so specifies any occupation of land other than farming or market gardening, with the qualification "but see section 10". Section 10 defines commercial occupation, and states that the commercial occupation of land in the United Kingdom is treated for income tax purposes as the carrying on of a trade or part of a trade.

31. It is necessary, therefore, to consider whether an activity which is not a trade within section 5 might nevertheless fall within section 10, and, if so, what tax consequences would follow for the treatment of the income. That is dealt with in relation to the appeal later in this judgment.

32. Finally, UK activity which qualifies as the "commercial letting of furnished holiday accommodation" (as defined in section 323 ITTOIA) is dealt with by section 127 of the Income Tax Act 2007. Such activity is defined as a "UK furnished holiday lettings business". A person carrying on such activity is treated for income tax purposes as carrying on a single trade but with various modifications to the normal tax rules which apply to an actual trade. Where an activity falls within this regime, we consider below in the context of this appeal whether it could also fall within section 5 or section 268, and with what consequence for the taxation of the income.

**Discussion**

33. We considered the following questions in relation to the income which is the subject of this appeal:

    (a) Is the income property income or trading income?

    (b) Insofar as it is relevant to question (a), since HMRC's settled practice is to tax hotels and bed and breakfasts as trades, to what extent can Mr Nott's activities be distinguished from such arrangements?

    (c) Does the income fall within section 10?

    (d) If Mr Nott's activities constitute a furnished holiday lettings business within the Income Tax Act 2007, what effect, if any, does that have on questions (a) to (c)?

**Property or Trading**

34. As discussed above, the tax legislation has long sought to grapple with the dividing line between property and trading income. The starting point in the analysis – what HMRC in their submissions called "the default position" – is that income derived from the exploitation of property is to be taxed as property income. In certain situations, however, the taxpayer may be able to establish that the activities giving rise to the income constitute a trade. While the existence of a trade is ultimately a question of fact, it was argued by both parties that case law establishes certain characteristics as having particular significance.

35. Passages from two decisions relevant to this appeal neatly summarise this position. In the decision of the House of Lords in *Salisbury House Estate, Ltd v Fry* [1930] 15 TC 266, Lord Macmillan stated (at page 330):

> "A landowner may conduct a trade on his premises, but he cannot be represented as carrying on a trade of owning land because he makes an income by letting it. The relatively insignificant services for which the company makes charges to its tenants are not in my opinion sufficient to convert the company from a landowner into a trader, though the profits so made may quite properly be charged with tax under Schedule D.
>
> To hold otherwise would be to invert the rule that the principal follows the accessory."

36. In the more modern case of *Griffiths v Jackson* [1985] 56 TC5 83, Vinelott J. reaffirmed the force of this principle while helpfully summarising its historical origins (at page 190):

> "It is a cardinal principle of United Kingdom tax law that "income derived from the exercise of property rights properly so-called" by the owner of land (freehold or leasehold) is not income derived from the carrying on of a trade. The words I have cited come from the speech of Lord Macmillan in Salisbury House Estate, Ltd v Fry 15 TC 266 at page 329. The historical origin of the principle is that tax under Schedule A was formerly charged "in respect of the property in all lands … capable of actual occupation" and was so charged on the annual value of the land. Tax in respect of the occupation of land (except a dwelling house or land occupied for the purpose of a trade, profession or vocation) was charged under Schedule B and was so charged on the assessable value of the land. As tax was charged under Schedule A in respect of the owner's proprietary rights, it could not be charged again under Schedule D in respect of the income derived from the land unless the income was derived from some source other than the exploitation of the owner's right of property."

37. On the face of it, income from a business of letting property, such as that in this appeal, would fall naturally within the wording of section 266(1): "'generating income from land' means exploiting an estate, interest or right in or over land as a source of rent or other receipts." It would, on that basis, constitute a "UK property business", the profits of which would be taxable as property profits under section 268. What factors might indicate that such income would nevertheless fall to be taxed as the profits of a trade?

38. Perhaps because section 268 is, in effect, the starting position, consideration of the relevant case law shows that the normal "badges of trade" have not been found to be of particular assistance to the courts in addressing this issue. To take only some of the badges, in relation to income from letting property, a profit-seeking motive, the number of lettings, the nature of the asset, and the nature of the financing, could all be present in a typical property letting business without themselves pointing in the direction of a trade.

39. Both parties argued that case law does, however, identify two factors which are to be given particular weight in distinguishing property and trading income, namely whether the taxpayer is in **occupation** of the property giving rise to the income and the level of **services** provided by the taxpayer in relation to that property.

40. Both parties referred the Tribunal in their arguments to various published statements in this context from HMRC. In HMRC's Property Income Manual, it is stated at PIM4300:

"**Whole activity a trade**

The whole letting activity will only constitute a trade where the owner remains in occupation of the property and provides services over and above those usually provided by a landlord. The provision of bed and breakfast, for example, is clearly trading. Essentially the distinction lies between the hotelier (who is carrying on a trade) and the provider of furnished accommodation (who is not). An important difference is that in a hotel etc the occupier of the room does not acquire any legal interest in the property."

41. Similarly, HMRC's Business Income Manual states, at BIM22001:

"Income from furnished lettings is rarely trading income, even when the landlord works full time running the rental business.

It is only treated as a trade when the landlord remains in occupation of the property and provides services substantially beyond those normally provided by a landlord. This will be the case, for example, where the activity consists of providing bed and breakfast, or running a hotel or guesthouse."

42. We deal below with the comparison between Mr Nott's business and that of a bed and breakfast or hotel. The first issue for consideration is the extent to which the relevant case law supports the "occupation plus services" test referred to in the two extracts and, if so, the extent to which those features are present in Mr Nott's case.

43. We were referred by the parties to several cases which we considered in reaching our judgment. Those which we regard as being most material are as follows:

*The Governors of Rotunda Hospital, Dublin v Coman (Surveyor of Taxes)* (7 TC 517)

*Salisbury House Estate, Ltd v Fry ((HMIT)* (15 TC 266)

*Westminster City Council v Southern Railway Company* [1936] 2 All ER 322

*Sywell Aerodrome, Ltd v Croft (HMIT)* (24 TC 126)

*Gittos v Barclay (HMIT)* [1982] 55 TC 633

*Griffiths v Jackson* 56 TC 583

*Maclean v Revenue and Customs Commissioners* [2007] STC (SCD) 350.

44. The HMRC published practice quoted above was accepted by both parties as an accurate statement of the law. One might therefore reasonably expect the cases referred to, which span a period of some ninety years, to elucidate the "occupation plus services" concept, and to provide guidance on its application in practice to income from letting property.

45. We now consider the key cases in turn, from which it will be seen that a more nuanced picture emerges.

46. *The Governors of Rotanda Hospital* was relied on heavily by Mr Nott in his submissions to the Tribunal. He argued that the decision establishes that the most significant factor in categorising property profits as trading income is occupation by the taxpayer of the property from which the income derives. He further argued that most of the other authorities cited by HMRC (which we discuss below) were not materially relevant, because they concerned situations where the taxpayer was not in occupation and where, as a consequence, it was necessary to establish a much higher level and degree of additional services.

47. *Rotunda* concerned the hiring out by the Governors of the hospital of certain concert, exhibition, refreshment and ball rooms for the purposes of musical or dining entertainment. The rooms were prepared by the Keeper of the Rotunda Rooms, who remained on the premises at all times, attending to lights and fires and regulating the conduct of the patrons. The rooms were equipped for purpose with seating, heating and lighting.

48. The House of Lords held that, on the facts, the activities amounted to a trade, that trade being one of providing and letting rooms for entertainment. In reaching that finding, it was held that the services provided were not merely incidental to the letting of the rooms. In the words of Viscount Finlay (at page 582):

"Profits are undoubtedly received in the present case which are applied to charitable purposes, but they are profits derived not merely from the letting of the tenement but from its being let properly equipped for entertainment, with seats, lighting, heating and attendance. The subject which is hired out is a complex one. The mere tenement as it stands, without furniture, etc, would be almost useless for entertainment. The business of the Governors in respect of those entertainment is to have the hall properly fitted and prepared for being hired out for such uses."

49. Viscount Cave expressed himself in similar terms, at page 585:

"I am unable to see how the profits in question can be said to be derived from the Rotunda Rooms alone. They result, not from the letting of bare rooms, but from the whole venture, consisting of the equipment, and disposal of the rooms with their fixtures and furniture and the provision of the service of heating, lighting and attendance. They may perhaps be described as profits of

a trade or concern in the nature of trade, that is to say, of the business of providing and letting rooms for entertainment …."

50. *Salisbury House Estate*, decided in 1930, was relied on by HMRC. The case concerned unfurnished offices which were leased, with the landlord providing lighting, heating, caretaking and other services. Some of the services were optional and only charged for if taken up. The taxpayer also provided and operated lifts in the building, and provided uniformed staff, cleaners, housekeeper and concierge services.

51. The House of Lords held that on the facts the total income fell to be taxed as property rather than trading income (as then was, Schedule A rather than Schedule D). Much of the discussion concerned the need for exclusivity amongst the various Schedules. The court remarked that *Rotunda* "… entirely differs in its facts and appears to throw little light on the law in question before this House" (Lord Atkin at page 321). The ratio for the decision in *Salisbury* appears to be that on the facts the services offered by the taxpayer were not sufficiently significant to supplant the natural characterisation of the leasing income as property income: see the passage from Lord Macmillan's judgment quoted at [35] above.

52. *Sywell Aerodrome* concerned income which was potentially assessable under any of the former Schedules A, B or D. The taxpayer's argument was that the income was properly property income taxable under Schedule A, or income from the occupation of land taxable under Schedule B. The income arose from various licences of the aerodrome, and the taxpayer also provided the services of a guardsman and made available first aid appliances and tools.

53. The Court of Appeal held by a majority that the entire income was taxable under Schedules A or B. Having considered authorities including *Rotunda* and *Salisbury House*, Lord Greene stated (at page 143):

> "I have so far ignored the one thing done by the company which in my view falls outside the profit-making activities with which Schedules A and B are concerned – viz; the provision of tools and equipment which is a condition of the licence. Compliance with this condition cannot in my opinion change the whole picture and turn what would otherwise be profits covered by Schedule A or Schedule B into profits assessable under Schedule D, any more than would be the case if, for example, under housing bye-laws the landlord of a block of flats were bound to keep fire-fighting appliances on the premises. On principle, however, whatever part of the profits made by the company ought to be apportioned to the provision of this equipment [is a] matter for the Commissioners [and] is assessable under Schedule D. The point, however, is obviously too trivial to lead to any practical result.
>
> I have given the best consideration that I can to the authorities which, I must confess, do not appear to me to throw a particularly clear light on the point which we have to decide."

54. *Gittos v Barclay* is a more modern decision (1982). Its facts are closer to those in this appeal than those in *Rotunda, Salisbury House* or *Sywell Aerodrome*, in that the case concerned the taxation of an individual in respect of income from the letting of holiday villas. The High Court held that they

could not overturn the findings of fact which had led the General Commissioners to conclude at first instance that the profits were not profits of a trade. Before the General Commissioners, the taxpayer had relied heavily on the presence of many of the conventional "badges of trade". The court rejected an argument raised by the taxpayer that it made a material difference to this question whether the occupiers of the villas were tenants or only licensees. Goulding J's approach echoed that of the earlier decisions discussed above (at page 639):

"So the real question that was before the General Commissioners in the present case and which, so far as I can see, they properly grasped – and, indeed, they were referred to the Salisbury House case – was whether the activities of Mrs Gittos over and above the mere exploitation of her landed property were significant enough to make her a trader and not a mere landowner who derived an income by exploiting her property. It is not of course possible to give an answer to such a question in general terms. It is a question of fact and degree."

55. The decision in *Griffiths v Jackson* concerned income from various properties which were mainly let furnished to students and other short-term occupiers. The taxpayers provided various amenities and services, and spent considerable time in collecting rents and looking after the properties. The High Court overturned the decision of the General Commissioners that the taxpayers were carrying on a trade.

56. Vinelott, J. reaffirmed the "cardinal principle" that "income derived from the exercise of property rights so-called" by a landowner is not trading income, in the passage quoted at [36] above. Applying a similar approach to that in *Salisbury House* he stated (at page 591) :

"Thus, the income derived by the owner of property from letting the property furnished, whether for a short or a long term and whether in small or large units and whether in self-contained units or to tenants who share a bathroom or kitchen or the like, is not income derived from carrying on a trade but is still taxable under Schedule A or, in the case of para 4 [of Schedule A], under Case VI of Schedule D. Of course, if the owner provides services and the services are separately charged or the receipts can be otherwise apportioned in part to the provision of the services any profit derived from the provision of the services will be taxable as the profits of a trade. That was the case in Salisbury House Estate, Ltd v Fry. But the rents the owner derives from the use of the different parts of the property are not receipts of a trade."

57. Vinelott, J. rejected the taxpayer's argument based on *Rotunda* (at page 592):

"However, on a close examination of the facts of that case it does not, in my judgment, support his argument. In that case the taxpayers remained in legal occupation of the entertainment rooms and retained control over them. The income was not derived from their property in the rooms, as it would have been if they had parted with legal occupation to someone who had carried out the activities of providing the rooms for public entertainment. That was the ground on which the Rotunda Hospital case was distinguished in Salisbury House Estate, Ltd v Fry. Viscount Dunedin said at page 309:

"But the rooms were not let to anyone. There was no question of including the rents of the rooms in the profits which were calculated under Schedule D; the hospital was held to be in occupation of the whole premises." "

58. He continued by discussing the relevance and meaning of "occupation" in this context as follows (at page 592):

"The Rotunda Hospital case, in fact, is a useful illustration of the way in which the owner of land may, without parting with his occupation of it, exploit his rights of property and occupation by carrying on a trade.

That, I think, affords the answer to Mr. Sokol's alternative argument. He drew an analogy between the position of these taxpayers and that of a hotel owner or the landlord of a lodging house. It was the analogy of a lodging house keeper which led Rowlatt J. to conclude in Salisbury House Estate, Ltd. v Fry that the taxpayer was carrying on a trade (see page 282). However, as Lord Russell of Killowen pointed out in Westminster Council v Southern Railway Co. [1936] AC 511 at page 530, the landlord of a lodging house remains in occupation and "for the purpose of that business he has a continual right of access to the lodgers' rooms and … in fact, retains the control of ingress and egress to and from the lodging house, notwithstanding that the power of ingress and egress at all times is essential to the lodger". That was a rating case but in J.A. and J. Dawson v Counsell 22 TC 49 Scott L.J. pointed out that "the occupier for tax purposes is broadly the same kind of occupier as the occupier for rates". The distinction between a hotelier or a lodging house keeper, on the one hand, and the owner of property who lets furnished rooms and provides services is no doubt in practice a narrow one, more particularly in these days of self-service hotels and motels, but the principle is clear and in the present case there can be no doubt on which side of the line the taxpayers' activities fall. It is quite clear from the terms of the tenancy agreements and the taxpayers' form of letter that they let rooms furnished to tenants, albeit with shared facilities and some services."

59. Finally, we considered *Maclean*. While only a decision of the Special Commissioners, this contains a useful review of the authorities discussed above. The following passage from the judgment of J Gordon Reid QC (at page 359) is in our view particularly pertinent:

"**Guiding Principles**

From the authorities cited, I derive, albeit with some difficulty, the following principles. (1) Income derived from the exercise of property rights properly so-called by the owner of land, that is to say the exploitation of the right of property and the right of occupation, is not income derived from the carrying on of a trade. (2) Income derived by an owner from granting or limiting his rights as owner of the land in favour of others is not regarded for income tax purposes as the carrying on of a trade. Thus, income derived from the commercial letting of furnished accommodation, whether for a short or long period, is not generally regarded as income derived from carrying on a trade, even although this activity may properly be described as the carrying on of a business. *Business* is a wider concept than *trade*. (3) Activities over and above the mere exploitation of heritable property or turning to profitable account the land, of which he is the owner, may be significant enough to classify a man's business as a trade. Whether the provision of services or

other activities are significant enough to cross the line between land ownership and commercial enterprise in land is a question of fact and degree depending upon the nature and extent of the operations or activities concerned. (4) However, the fact that an owner makes the visit to his land by a licensee more attractive by providing various services, eg keeping the property in a proper state and condition, will not turn exploitation of property rights into a trade. (5) Whether income is derived from the location of the land, which is the normal manner in which property in land yields revenue, is a relevant consideration.

Like so many areas of law, principles can be stated but their application to any given set of facts may be attended with the greatest difficulty. I have not found the reasoning in the authorities particularly easy to apply to the circumstances of this appeal and such principles as I have been able to extract, I have found to be of limited value and of questionable utility in the modern context of carrying on the business (to put it neutrally) of providing serviced apartments."

60. Drawing together these various authorities, one striking point is that none of them articulates the determinative criteria in establishing a trade in this context as occupation by the taxpayer combined with a substantial level of additional services. There are "guiding principles" derived from the authorities summarised in *Maclean*. There are numerous conclusions to the effect that additional services provided by a landlord must be substantial if they are to stand any prospect of displacing the "cardinal principle" and establishing a trade. And there are several pronouncements as to the limited value of the described cases given the importance of the facts.

61. In relation to the significance of occupation, it may be that the passage from *Griffiths v Jackson* quoted at [58] above has been taken by HMRC and others to mean that a trade in this context can be established only where there is occupation by the taxpayer. A close reading of the passage shows that in fact it is not saying this. It is attempting to reconcile the various authorities by observing that continued taxpayer occupation of the land, as in *Rotunda*, may help to distinguish the lodging house keeper (in *Salisbury House*) from the property owner who lets furnished rooms and provides services.

62. We asked HMRC to amplify the precise basis for the statement in BIM22001, quoted at [41] above, that a furnished lettings business "is only treated as a trade when the landlord remains in occupation of the property and provides services substantially beyond those normally provided by a landlord". We also asked them, in view of Mr Nott's submission that occupation was by far the most significant factor, what relative weight they might attach to occupation and services. HMRC's response to the Tribunal provided an interesting comparison to BIM22001:

"HMRC does not attach particular weight to occupation or services. We instead examine the nature of the activity that gives rise to the payment."

63. HMRC further articulated this approach as a two-fold test intended to identify the true derivation of the income. The first question, they submitted, is "what is the activity giving rise to the payment?". The second question is "what are

customers paying for – the use of the land, or a package of services forming part of a trade?".

64. While observing that this is essentially the same question posed from different perspectives, we find this a more objective distillation of the case law than the "occupation plus services" test. It may be less granular, but is consistent with the approach in the decided cases, which is to determine, in the words of Lord Atkinson in *Rotunda* , "what is let, paid for and used" (page 592). Clearly, in reaching that determination, the nature and level of any services offered by the taxpayer will be important if the "cardinal principle" is to be displaced. Whether or not the taxpayer remains in occupation of the premises will also be relevant. But we do not find authority in the cases for the proposition that these two issues are determinative.

65. It is nevertheless necessary, and we trust helpful, to consider the submissions of the parties in relation to these two issues, and their application on the facts of this appeal to Mr Nott's letting income.

66. Let us deal first with occupancy. In our view, the decisions in *Rotunda* and *Griffiths v Jackson* can best be regarded as demonstrating that a property owner who gives up occupation of his property in return for payment is very likely to be generating property income. He is monetising his property asset in the most straightforward way, by, in effect, selling the right to occupy it. Conversely, a property owner who remains in occupation is, all else being equal, more likely to be able to show that, if additional services are being provided, it is (in HMRC's formulation) a package of services forming part of a trade from which his income derives.

67. Mr Nott argued, partly on the basis of *Rotunda* and partly by reference to section 10 (which we discuss below), that occupation was by far the most significant factor in establishing a trade. He further argued that this meant that most of the other decided cases discussed above were not materially relevant to his situation, because those other cases concerned situations where the taxpayer was not in occupation and where, as a consequence, a much higher level of services would need to be demonstrated to establish a trade.

68. Mr Nott presented and argued his case eloquently, but we find no support for this approach. While occupancy or the surrender of it is relevant, we consider the correct approach, on the basis of the case law and statute, to be that described in [66] above.

69. However, the question of whether or not the taxpayer remains in occupation is important to the analysis, albeit not to the degree suggested by Mr Nott. It is therefore necessary to consider whether Mr Nott was in occupation in relation to the Units the income from which was the subject of this appeal. This involves two related questions. First, what does "occupation" mean in this context? Secondly, what property must be so occupied?

70. The meaning of occupancy in this context is not straightforward. Mr Nott argued that it means legal or "paramount" occupancy, relying in particular on *Westminster Council v Southern Railway*. In his submission, it is to be interpreted in a land law sense, as being satisfied where there is both physical

possession and control of the relevant land. He argued that the terms of occupancy of the Units meant that he satisfied this test, since he could enter the Units at will, no tenancy could arise in law, and he retained rights of ingress and egress to the Units. HMRC, on the other hand, argued that in this context occupancy was a question of fact, and should be given its normal meaning. They further argued that it must be the taxpayer's occupation which is operative to generate the income, not that of the guest, given their preferred formulation that the real test is "what is the income for?".

71. The decision in *Westminster Council* that occupation meant permanent occupation in a legal sense arose in a very different context to the tax categorisation of letting income. It concerned the ratings position where, in effect, there was concurrent or competing occupation. However, in the passage from *Griffiths v Jackson* quoted at [58] above, Vinelott J. does appear to take the view that *Westminster Council* should apply in relation to letting income, in that he supports the statement by Scott L.J. in *J.A. and J. Dawson v Counsell* 22 TC 49 that "the occupier for tax purposes is broadly the same kind of occupier as the occupier for rates".

72. For our part, we would have preferred HMRC's formulation of "occupancy", but for this passage from Vinelott J.'s judgment in *Griffiths v Jackson*. We say this for three reasons. First, given that, in our view, the better approach is to focus on what the income arises from, occupancy in that context is more likely to require physical, real occupancy by the owner of the property rather than mere retention of the paramount legal title. We observe in this respect that occupation of the relevant premises in Rotunda was determined in part by reference to the presence of an on-site housekeeper physically resident in the rooms from which the income was derived. Secondly, we would be cautious in extending a decision (in *Westminster*) in a very different context. Thirdly, if the correct test is paramount occupation in a legal sense, it should logically follow that it is necessary in determining the presence or absence of occupancy to analyse closely the legal nature of a guest's occupancy rights. HMRC, at times, suggested that it was indeed significant that in Mr Nott's case guests were granted a licence to occupy. In their Property Income Manual, HMRC state (at PIM 4300, quoted at [40] above) that:

"An important difference [between a furnished letting and a hotel] is that in a hotel etc. the occupier of the room does not acquire any legal interest in the property."

It is nevertheless not clear to us why the precise legal effect of the letting should have a material effect. We would prefer the approach of Goulding J. in *Gittos v Barclay* when dealing with the argument by the taxpayer that it was critical to determine whether the holiday occupiers were tenants or licensees [at page 638]:

"However, the real question before me, as it was before the Commissioners, is whether or not the income is profit of a trade, and for that purpose I think the question whether the occupying holidaymakers were tenants or licensees is at most of only slight importance. In that respect compare the observations of Lord Green M.R. in Croft v Sywell Aerodrome, Ltd. 24 TC 126 at page 139".

73. It is unclear, given the passage in *Griffiths v Jackson* discussed above, whether Mr Nott is correct that occupancy in this context requires only paramount legal occupancy, on the basis of *Westminster*. However, that is not the end of the matter. In order for Mr Nott to establish that he is in occupation in relation to his appeal, he must prove that he is in occupation of the property or properties from which the relevant income arises.

74. Mr Nott argued that the Estate, including the Units, should properly be viewed as a single parcel of land, of which he was the occupier. He laid stress on the fact that guests had no rights of ingress or egress to a Unit, or the holiday facilities they were entitled to enjoy, other than via land owned and controlled by Mr Nott. He argued that the only right or interest which guests obtained was a personal licence to occupy a Unit, to the exclusion of others and subject to the terms of the letting conditions. Such arrangements, he argued, were in substantive terms indistinguishable from those of a hotel or bed and breakfast, and the fact that Units were marketed as separate "cottages" was insufficient to distinguish the Units from such arrangements.

75. HMRC argued that the occupation which was relevant in determining whether the income was property income or trading income was that of each Unit. While it might be possible to regard the Estate as a "parcel of land", they submitted that on any realistic view each cottage was a self-contained unit of accommodation. Each Unit was not only capable of separation, but had in fact been separated. A guest obtained a licence to occupy a Unit, not the Estate, and in particular no other Units or properties on the Estate. The segregation was supported by the relevant insurance documentation, which dealt with each cottage separately.

76. HMRC further argued that "paramount" occupancy by Mr Nott was not in any event supported by the terms and conditions of the standard booking agreement for a Unit. Those terms were not consistent with Mr Nott's assertion that guests had no rights of ingress or egress to the properties: see, for instance, (26) and (27) at [14] above. Further, Mr Nott did not retain full control over access to the Units, as guests might enter and leave as they wished during their booking and did not, for instance, have to leave keys with a housekeeper on each departure.

77. While we have some sympathy with Mr Nott's arguments, we conclude that HMRC's analysis is correct, in that Mr Nott does not "occupy" each of the Units, however occupancy is properly defined. In our view, it is unduly artificial to regard the Estate as a single parcel of "land", land rather than property being the language used in sections 264 to 268. We also find force in HMRC's arguments regarding the terms and conditions of the letting arrangements. We do not consider the fact that access to the Units is via land owned by Mr Nott outweighs those considerations.

78. In any event, we find that on the facts Mr Nott's argument is not sustainable, because the Estate is not comprised solely of the Units. The Manor House is rented out by Mr Nott (such rent being taxed as property income); one of the cottages, not within the Units in this appeal, is owned by Mr Nott's sister; and there are two residential cottages on the Estate, one of which is inhabited by the Estate Manager and the other by Mr Nott. It cannot be argued on any

realistic basis that all of these properties can somehow be left out of account and the Units thereby regarded as a single parcel of "land" of which Mr Nott is in occupation.

79. The second issue which we considered was the services provided to guests by Mr Nott. As the discussion of the relevant case law earlier shows, in order to displace the "cardinal principle", the services offered by a landlord must be such as to convert what is being sold into a package of services of which the accommodation enjoyed by guests or customers is only part.

80. Mr Nott argued that HMRC's practice of requiring that additional services be provided which were "substantially" beyond those normally provided by a landlord was not justified as a matter of law, and merely operated to afford HMRC a subjective discretion whether to recognise trading status as arising in any particular case. We disagree. The extract from Lord Macmillan's judgment in *Salisbury House* quoted at [35] above states that "the relatively insignificant services for which the company makes charges to its tenants are not in any opinion sufficient to convert the company from a landowner into a trader ….". *Sywell Aerodrome* considers whether the additional services could "change the whole picture and turn what would otherwise be property covered by Schedule A or Schedule B into profits assessable under Schedule D". And *Gittos v Barclay* identified as the real question "whether the activities of Mrs Gittos over and above the mere exploitation of her landed property were significant enough to make her a trader ….".

81. The additional services offered to guests by Mr Nott are largely described at (19) to (22) of [14] above. Mr Nott argued that the provision of services was of considerably less significance than the existence of occupation. As explained earlier, we rejected that argument. Mr Nott submitted that the services offered to guests in the Units were in any event substantially greater than those normally offered by a landlord. This was so, he argued, both as regards the services offered in relation to the Units themselves and as regards the significant recreational services available on the Estate to guests in the Units.

82. HMRC, on the other hand, argued as follows. Most of the services offered by Mr Nott were consistent with those typically provided by a landlord. As regards the recreational facilities, they were properly regarded as features which increased the attractiveness of the Units for letting purposes rather than as additional services. As regards the provision of breakfasts and daily cleaning, in each case for an additional charge, these enhanced and were merely incidental to the main profit-generating activity of letting the Units.

83. We were shown correspondence between HMRC and Mr Nott in which HMRC accepted that it might be appropriate to regard income from breakfasts and daily cleaning as a separate trade (as suggested, for instance, in *Salisbury House*). Doubtless the amounts involved meant that in practice this was of little significance.

84. In their submissions as to services, HMRC cited the conclusions of the Upper Tribunal in *Revenue and Customs Commissioners v Pawson's Personal Representatives* UKUT 050 (TCC). However, given that that case concerned

inheritance tax and whether a holiday letting business was disqualified from business property relief because it was primarily an investment, we would prefer to base our conclusions on those authorities discussed above, which are more directly in point.

85. Having considered the additional services provided by Mr Nott, we consider that, while extensive, they are not such as to "change the whole picture" in the words of Lord Greene in *Sywell Aerodrome*. They are in large part consistent with the services normally provided by a landlord of furnished holiday accommodation. We agree with HMRC that the recreational facilities offered are in substance features intended to increase the attractiveness of the Units for letting, rather than additional services. The breakfasts and daily cleaning which are offered for an additional fee are insufficient to change the profit derivation from the exploitation of property to a package of services comprising a trade.

**Hotels and Bed and Breakfasts**

86. Mr Nott argued that his activity was, in all material respects, indistinguishable from that of many hotels and bed and breakfast establishments. Since HMRC's published practice (referred to at [40] and [41] above) was to treat such establishments as trades for tax purposes, both in fairness and in law his activity should be taxed in the same way. He submitted that HMRC had failed to look past the "holiday cottage" label at the relevant facts. Mr Nott's arguments in this respect were similar to those raised by the taxpayer in *Maclean* (at page 357):

"from the viewpoint of the guests they were receiving the services of a hotel and not just self-catering accommodation …. These services were everything you would expect from a small hotel."

87. HMRC accepted that labels were not determinative, but denied that they had failed to look carefully at the relevant facts in relation to Mr Nott's activity. They argued that, in any event, Mr Nott's activity differed from that of a typical hotel or bed and breakfast both as to occupation and services, as discussed above. Further, they argued, in normal commercial parlance the Units could not simply be relabelled a "hotel", as guests would not recognise the arrangements as such. In particular, guests in a Unit occupied a separate building, not a room in a single building.

88. We would agree that the dividing lines between various types of rental accommodation have become increasingly fluid. In determining "what is being paid for", the spectrum is broad. There are hotels which provide very little in the way of additional services, and at the other end of the spectrum luxury hotels which have available to rent self-contained properties within their grounds. However, we agree with HMRC's argument that the tax treatment of other businesses (on which we received no evidence) cannot operate to convert Mr Nott's activity into a trade if there is no trade on the facts. While Mr Nott did argue that his activity was substantially similar as regards occupation and services to that of a hotel or bed and breakfast, he did not go so far as to suggest that it was in fact a hotel or bed and breakfast. We

agree with HMRC that to have described the Units as such to potential guests would have been confusing and misleading.

89. We would observe in passing that HMRC's practice of treating all hotels and bed and breakfasts as trades may be unduly simplistic. As explained above, we regard the "profit derivation" test as being the appropriate test established by case law in relation to the "cardinal principle" where income arises from exploiting property. A more mechanistic test such as "occupation plus substantial additional services" runs the risk of laying undue emphasis on labels such as hotel and bed and breakfast. There may be hotels or bed and breakfasts where "what is being paid for" is in substance little more than what is being paid for in a furnished letting. Particular care is also needed in delineating HMRC practice where, as here, no relevant statutory definitions of "hotel" or "bed and breakfast" are in point. That is, however, not relevant to the determination of this appeal.

**Section 10**

90. With certain exceptions not relevant to the appeal, section 10(1) provides that the commercial occupation of land in the United Kingdom is treated for income tax purposes as the carrying on of a trade. The occupation of land is commercial if it is managed on a commercial basis and with a view to the realisation of profits (section 10(2)).

91. At first blush, section 10 appears to cut across the property/trading income divide. How does it fit together with that divide, what is meant by "occupation" in section 10, and does Mr Nott satisfy that test?

92. Consideration of the statutory predecessors to section 10 shows that it is intended to apply where the commercial occupation of land falls short of amounting to a trade on basic principles. As HMRC submitted to us on being asked for their view of section 10, "Section 10 ITTOIA has a narrow meaning. In effect it is a "sweep up" clause for income that historically was taxed under Schedule B."

93. As to the meaning of "occupation" in section 10, surprisingly we were not referred by either party to the decision in *Webb v Conelee Properties* [1982] STC 913. That case, relating to a predecessor to section 10, makes it clear that in order for section 10 to apply the taxpayer must be in "actual" occupation of the land. That finding was upheld in *Griffiths v Jackson* (at page 593). In this context, "actual" must in our view refer to physical occupation, rather than merely holding paramount legal title.

94. We conclude that section 10 is not intended to cut across sections 5 and 268, and that in any event Mr Nott is not in "actual" occupation of the Units, applying *Webb v Conelee*, given our conclusion earlier that he is not in occupation of the Units for trading purposes.

**Furnished Holiday Lettings Rules**

95. The Income Tax Act 2007 contains a special regime for UK furnished holiday lettings ("**FHL**") businesses. The tax benefits of the regime were scaled back

considerably in 2010. It was agreed by the parties, and is clear as a matter of law, that where the relevant conditions are satisfied the taxpayer is treated under the regime as trading for certain tax purposes, although he is not carrying on a trade on basic principles.

96. We were shown correspondence between HMRC and Mr Nott which indicated that HMRC accepted Mr Nott's activity as falling within the FHL regime. Mr Nott argued that HMRC had in effect pre-judged the proper characterisation of his activities, and pigeon-holed it as being within the FHL regime and only the FHL regime, and not an actual trade.

97. Mr Nott submitted that the FHL regime was in effect permissive for a taxpayer, and the fact that its conditions might be satisfied did not preclude the taxpayer from establishing that his activity was in fact a trade, depending on the facts and circumstances. We agree with him, but observe that in practice the question is likely to be moot, because a taxpayer who can prove a trade need not in general avail himself of the quasi-trading benefits provided by the FHL rules. We found no evidence in this case that HMRC had failed to consider whether Mr Nott's activities amounted to an actual trade for tax purposes, either because they had pigeon-holed those activities as an FHL business or for other reasons.

## Conclusion

98. We have sympathy with Mr Nott, but for the reasons given above, his appeal is dismissed.

## Right to Apply for Permission to Appeal

99. 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.

**THOMAS SCOTT**
**TRIBUNAL JUDGE**

**RELEASE DATE: 18 FEBRUARY 2016**