

Uncertainties as to the corporation tax treatment of property development business for letting (build to rent)

Proactive submission by the Chartered Institute of Taxation

1 Introduction

1.1 This submission considers uncertainties in relation to the point at which

- a business,
- an investment business and
- a property business

commence for corporation tax purposes in the context of property development for letting (build to rent) by a special purpose vehicle (SPV). The SPV may be part of an established group or corporate partnership or a standalone company. It is assumed that the SPV has the commercial organisation and continuity in place to undertake a development including committed access to funding and service agreements in place.

Our stated objectives for the tax system include greater certainty, so businesses can plan ahead with confidence.

- 1.2 The issue of commencement of a property business and the related uncertainty is of also of significance to the Real Estate Investment Trust (REIT) regime. We understand that HMRC consider a property acquired in a newly incorporated company to be a REIT asset from commencement, where there is the intention of pursuing a property business. We also understand that HMRC's position will be included in their guidance.
- 1.3 Although there is manual guidance on what constitutes a business (and therefore its commencement) for some tax purposes and the beginning of a 'rental business', there is uncertainty about how the tests apply to property development for letting undertaken by a SPV.
- 1.4 It is recognised commercial practice to undertake a development or refurbishment of a building, that is to be held on completion as an investment for rental, in an SPV established for that purpose. The use of an SPV ensures the undertaking is separate from other commercial activities, it is not tainted by prior activities or by pre-existing obligations, it provides strategic flexibility and may facilitate a property investment joint ventures to share risk and rewards.

- 1.5 The commencement dates are important - for example for group companies where group relief is available or for pre-commencement expenditure outside the statutory seven year period¹ because:
- non-trading loan relationship debits may arise with excess debits available for group or consortium relief if a UK company has started to carry on a '*business*'. (For a non-resident landlord, finance costs will only be deductible once a '*property business*' has commenced.)
 - Deductible management expenses may arise when an '*investment business*' commences, again potentially available for group relief.
 - The SPV will be eligible to claim capital allowances and land remediation relief once a '*property business*' has commenced and a property is acquired
- 1.6 Appendix 1 outlines a fairly typical chronology of the stages of acquisition to letting. Appendix 2 reproduces earlier legislation: ICTA 1988 section 15 (Schedule A) and FA 1998 section 38 and Schedule 5 for ease of reference.

2 Summary of questions

2.1 Commencement of a 'business'

It appears that an SPV commences a 'business' as soon as it has the commercial organisation and continuity in place to undertake a development, for example, with group or third-party services agreements and funding secured. Does HMRC agree? If so, commencement of a business may occur before the property is acquired, on the facts.

The question of the commencement of a business in this context is considered further at paragraph 3.

2.2 Commencement of an 'investment business'

Would HMRC agree that the SPV with property investment objectives starts to carry on an investment business when it acquires the property and has the commercial organisation to undertake the development

The question of the commencement of an investment business in this context is analysed further at paragraph 4.

2.3 Commencement of a property business

Given the reference to profits of a property 'business' in CTA 2009 Chapter 3, would the SPV's 'property business' commence, when

- the SPV has the commercial organisation and continuity to undertake a development; or
- where the SPV has the commercial organisation and continuity to undertake a development and acquires a property for development

The question of the commencement of a property business in this context is analysed further at paragraph 5.

¹ CTA 2009 section 61

3 Commencement of a 'business'

3.1 Under CTA 2009 section 9(1) and (2)

- 1) An accounting period of a company begins—
 - a) when the company comes within the charge to corporation tax, or
 - b) immediately after the end of the previous accounting period of the company, if the company is still within the charge to corporation tax.
- 2) For the purposes of this section a UK resident company is treated as coming within the charge to corporation tax when it starts to carry on business if it would not otherwise be within the charge to corporation tax.

CTA 2009 Section 301 provides that a company has a non-trading deficit for an accounting period if net non-trading debits arise in the accounting period. Deficits on non-trading loan relationships can be surrendered as group relief subject to the corporate interest restriction, anti-hybrid, transfer pricing and other deductibility rules.

3.2 Under section 1167 CTA 2010, a UK resident company first comes within the charge to corporation tax when the company acquires a source of income such as interest from cash on deposit or from another interest-bearing receivable balance or otherwise brings itself within the charge in one of the ways suggested in *Walker v Centaur Clothes Group Ltd*. However, assuming the SPV is not 'otherwise within the charge to corporation tax', the date on which the SPV starts to carry on business will cause it to come within the charge to corporation tax and will start an accounting period in accordance with section 9, triggering the availability of non-trading debits.

3.3 There is no definition of 'business' in section 9 of CTA 2009 and therefore it takes its ordinary meaning. What constitutes a 'business' is often a grey area in terms of HMRC's approach depending upon the tax statute under consideration.

One explanation of HMRC's view of the meaning of 'business' is set out at CG65715 in the context of TCGA 1992 section 162 relief for an individual where the ordinary meaning of business is also determinative.

CG65715

Business' is not defined for the purposes of TCGA 1992 so the word must be given its normal meaning. It should be treated as including a trade' but it also goes wider than that. The terms business' and trade' are not synonymous.

It is a question of fact whether a particular activity constitutes a business. It is not easy to draw the line, and each case must be judged on its own facts.

The case of American Leaf Blending COSdn Bhd v Director-General of Inland Revenue [1978] 3 All ER 1185 (a Malaysian tax case heard by the Privy Council) is useful authority for what is meant by 'business' and highlights the fact that what may constitute a business if carried on by a company may not be a business if carried on by a private individual.

The meaning of 'business' in the context of incorporation relief was considered by the Upper Tribunal in the case of Ramsay v HMRC [2013] UKUT 0226 (TCC). That decision confirms that where the Courts have

considered the words elsewhere the particular context of the legislation involved often restricted the meaning. The First Tier Tribunal had misdirected itself by relying too much on such cases.

In his decision, Judge Berner set out the relevant factors to establishing whether if an individual is carrying on a 'business' for the purpose of incorporation relief:

Firstly, there are the factors that point to the activities involved being broadly what you would expect in a business:

- *Is there a 'serious undertaking earnestly pursued' or a 'serious occupation'?*
- *Is there an occupation or function actively pursued with reasonable or recognisable continuity?*
- *Is there a certain amount of substance in terms of turnover?*
- *Are the activities conducted in a regular manner and on sound and recognised business principles?*
- *Are they of a kind which, subject to differences of detail, are commonly made by those who seek to profit by them*

An important additional factor is the extent of the activities. The First Tier Tribunal found against Mrs Ramsay partly because it considered that the activities she undertook in relation to her property were 'normal and incidental to the owning of an investment property'. That was not the correct test in this context:

'It is the degree of activity as a whole which is material to the question whether there is a business, and not the extent of that activity when compared to the number of properties or lettings'.

- 3.4 Having noted that there is a more stringent test for an individual than a company on the authority of *American Leaf*, the guidance does not consider further when a company may be carrying on a business. At paragraph 684 of his judgment, Lord Diplock considers the point in detail:

'In the case of a private individual it may well be that the mere receipt of rents from property that he owns raises no presumption that he is carrying on a business. In contrast, in their Lordships' view, in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business. Where the gainful use to which a company's property is put is letting it out for rent, their Lordships do not find it easy to envisage circumstances that are likely to arise in practice which would displace the prima facie inference that in doing so it was carrying on a business.

The carrying on of 'business,' no doubt, usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between. In the instant case, however, there was evidence before the special commissioners of activity in and about the letting of its premises by the company during each of the five years that had elapsed since it closed down its former tobacco business. There were three successive lettings of the warehouse negotiated with different tenants; there was the removal of the machinery from the factory area which made it available for use for storage and a separate letting of that area to a fresh tenant; and as recently as October 1968 there was the negotiation of a letting to a single tenant of both the factory area and the warehouse.'

- 3.5 For a partnership to exist there must be a business, therefore HMRC's guidance on whether a partnership exists is also helpful to the question of what constitutes a business.

PIM1030

When does a partnership exist: more detail

A partnership is defined by Section 1(1) Partnership Act 1890 (which is reproduced in [PM133000](#)) as:

‘The relation which subsists between persons carrying on a business in common with a view of profit’

It is not enough to constitute a partnership that property is jointly owned or that the joint owners receive a share in the rents derived from it (Section 2 Partnership Act 1890). For there to be a partnership there must be a business. This is defined in Section 45 Partnership Act 1890 as including ‘every trade, occupation or profession’ and is a wider concept than ‘trade’. Griffiths v Jackson [1982] 56TC583 suggests that letting property may sometimes be a business.

Most cases of jointly owned property will fall short of the degree of business organisation needed to constitute a partnership. To accept that a partnership exists you would have to be satisfied that there is a similar degree of business organisation as in an ordinary commercial business. This means more than treating rental income as derived from a business of letting property - it must be business apart from that. See also the general guidance on the nature of partnerships at [PM130000](#) onwards.

Further at

PM120100 - What is a partnership?

‘Business’ is defined as including ‘every trade, occupation or profession’. So ‘business’ is a very wide term, embracing almost every commercial activity, and is much wider than trade or profession alone. It includes a business of making investments. Simply making an investment is not enough, there has to be sufficient organisation, continuity to make the activity a business.

- 3.6 We suggest that an SPV with the commercial organisation and continuity to undertake a development such that it has an approved business plan, an expectation of funding to enable it to pursue that plan, and has started business activities relating to that business plan such as appointing advisers and service providers that relate to the business would satisfy the tests set out in *American Leaf* and the criteria at PM120100 as to the commencement of a ‘business’. Commencement of a business may therefore occur before the property is acquired, on the facts. If HMRC disagree, at what point does HMRC consider a business begins?

4 Commencement of ‘an investment business’

- 4.1 The SPV will ultimately carry on an investment business for which the rental income will be the return on investment in the property. When does that ‘investment business’ commence? As noted above, the point is relevant to group relief that may be available for management expenses of the SPV’s investment business.
- 4.2 At CTM01420 (Corporation Tax: accounting periods: commencement - special cases), the guidance indicates:

CTA09/S9 (2) (formerly ICTA88/S12 (4))

An investment company’s only income may be dividends from other UK companies. Such dividends are excluded from the charge to CT by CTA09/PART9A, and formerly by ICTA88/S208 and CTA09/S1285. But the effect of CTA09/S9 (2), formerly ICTA88/S12 (4), is that the company is treated as coming within the charge to CT at the time it starts to carry on business. It starts business on the date when it first holds shares in another non-dormant company, and its first accounting period starts on that date. (Our underlining) These provisions allow it to claim management expenses under CTA09/S1219, formerly ICTA88/S75, see CTM08000 onwards.

By analogy is HMRC's view that an investment company starts an investment business when it first acquires the property?

- 4.3 CTA 2009 section 1218B provides that a 'company with investment business' means 'a company whose business consists wholly or partly of making investments'. Chapter 2 (section 1219 et seq.) determines relief for management expenses. Guidance on the meaning of an 'investment business' is given at CTM08050 that includes the following:

In the context of CTA09/S1218B 'making' can mean simply 'investing and holding'. This comes from the dicta of Rowlatt J in CIR v Tyre Investment Trust Ltd 12TC656. There is no reason for you to refuse investment company status to a company that makes a single investment, on that ground alone.

It is noted that at CTM08050 HMRC place some emphasis on the 'importance of a company's purpose in determining its business' and states, following a review of the case law, that:

'The essential point you can infer from these cases is that it is not enough that a company has investments, but rather its business (in the sense of its occupation) must consist in the making of investments. That is a question of fact to be decided by looking at the totality of the company's functions and activities.'

- 4.4 Would HMRC agree that the SPV with property investment objectives begins to carry on an investment business when it acquires the property on the basis that it has the commercial organisation (as described at 3.6 above) to undertake the development?

5 Commencement of a 'property business'.

- 5.1 CTA 2009 section 205 states that a company's UK property business consists of—

- a) every business which the company carries on for generating income from land in the United Kingdom, and
- b) every transaction which the company enters into for that purpose otherwise than in the course of such a business.

For the purposes of section 205(a), generating income from land is defined in section 207 as exploiting an estate, interest or right in or over land as a source of rents or other receipts.

Section 205(a) refers to a 'business' (see above at paragraphs 3 and 4 for commencement of a 'business' and an 'investment business').

- 5.2 PIM2505 considers the start of a 'rental business'. (It does not use the term 'property business' a term first used in CTA 2009 following the Tax Law Rewrite².)

PIM2505 Beginning and end of a rental business: commencement

ITTOIA/S57 and CTA09/S61

² See CTA 2009 Chapters 2 and 3. See for derivation : ICTA 1988 section 15 (Schedule A) and FA 1998 section 38 and Schedule 5 reproduced at Appendix 2

Start of rental business

The date a rental business begins is a question of fact that depends on the nature of the rental business. Normally a rental business will begin when the customer first enters into a transaction that exploits their land or property in a way which gives rise to a receipt of some kind.

Where the rental business is letting property, the business can't begin until the first property is let. You need to distinguish between activities that are preparatory to letting and those business activities that are part of letting. Once a rental business has started, all activities will be treated as carried out in the course of one business, subject to the points made in PIM1020 about businesses carried on in different capacities and the points made at PIM1030 about partnerships.

And further on that page:

The question of when a rental business starts normally only arises, therefore, when a customer receives income from property for the first time or begins to exploit their land and property for a profit for the first time.

- 5.3 The latter paragraph might suggest HMRC consider it is possible to 'exploit' the property as a source of profit (in the context of a rental business) before receiving rent notwithstanding the earlier text. In section 205(a) the wording '*for generating income from land in the United Kingdom*' is a purpose test, and surely can be prospective, that is, you can do something for a purpose that will give results in the future, the generation of rents being the future purpose.

In that case the property under development, even if partially completed, could be seen as an asset exploited as a source of rents by reason of the development activity.

- 5.4 There is no authority quoted in the manual for the start of a 'rental business' which leads to uncertainty as to its basis and origins. Is this approach HMRC's view or does HMRC consider there is case law authority? If the latter please could HMRC indicate the authorities or authority?
- 5.5 We note that, in contrast to the HMRC's view of commencement ('*Where the rental business is letting property, the business can't begin until the first property is let.*') HMRC's approach to determining the permanent cessation of a UK property business³ at PIM 2510 indicates consideration should be given to the type of activities and whether they amount to a continuation or a permanent cessation as a question of fact. The guidance indicates that for a rental business to cease the customer must end all activities giving rise to receipts from land and property. The guidance further provides that as a rule of thumb where a let property is sold and a new property is acquired the business is not treated as having ceased if there is a gap of less than 3 years between lettings and different properties are let before and after the gap. It is unclear why the threshold for commencement and cessation of a property business should differ so markedly. There is potential for economic distortion in relation to commencement where a newly established SPV may decide to acquire a property for refurbishment and retain a tenant for a short period in order to ensure the property business has commenced even if the preference commercially is to acquire a vacant property.
- 5.6 CTA 2009 section 210 introduces the requirement to calculate the profits of a property business in the same way as the profits of a trade subject to section 210(2), section 211 (excluding loan relationships/derivative contracts) and section 212 (capital allowances treated as expenses of a property business). The list at section

³ CTA 2009 section 282

210(2) of the provisions of Part 3 (trading come) that apply for the purposes of calculating the profits of a property business include section 61 (pre-trading expenses).

- 5.7 As noted, the profits of a property business are calculated in the same way as the profits of a trade (section 210(1)). HMRC's guidance indicates that the taxpayer is not actually treated as if they are trading unless they meet the normal trading tests (see PIM1020 - Introduction: what is a UK property business?). In determining when a property business commences for the SPV, it is not clear whether HMRC would apply the commencement provisions for a 'business' or take the view that the commencement test for a trade must be satisfied.
- 5.8 Put another way, is the date of commencement of a property business determined by question a) or question b) below :
- a) Has a property business (not a trade) come into existence that is being carried on with the intent of future exploitation of land for rents?' If it has, the company comes into the charge to corporation tax (para 3.1 above). The computational provisions applicable for a trade are applied to determine profits, from the date on which the property business came into existence.
 - b) Has a property business come into existence AND are the commencement provisions that apply for a trade satisfied? If so, then apply the computational rules for a trade, from the date on which the commencement provisions for a trade were satisfied.
- 5.9 Noting that Chapter 3 refers to a 'business', if the commencement tests for a trade are followed (per answer b) in para 5.8 above), that seems to call into question the established principle that a business is a wider concept than a trade. If it is accepted that a business is a wider concept than a trade, then it follows that a business may commence before the normal rules for commencement of a trade might be satisfied. We consider that the provisions in section 210 et seq. are merely computational provisions and do not impact on whether a business has begun. If that is correct, is HMRC's view that the SPV's property business would commence:
- when the SPV has the commercial organisation and continuity to undertake a development (satisfying the tests set out in *American Leaf* and the criteria at PM120100); or
 - when the SPV has acquired an estate, interest or right that it is capable of being exploited as a source of rents or receipts by virtue of its commercial organisation. Consequently, capital allowances would be available from the date of commencement once qualifying expenditure is incurred.
- 5.10 If, however, HMRC consider it is necessary for the property business to satisfy the tests as for the commencement of a trade it is not clear how the tests will operate in this context.

6 Acknowledgement of submission

- 6.1 We would be grateful if you could acknowledge safe receipt of this submission.

The Chartered Institute of Taxation

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Appendix 1

Typical stages acquisition to occupation

- A new (UK incorporated and UK resident) subsidiary is established and directors are appointed. The objects of the SPV are to make property investments. The company is a 100% subsidiary of an established property investment group.
- Typically the SPV is funded by a mixture of third party and/or intercompany debt.
- Group employees provide a service to the new SPV to undertake the development, the employee costs are recharged on arm's length terms.
- The company acquires a UK property (typically) with vacant possession from a third party or transfers a property from another company in the group. A scheme for development of the property for commercial letting is worked up.
- Development work commences.
- Building nears completion. A letting agent is appointed to identify prospective tenants. (The process of identifying prospective tenants may take months or even longer).
- Tenant is identified *
- An agreement for lease is entered into that includes obligations to complete the building to the tenant's specified requirements.
- Practical completion.
- Tenants take occupation.
- SPV receives first rental payment.

* In some cases, a tenant will be identified well before a building nears completion, or even before commencement of development works with the tenant playing a part in the actual design of the building for their requirements.

Appendix 2 Legislation preceding CTA 2009 sections 205, 207

ICTA 1988 section 15 (Schedule A)

Schedule A

(1)

The Schedule referred to as Schedule A is as follows:—

‘SCHEDULE A

1

Tax under this Schedule shall be charged on the annual profits or gains arising in respect of any such rents or receipts as follows, that is to say—

(a)

rents under leases of land in the United Kingdom;

(b)

rentcharges, ground annuals and feu duties, and any other annual payments reserved in respect of, or charged on or issuing out of, such land;

(c)

other receipts arising to a person from or by virtue of his ownership of an estate or interest in or right over such land or any

2

Tax under this Schedule shall be charged by reference to the rents or receipts to which a person becomes entitled in the chargeable period.

Exceptions

3

Paragraph 1 above does not apply—

(a)

to any yearly interest, or

(b)

to any profits or gains charged to tax under Schedule D by virtue of section 55, or

(c)

to any payment so charged by virtue of section 119 or 120;

and has effect subject also to the provisions of section 98 with respect to tied premises.

4

Where rent is payable under a lease under which the tenant is entitled to the use of furniture and tax in respect of the payment for its use is chargeable under Case VI of Schedule D, tax in respect of the rent shall be charged under that Case instead of under this Schedule unless the landlord elects that this paragraph shall not apply.'

(2)

An election that paragraph 4 of Schedule A shall not apply shall be made by notice to the inspector given within two years after the end of the chargeable period; and where such notice is given, any adjustment of the liability to tax of the person giving it which is required in consequence thereof may be made by an assessment or by repayment or otherwise as the case may require.

(3)

Profits or gains arising in any chargeable period from payments for any easement over or right to use any land made to the person who occupies the land shall not be excluded from the charge to tax under Schedule A by reason only that he is chargeable with respect to the land under Schedule B, but shall be treated for the purposes of Schedule A as limited to the amount (if any) by which they exceed the assessable value for the purposes of Schedule B of his occupation of the land in that period.

(4)

Part II contains further provisions relating to the charge to tax under Schedule A.

FA 1998 section 38 and Schedule 5

In section 15(1) of the Taxes Act 1988 (the Schedule A charge), for Schedule A substitute—

'SCHEDULE A

1

(1)

Tax is charged under this Schedule on the annual profits arising from a business carried on for the exploitation, as a source of rents or other receipts, of any estate, interest or rights in or over land in the United Kingdom.

(2)

To the extent that any transaction is entered into for the exploitation, as a source of rents or other receipts, of any estate, interest or rights in or overland in the United Kingdom, it is taken to be entered into in the course of such a business.

(3)

All businesses and transactions carried on or entered into by a particular person or partnership, so far as they are businesses or transactions the profits of which are chargeable to tax under this Schedule, are treated for the purposes of this Schedule as, or as entered into in the course of carrying on, a single business.

There are qualifications to this rule in the case of—

(a)

companies not resident in the United Kingdom (see subsection (1A)below); and

(b)

insurance companies (see sections 432AA and 441B(2A)).

(4)

The receipts referred to in the expression 'as a source of rents or other receipts' include—

(a)

payments in respect of a licence to occupy or otherwise to use land or the exercise of any other right over land, and

(b)

rentcharges, ground annuals and feu duties and other annual payments reserved in respect of, or charged on or issuing out of, the land.

2

(1)

This Schedule does not apply to profits arising from the occupation of land.

2

This Schedule does not apply to—

(a)

profits charged to tax under Case I of Schedule D under—

section 53(1) (farming and market gardening), or

section 55 (mines, quarries and other concerns);

(b)

receipts or expenses taken into account as trading receipts or expenses under section 98 (trading premises);

(c)

rent charged to tax under Schedule D under—

section 119 (rent, etc. payable in connection with mines, quarries and other concerns), or

section 120(1) (certain rent, etc. payable in respect of electric line wayleaves).

(3)

The profits of a Schedule A business carried on by a company shall be computed without regard to items giving rise to—

credits or debits within Chapter II of Part IV of the M1Finance Act 1996 (loan relationships), or

exchange gains or losses within Chapter II of Part II of the M2Finance Act 1993 (foreign exchange gains and losses), or

qualifying payments within Chapter II of Part IV of the M3Finance Act 1994 (interest rate and currency contracts).

This Schedule does not affect the operation of those provisions.

3

(1)

For the purposes of this Schedule a right to use a caravan or houseboat, where the use to which the caravan or houseboat may be put in pursuance of the right is confined to use at a single location in the United Kingdom, is treated as a right deriving from an estate or interest in land in the United Kingdom.

(2)

In sub-paragraph (1)—

‘caravan’ has the meaning given by section 29(1) of the Caravan Sites and Control of Development Act 1960; and

‘houseboat’ means a boat or similar structure designed or adapted for use as a place of human habitation.

4

(1)

In the case of a furnished letting, any sum payable for the use of furniture shall be taken into account in computing the profits chargeable to tax under this Schedule in the same way as rent.

Expenses in connection with the provision of furniture shall similarly be taken into account in the same way as expenses in connection with the premises.

(2)

A furnished letting means where—

(a)

a sum is payable in respect of the use of premises, and

(b)

the tenant or other person entitled to the use of the premises is also entitled, in connection with that use, to the use of furniture.

(3)

This paragraph does not apply if the receipts and expenses are taken into account in computing the profits of a trade consisting in, or involving, making furniture available for use in premises.

(4)

In this paragraph—

(a)

any reference to a sum includes the value of consideration other than money, and references to a sum being payable shall be construed accordingly; and

(b)

‘premises’ includes a caravan or houseboat within the meaning of paragraph 3.’.