

WHEN DOES A TRADE COMMENCE? THE RULES, FOR TAX PURPOSES



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It is important to ascertain the date on which a trade commences, for tax purposes. We summarise the main principles, from legislation, case law and HMRC's guidance.

COMMENCING TO TRADE, FOR INCOME TAX AND CORPORATION TAX PURPOSES

Some general principles have been established in case law as to whether a trade has commenced, and HMRC summarises these in its Business Income Manual at [BIM80500-80525](#):

- **There must be an activity and a customer:** In the case of *Ransom v Higgs* [1974] (TC 50 1), Lord Morris stated:

“To be engaged in trade or in an adventure in the nature of trade surely a person must do something, and if trading he must trade with someone”
- **The acts of setting up and commencing a trade are different:** In the case of *Mansell v Revenue and Customs Commissioners* [2006] (SPC 551), the Special Commissioner stated:

“A trade cannot commence until it has been set up and acts of setting up are not commencing or carrying on the trade. Setting up trade includes setting up a business structure to undertake the essential preliminaries, getting ready to face your customers, purchasing plant, and organising the decision making structures, the management, and the financing.

Before a trade can be said to commence there must be a fairly specific concept of the type of activity to be carried on. Further, an activity which consists merely of a review of the possibilities in the expectation or hope that information will be obtained to justify going into a business of some kind is not the carrying on of a trade. It is not always necessary that a sale is made or a service supplied before a trade can be said to be commenced for purposes of S 218 FA 1994.



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A trade commences when the taxpayer, having a specific idea in mind of his intended profit making activities and having set up his business, begins operational activities. Operational activities means dealing with third parties immediately and directly related to the supplies to be made which it is hoped will give rise to the expected profits and which involve the trader putting money at risk.

The acquisition of the goods to sell or to turn into items to be sold, the provision of services, or the entering into a contract to provide goods and services are operational activities and the kind of activities which contribute to the gross (rather than net) profit of the enterprise. However, carrying on negotiations to enter into the contracts which, when formed, constitute operational activity is not sufficient. At that stage, no operational risk has been undertaken and no obligation has been assumed which directly relates to the supplies to be made. It is not until those negotiations culminate in obligations or assets, and give rise to a real possibility of loss or gain that an operational activity has taken place. Negotiations may be part of setting up the trade but they do not betoken commencement."

HMRC comments at [BIM80505](#):

"The length of the setting up phase may vary and can be particularly long where complex modern technology is involved. As a general rule, a trade cannot commence until the trader:

- Is in a position to provide those goods or services which it is, or will be, his or her trade to provide, and
- Does so, or offers to do so, by way of trade.

Trading activity need not be on a large scale. But the production and sale of a small amount of stock-in-trade resulting from, for example, the trial run of a process would not necessarily mean that a trade had started (the nature of the activity may be characteristic of testing rather than of the trade to be carried on)."

- **All the facts and circumstances must be considered:** In the case of *Marson v Morton and Others* [1986] (59 TC 381), the Vice-chancellor stated: "It is clear that the question of whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case".
- **Trading before company formation:** HMRC comments at [BIM80525](#): "A company cannot commence trading before it comes into legal existence. Thus a company formed under the Companies Acts cannot commence trading until it is incorporated (although it might have succeeded to a trade which before the date of its incorporation was carried on by someone else)."
- **Companies becoming UK-resident:** an overseas company not previously trading in the UK through a permanent establishment, branch or agency is treated as starting to carry on a trade when it starts to be within the charge to corporation tax on becoming UK-resident (S 41 CTA 2009).

Some particular cases:

- A company which processed and marketed butchers' by-products was incorporated in June 1913. Shortly thereafter, it erected premises, purchased machinery and plant, and entered into agreements for the purchase of products and the sale of finished products. In August 1913 it engaged a foreman, and began actual processing in October 1913. It was held that the trade began in October 1913. (*Birmingham & District Cattle By-Products Co Ltd v CIR* [1919])
- Retail shops commence trading when they first open their doors for business (*J & R O'Kane & Co v CIR* [1922] 12 TC 303).
- With regard to service-type trades, an electronic engineer was held to have commenced trading when he entered into his first contract of engagement as an electronic designer (*Napier v Griffiths* [1990] (63 TC 745)). The Court noted that there was no evidence that up to that point the taxpayer was actively engaged in any business activities, or in doing anything preparatory to commencing business.

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HIGH TECHNOLOGY BUSINESSES

HMRC comments at [BIM80515](#):

“Some businesses may be set up to exploit an item of intellectual property (for example, in the case of biotechnology or other ‘hi-tech’ companies, a patent). They may raise substantial amounts of capital on the strength of this. But at the initial stages no decision may have been taken as to how best to realise the value of the patent (the business could develop, manufacture and sell a product, it could license the patent to others to do this, or it could undertake a combination of both). Large sums may be spent on research and development before the business decides what route to follow.

Until the business has decided how it will go about exploiting the patent it is unlikely to meet the criteria for commencing to trade. So its activities will be entirely preparatory. One result of this is that the losses arising from the initial activities are not trading losses. So they cannot be offset against other income (from, for example, the investment of the initial funding). But some relief may be available under the provisions for research and development tax incentives in S 1045 CTA 2009 or as pre-trading expenditure”.

PROPERTY DEALING AND DEVELOPMENT

Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. However, depending on circumstances, intentions may be changed (Lionel Simmons Properties Ltd (in liquidation) and Others v Commissioners of Inland Revenue [1980] 53 TC 461)).

The enhancement of land, limited to development of the infrastructure, does not entail trading (The Hudson’s Bay Company v Stevens [1909] (5 TC 421)).

HMRC comments at [BIM60530](#):

“A trade of dealing in land exists where land and/or property is acquired or developed with a view to profit on disposal. This is in contrast to the situation where property is acquired for investment, usually rental income, but over time that property may increase in value and a profit may therefore be realised from its eventual disposal. This increase in value may arise as a result of movement in the property market or from action taken by an owner to enhance the value of the property for investment purposes.

To establish if an individual or company is trading, the facts of each case are key. The list below gives some factors which could have an impact when considering if the business is carrying on a trade or investment in respect of land. This list is not definitive and each case will depend on its individual facts and circumstances.

- Length of time the land is owned.
- Intention at purchase date.
- Any change of intention.
- How the acquisition is funded.
- The usage of the property by the owner.
- Whether it is developed or improved (rather than repaired) Awbefore disposal.
- Whether there is a connection with an existing trade – for example a builder buying a property to renovate and sell.

PROPERTY RENTAL BUSINESSES (NON-TRADING)

In its Property Income Manual at [PIM2505](#), HMRC states:

“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.”

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