

## Carrying on a trade

### (Lecture B1231 – 12.02 minutes)

It is a well-known fact that the word 'trade', which is important for so many aspects of income tax (and, indeed, other taxes), is not defined in the tax legislation. The closest which we have to a definition can be found in:

- S989 ITA 2007; and
- S1119 CTA 2010.

Both sections tell us that 'trade includes any venture in the nature of trade' – not really a hugely helpful clarification!

It therefore comes as no great surprise that there have been a considerable number of cases on the subject of whether someone is carrying on a trade and, although they all turn on their individual facts, several important principles have emerged.

In *Ransom v Higgs* (1974), Lord Wilberforce said that, when Parliament introduced the reference to trade in 1799, they wisely abstained from defining it and left it to the Courts to decide what the word means. In the same case, another of the House of Lords judges (Lord Reid) called a trade 'operations of a commercial character by which the trader provides to customers for reward some kind of goods or services'. It should be noted that, on the evidence, the taxpayer was held not to be trading.

There are of course the famous 'badges of trade' set out in the final report of the Royal Commission on the Taxation of Profits and Income which was published in June 1955. These badges of trade were examined in detail in *Marson v Morton* (1986) and each one has had its own gloss placed upon it by the Courts.

One of the issues which is currently very relevant arises from ATED. This is because ATED is not chargeable where the person entitled to the interest in land is carrying on a property development trade and the land is held exclusively for the purposes of developing and reselling the land in the course of the trade – see S138 FA 2013.

This has been highlighted by the Upper Tribunal hearing in *Hopscotch Ltd v HMRC* (2020) where the taxpayer company claimed relief from ATED on the basis that it was carrying on a trade. The First Tier Tribunal decided that the company was not carrying on a trade and so, on appeal, the matter fell to be considered by the Upper Tribunal.

This case is interesting because of its novelty. The arguments are nearly always the other way round, with HMRC maintaining that the taxpayer is carrying on a trade so that any profit is chargeable to tax as income. In this instance, HMRC contended that they were not, given that carrying on a trade would entitle the company to relief from the ATED charge.

One particular area of difficulty is where an intention to trade is formed after the purchase of the relevant asset. It will sometimes be the case that an asset is acquired for the purposes of investment (or, in the case of a property, perhaps for private use), but later there is an intention to sell. The question which then arises is whether a trade has commenced so that there would be an

appropriation to trading stock (with capital gains consequences under S161 TCGA 1992). There is no doubt that this can occur – see, for example, the Court of Appeal’s decision in *Taylor v Good* (1974).

In *Hopscotch Ltd v HMRC* (2020), the Upper Tribunal judges laid out very clearly the following fundamental rules in this regard:

- (i) An asset can be held as trading stock or it can be held for non-trading purposes as an investment for capital appreciation or income generation or otherwise.
- (ii) An asset is either held for the purposes of a trade or it is not. There is no intermediate status.
- (iii) The mere fact that an asset was acquired for one purpose does not preclude the asset from being subsequently held for another purpose.
- (iv) Steps taken to enhance the value of an asset are capable of being steps taken either for the purposes of a trade or for the purposes of a non-trading activity.
- (v) In determining the question of whether an asset is held for the purposes of a trade, it is relevant to consider whether it was brought into use for the purposes of a pre-existing trade.
- (vi) In a case where there is no pre-existing trade, there has to be evidence that a trade has been newly set up which entitles the fact-finding body to come to a view that it is more than the taking of steps simply to enhance the value of the asset. This principle was established by the House of Lords in *Simmons v CIR* (1980).

*Hopscotch Ltd* owned a residential property (not held as trading stock) which the company decided to sell. However, it would not sell and so, after consulting with their advisers, *Hopscotch Ltd* resolved that it should be totally redeveloped since the redevelopment would result not only in a sale but in additional profits as well.

Accordingly, the company took detailed advice relating to the development, sought planning permission and borrowed money to finance the cost of the work.

These are exactly the sort of facts which would encourage HMRC to advance the argument that a trade had commenced. However, in the *Hopscotch Ltd* case, the Upper Tribunal said that this represented nothing more than the company taking steps to enhance the value of the property prior to a sale. HMRC contended that the work involved in redeveloping the property was not enough to constitute a trade. The work, they said, was similar to that routinely undertaken by landowners not carrying on a trade.

As mentioned above, the First Tier Tribunal held that the facts did not support the conclusion that a trade had commenced. The Upper Tribunal upheld this decision.

It will be interesting to see what happens when these same arguments are deployed by a taxpayer in the future. There is of course no assurance that HMRC will accept this reasoning when used against them in another case, but either way this decision looks to have some seriously helpful planning possibilities.

*Contributed by Robert Jamieson*