Property commencement rules: a case for an earlier start

Property Tax | Large Corporate

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UK property businesses may commence earlier than currently recognised under the property commencement rules, allowing earlier claims for deductions and reliefs in certain circumstances.

Key Points

What is the issue?
HMRC generally treats a UK property business as commencing only when rental income is first received, which delays the point at which a company is recognised as carrying on that business for corporation tax purposes.

What does it mean for me?
This affects when deductions and reliefs, such as capital allowances and land

remediation relief, can be claimed, potentially deferring tax relief on significant upfront development expenditure and affecting the timing of payments and after-tax cash flow.

What can I take away?
There is a strong statutory argument that a property business can commence earlier, once activities are sufficiently organised and directed towards generating rental income, meaning HMRC's approach may be open to challenge in appropriate cases.

This article examines HMRC's interpretation of when a UK property business commences and considers whether the statutory framework supports an alternative analysis. It focuses in particular on cases where the company is a special purpose vehicle within an established property investment or real estate investment trust (REIT) group.

The timing of commencement has important implications for the availability of certain reliefs and allowances, and for the amount of expenditure allowable in computing UK property business profits.

It is argued that, on a proper construction of the legislation, a UK property business may commence at an earlier stage than suggested by HMRC guidance, where a company has embarked on a commercially organised course of conduct directed towards the exploitation of land as a source of income.

Corporation tax commencement rules

To determine when a UK property business commences, we must first identify when a company comes within the charge to corporation tax. A company may do so either by having a source of income or by beginning to carry on a business, which in turn triggers the commencement of an accounting period for corporation tax purposes under Corporation Tax Act (CTA) 2009 s 9(1).

Under CTA 2009 s 9(2), a UK resident company comes within the charge to corporation tax when it starts to carry on business, if it would not otherwise be within the charge. Under CTA 2009 s 9(1), an accounting period begins when the company comes within that charge. One of the principal triggers is therefore when

the company begins to carry on a business, even if it has not yet acquired a source of income.

Accordingly, a company may come within the charge to corporation tax before any income is arising, provided its activities have reached the point at which it can properly be said to be carrying on a business.

This position is reflected in both HMRC guidance and case law. A company may be within the charge to corporation tax where it is carrying on a business even though no income has yet arisen (see HMRC's Company Taxation Manual CTM01410 and *Walker v Centaur Clothes Group Ltd* [2000] STC 324).

The meaning of 'carrying on a business'

As there is no statutory definition of 'business', the term must be given its ordinary meaning. It is necessary to rely on judicial authority and on HMRC guidance for their view, both of which establish that 'business' is a broader concept than 'trade'. Whether a business exists is determined by the nature and scale of the activity, such that a business may commence before a trade begins.

The breadth of the concept is illustrated in the case of *American Leaf Blending Co v DGIR* [1979] AC 676, where it was observed that, 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 will prima facie amount to the carrying on of a business.

In *Ramsey v HMRC* [2013] UKUT 26 (TCC), the Upper Tribunal emphasised that the question is one of fact and degree, to be assessed by reference to whether the activities display a sufficient degree of organisation, continuity and extent.

HMRC guidance adopts a similarly wide interpretation. HMRC's Property Income Manual PM120100, referring to Partnership Act 1890 s1(1), notes that a partnership is 'the relation which subsists between persons carrying on a business in common with a view of profit', and that business includes'every trade, occupation or profession'. The guidance makes it clear that 'business' is a much wider concept than that of trade or profession. It encompasses most commercial activity, including investment activity, but a mere investment is not sufficient without the necessary degree of organisation and continuity.

Likewise, HMRC’s Company Taxation Manual CTM03591 confirms that ‘business’ is a wider concept than ‘trade’ and requires active engagement rather than passive holding of assets. HMRC’s Capital Gains Manual CG65715 similarly notes that, in the absence of a statutory definition in the Taxation of Chargeable Gains Act (TCGA) 1992, the term must be given its ordinary meaning and is not synonymous with ‘trade’.

In summary, a company will be regarded as carrying on a business where its activities display a sufficient degree of organisation, continuity and commercial purpose, and where it has the operational or management capability necessary to pursue those activities with a view to profit.

Once it is established that a business has commenced, it is then necessary to determine whether that business is a UK property business.

UK property business framework

CTA 2009 s 205(a) and (b) together define a UK property business. A UK property business consists of:

(a) every business which the company carries on for generating income from land in the UK; and

(b) every transaction which the company enters into for that purpose otherwise than in the course of such a business.

‘Generating income from UK land’ is defined in CTA 2009 s 207 as exploiting an estate, interest or right in or over land as a source of rents or other receipts.

Taken together, these provisions define the scope of a UK property business but do not determine when a business commences for corporation tax purposes, as defined in CTA 2009 s 9(1) and (2).

For UK tax purposes, a company comes within the charge to corporation tax when it has a source of income or when it commences a business. As noted above, both HMRC guidance and case law recognise that ‘business’ is a broader concept than ‘trade’, such that a business may commence before the normal rules for the commencement of a trade are satisfied.

A trade is generally regarded as commencing once the entity has moved beyond preparatory activity and has begun operational activities directed towards profit-making, even if no sales have yet occurred (see *Mansell v HMRC* [2006] SPC 551 and *Wardle v HMRC* [2024] UKFTT 543 (TC)). The question is one of fact and degree in each case.

In the context of a UK property business, HMRC guidance typically interprets the commencement as beginning only when the first property is exploited – that is, when rent is first received (HMRC's Property Income Manual PIM2505). This interpretation tends to delay commencement and results in a significant amount of expenditure being treated as pre-commencement.

However, given that 'business' is a wider concept than 'trade', where a company has the necessary degree of organisation and continuity, activities such as undertaking a development for the purpose of exploiting land as an eventual source of rents may themselves constitute the carrying on of a business. On that basis, a UK property business may properly be regarded as having commenced at a much earlier stage than HMRC guidance suggests, and even earlier than commencement of a trade.

Tax implications of the commencement rules

The timing of commencement of a UK property business has implications across a number of tax areas. Two areas of particular significance to the property sector are the timing of claims for capital allowances and land remediation relief. In both cases, relief is only available once the business is undertaking a qualifying activity (see Capital Allowances Act (CAA) 2001 s 11 and CTA 2009 s 1147). HMRC guidance generally treats that activity as beginning only when the first property is let, thereby delaying the point at which relief may be claimed.

Land remediation relief in particular has been the subject of recent government attention as a means of incentivising brownfield development expenditure. For large development projects, there may be a significant period, potentially several years, between the commencement of development and the generation of the first rental income. During this period, substantial expenditure is incurred on financing, land remediation and construction, giving rise to considerable upfront cash outflows.

Deferring the ability to claim land remediation relief until a qualifying property business is treated as having commenced undermines the policy objective of

incentivising such expenditure. In particular, it creates a disconnect between the timing of the relief, including the availability of tax credits for qualifying land remediation losses, and the expenditure that the regime is intended to incentivise.

Alternative statutory interpretation

As noted above, ‘business’ is a wider concept than ‘trade’ and encompasses any ongoing activity conducted with a view to profit. From a statutory perspective, a business may commence before income arises where there is sufficient evidence that the activity is commercially organised and that the company has the necessary operational or management capability for commercial exploitation. Case law supports the proposition that a business can exist prior to the generation of income where there is evidence of commercial organisation and activity.

CTA 2009 s 205(a) refers to every business which the company carries on for generating income from land in the UK. The provision is framed in purposive terms: the focus is on activity carried on for the purpose of generating land income, rather than at the point at which rental receipts first arise. The statutory language directs attention to the nature, extent and organisation of the company’s activities.

Nothing in the legislation requires that rents must already have arisen. The real question under s 205(a) is whether the company’s activities have reached the point at which they constitute a business carried on for the purpose of generating income from land. Activities such as the acquisition of land or property, development, pre-letting activity and engagement with third parties may therefore amount to the carrying on of such a business, where they form part of an organised and commercially directed course of conduct aimed at exploiting land as a source of rents.

CTA 2009 s 205(b) refers to every transaction which the company enters into for that purpose otherwise than in the course of such a business. It operates as a supplementary provision, ensuring that transactions entered into for that purpose are brought within the UK property business even where they occur outside the ordinary course of that business.

Taken together, these provisions show that the statutory regime is intended to capture purpose-driven, income-directed commercial activity, rather than activity defined solely by the receipt of rental income. Section 205(a) sets the threshold by

reference to the degree and organisation of the land-exploitation activity, while s 205(b) operates as a catch-all, bringing within the UK property business transactions undertaken for that purpose even where they fall outside its ordinary course.

Part of an established property investment group

It may reasonably be argued that the special purpose vehicle has commenced a property rental business where:

- it is incorporated within an established property investment group;
- it has entered into management and financing agreements with its parent or associated companies for the purpose of raising finance; and
- it has acquired an interest in land with a view of undertaking a development.

In these circumstances, the special purpose vehicle has a sufficient degree of organisation, together with the necessary operational and management capability, and is actively engaged in steps directed at exploiting land as a source of income. This goes beyond passive asset creation and constitutes active commercial exploitation of land in accordance with the statutory purpose test.

On a proper reading of s 205(a), such activity constitutes carrying on a business for generating income from land.

Application to REIT groups

Where the special purpose vehicle forms part of a REIT group, the analysis is strengthened. The group is already established as carrying on a property rental business, and the special purpose vehicle operates within an existing commercial and management infrastructure dedicated to the exploitation of that land. Its acquisition and development activities are not speculative or exploratory but form part of an organised and ongoing property rental enterprise. This context supports the characterisation of the special purpose vehicle’s activities as business operations rather than preparatory steps.

This view is supported by both HMRC and the statutory framework. HMRC’s Investment Funds Manual IFM24045 (‘Development for own use’) states: ‘A company may acquire a building or land to develop it with a view to retaining the completed

property as part of its investment portfolio. The value of the property as it is being developed will count as assets involved in the property rental business for the property rental business and Balance of Business Conditions, even though it is yet to generate rental income.’

In addition, CTA 2010 s 529(3) provides that the property rental businesses of the members of a group are to be treated as a single business. This reinforces the conclusion that activities undertaken by a special purpose vehicle within a REIT group should be viewed in the context of the wider group business, rather than in isolation.

Lifecycle of a property business

1. A new special purpose vehicle (UK incorporated and UK resident) is established and directors are appointed. The special purpose vehicle is typically a wholly owned subsidiary of an established property investment group, and its objectives are to make property investments.
2. The special purpose vehicle is usually funded by a mixture of third party and/or intra-group debt.
3. Group employees provide services to the new special purpose vehicle, including development management, asset management and leasing support. The employee costs are recharged on arm’s length terms.
4. The special purpose vehicle acquires an interest in UK land, either from a third party or from another group company. A development scheme for commercial letting is formulated.
5. Development activity commences, including construction and associated project work.
6. During the development phase, active steps are taken to identify and engage prospective tenants, including marketing and preliminary negotiations.
7. A tenant may be identified and an agreement for lease entered into. In some cases, an agreement may be entered into at a much earlier stage, potentially before development work has commenced. In such cases, the tenant may play a role in the design and specification of the building.
8. Practical completion of the development is achieved.
9. The property is first let and rental income begins to be generated.

Under HMRC’s view, commencement occurs at step 9, when the property is first let and income generated. Under the alternative interpretation outlined above, commencement may occur at an earlier stage, potentially from step 4 onwards, once the company has acquired an interest in land and embarked on an organised and commercially directed course of conduct aimed at exploiting that land as a source of income.

Conclusion

On a proper construction of the legislation, a newly incorporated special purpose vehicle that has the commercial organisation and operational capability to undertake development activity, and that has acquired an estate, interest or right in or over land with a view to exploiting that land as a source of income, is carrying on a UK property business. The statutory test focuses on the taxpayer’s purpose and the commercial exploitation of land, rather than on the mere mechanics of receiving rental income.

Where the statutory language and commercial reality indicate that the business of generating land income is already underway, the better view is that the business has commenced. In those circumstances, HMRC’s interpretation, which effectively defers commencement until the point at which rental income is first received, risks placing undue weight on that factor and narrowing the statutory test beyond its natural meaning.

Accordingly, there is a a strong basis for concluding that an alternative interpretation is consistent with the statutory framework.

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