

Is it a trade or a hobby? (Lecture B1299 – 11.05 minutes)

Background

The question sometimes arises whether an individual's part-time or occasional activity constitutes a hobby or a trade. The distinction can be important.

For example, individuals who buy and sell goods on internet sites such as Amazon and Etsy on a regular and structured basis may well be challenged by HMRC if profits from those sources are not declared as trading income.

What is a trade?

Unfortunately, there's very little guidance on the meaning of 'trade' in the tax legislation. 'Trade' is simply defined (in ITA 2007, s 989) as including 'any venture in the nature of trade' (NB an identical definition applies for corporation tax purposes, in CTA 2010, s 1119).

A 'venture in the nature of trade' might lack infrastructure and continuity, but otherwise contain characteristics of a trade. HMRC considers that activities which, in ordinary language may not be a full-blown trade, can nevertheless be taxable as trading income (BIM20065).

Is it a hobby?

In terms of whether something is a 'hobby', a dictionary definition of 'hobby' is 'an activity done regularly in one's leisure time for pleasure'. Aside from being a regular activity, a hobby will typically have some structure and purpose.

An activity that starts out as a hobby can escalate into a trade. For example, attending jumble sales or car boot sales are popular weekend activities. However, some people go one stage further and visit jumble sales and car boot sales regularly to buy goods with the intention of selling them for a profit on the internet marketplace.

A profit seeking motive is one of the 'badges of trade' (see below), and even a one-off transaction can be taxable as trading income, depending on the circumstances.

Trading allowance

If a hobby is taxable, the trading allowance is generally available. The trading allowance exempts trading, casual and/or miscellaneous income of up to £1,000 per tax year from income tax (ITTOIA 2005, ss 783A-783AR).

It is possible to elect for full relief not to be given, and to deduct actual expenditure instead. This may be beneficial if (for example) it gives rise to a trading loss.

Examples of activities that might be eligible for the trading allowance include casual babysitting, gardening or dog walking. If goods are sold which have been bought or produced (e.g., home baked cakes or handmade greetings cards) this activity is likely to be trading or a 'venture in the nature of trade', and once again the allowance potentially applies.

Badges of trade

The lack of statutory guidance on the meaning of 'trade' has resulted in extensive case law over the years. In addition, the 'badges of trade' can sometimes be helpful.

The badges of trade were first established by the Royal Commission for the Taxation of Profits and Income in 1955, using previous case law about what constitutes a trade. Subsequently, in *Marson v Morton* Ch D 1986, 59 TC 381, nine badges were identified. HMRC guidance (at BIM20205) lists these badges as follows:

1. Profit-seeking motive;
2. The number of transactions;
3. The nature of the asset;
4. Existence of similar trading transactions or interests;
5. Changes to the asset;
6. The way the sale was carried out;
7. The source of finance;
8. Interval of time between purchase and sale; and
9. Method of acquisition

However, applying the list of badges to the facts of individual cases in a mechanical fashion should be avoided, as this may not necessarily give the correct answer. For example, *Marson v Morton* included this statement:

"...I would emphasise that the factors...are in no sense a comprehensive list of all relevant matters, nor is any one of them so far as I can see decisive in all cases." In addition: "I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question...was this an adventure in the nature of trade?"

In *Salt v Chamberlain* [1979] STC 750, the Judge (Oliver J) stated: "...I doubt whether the question whether in any given case a person is or is not carrying on a trade is capable of solution by the application of a logical progression of propositions culled from decided cases. The question is, I think, one of overall impression".

Exceptions to the rule?

In some cases, HMRC may seek to argue that an activity does not amount to trading. For example, some activities (e.g., gambling) are more conducive to incurring heavy losses than others. HMRC's approach is supported by an old established case, *Graham v Green*, KB 1925, 9 TC 309. One of the judges in that case stated:

"There is no tax on a habit. I do not think "habitual" or even "systematic" fully describes what is essential in the phrase 'trade, adventure, profession or vocation'. All I can say is that in my judgment the income which this gentleman succeeded in making is not profits or gains..."

However, in *McMillan v Revenue and Customs* [2020] UKFTT 82 (TC), HMRC argued (unsuccessfully) that an individual's gambling winnings were trading income on the facts and evidence of the case.

In practice, whether someone is seeking to argue that their activity is a trade or a hobby, it is very important to ensure that complete and accurate evidence is kept demonstrating the characteristics of a trade or hobby as appropriate, in support of their argument (see *Edwards v Bairstow and Another* [1955] 3 All ER 48).

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