

HMRC interest in the Badges of Trade (Lecture B1423 – 16.50 minutes)

One of the issues which has caught the attention of the press recently is the news that HMRC are getting information from online selling platforms which might enable them to identify individuals who are not paying sufficient tax. This would be on the basis that the activities are significant enough to be trading such that income tax and National Insurance Contributions would be due.

It is not an easy argument for HMRC to make and relies on the 'badges of trading' being met. There is statutory definition of trade which includes 'any venture in the nature of trade' which is not helpful. In the end, it is a question of fact whether someone is trading so there is scope for a disagreement to arise as to whether there is trading taking place.

Much of the case law relating to trading comes from a time when there was no capital gains tax so the difference between trading and not meant the difference between paying tax and not. However, we do still see this issue addressed in some cases.

The badges of trade are generally those included in the list below but it has often been stressed that this is not a comprehensive list and no single issue is decisive. The list is:

- Is there a profit-seeking motive?
- Are there systematic and repeated transactions?
- What is the nature of the asset and can it only be turned to advantage by selling it?
- Are there similar trading transactions or interests?
- Have you made changes to the asset which makes it more saleable or saleable at a greater profit?
- Were the sales carried out in the way that is typical of trading?
- Was money borrowed to buy the asset and could the funds only be repaid by selling the asset?
- What is the interval of time between the purchase and the sale?
- How did you get the asset as acquisition by inheritance or gift might mean it is less likely to be trading?

It is possible to look at these in more detail, both in a general context and also from the view of an individual who is selling on a platform such as Ebay.

Profit seeking motive

This is a not an easy one to start with. No-one is going to buy an asset in any circumstances hoping that it is going to lose value. If you buy a house which you are going to let out you are also going to be hoping that it will go up in value if you ever want to sell it.

HMRC would need to prove that the asset was acquired with an intention to re-sell at a profit with other factors (discussed below) then needing to be considered. Some assets (and the example always given is shares) are more likely to be held as an investment and any asset which has an income stream attached to it can be seen more as an investment asset.

Of course, intention can change. Someone might buy a property which they intend to refurbish and let out. Their circumstances might then change such that they decide to sell or someone might make them an offer they can't refuse! In neither case would it be easy for HMRC to treat that as trading income.

With someone who is dealing on Ebay there is a going to be a clear difference between someone who is selling off surplus items and someone who is actively buying items to sell on the platform. Both will have a profit-seeking motive but the other badges can be used to demonstrate that there is no trade.

Repeated transactions

The more transactions there are, the greater the likelihood that you start to veer into trading. However, it is important to acknowledge that a single transaction can be trading so again this is not determinative.

A good illustration of the problem with repetition is seen in a tax case where a taxpayer started a driving school which they sold for a profit. He then repeated this some 30 more times. The first transaction was the sale of a capital asset but the High Court found that the repetition meant that subsequent transactions were trading.

In an Ebay type situation, an individual could have many transactions if they have a lot of surplus items to get rid of. However, it is unlikely (although not impossible) that would be over a long period of time. What might happen is that someone starts off using an online platform to sell accumulated 'junk' but then realises how profitable it can be and starts to source items to sell. It would be that point when you would have to consider if a trade has started.

Nature of the asset

In reality, an asset could be subject to trading but some are more likely to be problematic. In the HMRC Business Income Manual at para. 20245, it is acknowledged that there are issues with trading arguments with the following types of assets:

- Those commonly bought for investment, such as shares, which yield an income;
- Those where there is personal use or enjoyment such as paintings or classic cars;
- Fixed assets used in trade, for example plant and machinery.

This is not definitive since art dealers will be buying and selling paintings but they are clearly trading. The repeated references to shares typically being held as investments is part of a wider view within HMRC that share dealing is not normally a trade. This is because there are often losses involved and HMRC do not want such losses to be available to set off against other income.

In an Ebay situation, it is unlikely that the assets will be of the type which are normally held as investment. However, an online platform could still be used to sell assets previously held as investments which are now being liquidated by the owner.

Similar trading transactions

If a person who is buying and selling assets has related interest or expertise then it is more likely what they are doing is trading. A good example would be someone who is a builder who renovates property in their spare time and tries to argue that this is not a trading transaction. On one Court case the comment made was:

'a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel'.

From an online selling perspective, this might be relevant where someone has a trading business and uses Ebay or similar to sell off surplus stock. Such transactions would be part of the underlying trade.

Changes to the asset

A modification to make an asset more saleable would be typical of trading activities in some cases. This would also include buying in bulk and breaking down assets into smaller lots to facilitate a sale.

However, this does need to be taken with some caution. An Ebayer who has clothes to sell and does some minor repair work on the items before they are sold or where something is cleaned up before sale is not likely to be seen as a trader for this reason alone.

Was the manner of selling indicative of trading?

This badge can perhaps now be seen as somewhat obsolete. The options available to anyone who wants to buy and sell items is wide given the nature of the internet and social media. It is difficult to see that this would be relevant in many cases.

The cases in the past where this has been a relevant factor is where there has been a forced sale (in one case of a property portfolio) which was not found to be trading.

Was money borrowed to fund the activities?

This badge looks at a situation where you have borrowed money which can only be repaid by selling the item purchased. There was a case involving Norman Wisdom in the 1960s where he borrowed money to invest in silver to hedge against devaluation of the currency. He borrowed money at a very high rate of interest which meant he would have to sell the metal quickly as he could not fund the interest costs.

In the context of online sales, it is difficult to see that this would be relevant in many cases but it is still something that needs to be considered.

Time between purchase and sale

It makes sense that someone who buys and sells quickly could be at risk of this being treated as a trading transaction. However, there can be reasons for selling quickly, including deciding that you just don't like something!

In the context of online selling, a person who is selling off surplus goods is not going to be at risk of being caught by this. A person who starts to buy to sell is more likely to have problems.

Method of acquisition

As noted above, if something has been inherited or gifted, then it is less likely to be trading unless you have been gifted the property to enable you to trade with it!

The risk with online sales lies with the person who is buying to sell on the platform.

Conclusion?

The wide range of online selling platforms means that there is a difficulty in making generic conclusions about the risks involved here. Anyone who is not otherwise self-employed can make use of the £1,000 trading allowance even if they are deemed to be trading on a small scale.

This initiative (if it is that) by HMRC is more about tackling those who are using online selling as a way of dodging scrutiny from the authorities. It feels like the biggest risk is going to be where items are being bought specifically to sell online which does happen. The greyer areas might be with platforms such as Etsy where people are selling items they have made themselves. In many cases, there could be argument that they are just using such a platform to sell the products of a hobby and only really getting back a small return on materials used. When does this become a trade?

It is important in a wider context to consider whether trading is a better option. A recent case involving a couple who were denied a deduction for capital gains purposes for a payment made to an individual who project managed the renovation of a property they had purchased raises interesting questions. Their intention had been to renovate the property personally and then rent it out but circumstances changed. No relief was available for the 'profit share' as it was not an allowable deduction within s38 TCGA 1992. If they had presented this as a trade, would they have been able to argue that cost was wholly and exclusively for the trade? Other expenses, such as interest, are also not deductible for capital gains purposes.

Finally, it is worth acknowledging that HMRC do still look at trading where property transactions are not declared on the basis that private residence relief is due. However, a recent case on this point (which had a twist on the residency point as the taxpayer was claiming that they were living in job related accommodation) was found to be a capital transaction (albeit without the private residence relief) even though a number of properties had been renovated and sold over a relatively short period of time. This case shows how difficult it is to argue around the badges of trading.

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