



62 The Street
Ashted
Surrey
KT21 1AT

T: 01737 844322 F: 01737 844162
Email: david@dbeckman.com

David Beckman & Co Ltd
Chartered Accountants & Chartered Tax Advisers

The Badges of trade

THE BASIS OF THE CONCEPT

How do you establish whether a person is carrying on a trade?

In 1955 a report by the Royal Commission on the Taxation of Profits and Income reviewed case law and identified six badges of trade. This was the starting point and as you can imagine there has been some development in the area supplemented by case law. HM Revenue & Customs (HMRC) now lists nine badges of trade:

- profit seeking motive
- the number of transactions
- the nature of the asset
- existence of similar trading transactions or interests
- changes to the asset
- the way the sale was carried out
- the source of finance
- interval of time between purchase and sale
- method of acquisition.

PROFIT SEEKING MOTIVE

It is clear that having an intention to make a profit can indicate a trading activity, however by itself it is not enough. In case **Salt v Chamberlain – Ch D 1979, 53 TC 143; [1979] STC 750**, a research consultant made a loss on the Stock Exchange after trying to forecast the market. The loss was made after several years and over 200 transactions. This was not seen as trade and capital in nature. It was concluded that share trading by a private individual can never have the badges of trade pinned to them. These transactions are subject to capital gains tax.

In another case, **Rutledge v CIR – CS 1929, 14 TC 490**, the taxpayer was on a business trip to Germany a taxpayer purchased one million toilet rolls. On returning to the UK the sole consignment of toilet rolls were sold to one individual for a profit. The profit made on this large quantity single purchase and resale item was ‘an adventure in the nature of trade’. The case was decided on the fact that the purchase was not made for own use or investment purposes.

THE NUMBER OF TRANSACTIONS



CHARTERED
TAX ADVISERS

Registered in England Registered Number: 04744238
Registered Address: 62 The Street, Ashted, Surrey, KT21 1AT

Registered to carry on audit work in the UK and Ireland and regulated for a range of investment business activities by the Institute of Chartered Accountants in England & Wales

Registered with the Chartered Institute of Taxation as a firm of Chartered Tax Advisers

Director: David John Beckman
MA (Cantab) FCA CTA FPC

VAT No: 812 3468 46



A single transaction can amount to a trading activity, it is more indicative if there are repeated and systematic transactions. This was clearly displayed in the case **Pickford v Quirke – CA 1927, 13 TC 251**. A syndicate purchased a cotton-spinning mill with the intention of using it in a trade, however, on purchase of the mill it was in a worse state than first anticipated. The syndicate then decided to strip the mill of its assets and sell it piecemeal, making a profit. This was repeated a number of times with a number of mills. Due to the repeated nature of the transactions it was held that the profits were trading profits and taxable as such.

THE NATURE OF THE ASSET

This principle is more difficult to explain, it looks at the asset, problems arise when assets are bought either as:

- an investments that has the ability to generate income
- personal assets
- some assets used by a trade such as plant and machinery.

An important case in this area was **Marson v Morton – Ch D 1986, 59 TC 381; [1986] STC 463; [1986] 1 WLR 1343**. This was where land was purchased with the intention to hold it as an investment. No income was generated by the land, however, it did have planning permission. The land was sold later following an unsolicited offer. As the transaction was far removed from the taxpayer's normal activity (potato merchant) and was similar to an investment, it was not a trading profit. The transaction was not an adventure in the nature of a trade.

Another case **Wisdom v Chamberlain – CA 1968, 45 TC 92; [1969] 1 WLR 275; [1969] 1 All ER 332**, looked at the principle 'pride of possession' assets that generate no income. A taxpayer purchased two large quantities of silver bullion to counter the effects of the devaluation of the pound. The purchase was made following advice and was partly financed by loan. As the purchase was done on a short term basis in order to realise profit. There was an adventure in the nature of trade and was therefore assessed as trading profit.

Existence of similar trading transactions or interests

This is best demonstrated in the case **CIR v Fraser [1942] 24TC498**. In this case the taxpayer was a woodcutter who bought a consignment of whisky in bond. He subsequently sold the whisky through an agent at a profit. Within the decision the judge stated:

‘The purchaser of a large quantity of a commodity like whisky, greatly in excess of what could be used by himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by a process of realisation, I can scarcely consider to be other than an adventurer in a transaction in the nature of a trade... Most important of all, the actual dealings of the respondent with the whisky were exactly of the kind that take place in ordinary trade.’

Changes to the asset

It is important to take note of any changes or modifications made to an asset that may make it more marketable. In the case **Cape Brandy Syndicate v CIR – CA 1921, 12 TC 358; [1921] 2 KB 403**, members of a wine syndicate joined in a separate syndicate to purchase brandy from South Africa. Some was shipped to the East with the remainder being sent to London to be blended with French brandy, re-casked and sold at a profit. The taxpayer tried to argue that the transaction was of a capital nature from the sale of an investment. It was held that a trade or business was carried on and was assessable as a trading profit.

The way the sale was carried out

HMRC states in its guidance that it is always a pointer if a transaction follows that of a ‘undisputed trade’. The case **CIR v Livingston and Others 11TC538**, involved three unconnected individuals that together bought a cargo vessel. The vessel was converted into a steam-drifter and sold for a profit. The purchase was the first vessel the three individuals bought. An assessment was raised on the profit which was upheld as a trading profit. Within the decision the judge stated:

‘I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, in the nature of “trade”, is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.’

The source of finance

Determining the source of finance is important when deciding whether a trade is carried on. Finance taken out to purchase an asset, in the first instance may indicate that to repay the debt the asset would have to be sold.

This was demonstrated in the **Wisdom v Chamberlain – CA 1968, 45 TC 92; [1969] 1 WLR 275; [1969] 1 All ER 332** mentioned above.

Interval of time between purchase and sale

The length of time an asset is held is an important indicator of trade. The longer the period of ownership the greater the chance of it been seen as an investment rather than a trade. HMRC also look at the intention, if you can demonstrate an intention it could indicate the tax treatment. The two key cases on this are **Wisdom v Chamberlain – CA 1968, 45 TC 92; [1969] 1 WLR 275; [1969] 1 All ER 332** and **Marson v Morton – Ch D 1986, 59 TC 381; [1986] STC 463; [1986] 1 WLR 1343** both mentioned above.

Method of acquisition

Finally, it is important to look at how an asset is acquired. If it is inherited or gifted it is a good indication that a trade is not being carried, although this is not always the case. An asset acquire at a market could indicate that it has either been purchased for a trade or an investment.

The case **Taylor v Good** – CA 1974, 49 TC 277; [1974] STC 148; [1974] 1 WLR 556; [1974] 1 All ER 1137 concerned a taxpayer who purchased a house with the intention of using it as a family home. The taxpayer's partner did not approve the house and refused to move in, which forced the taxpayer to sell the house immediately. The purchaser genuinely had the intention of not buying the property for a profit motive. As the sale was a short period of time after purchase it was still not deemed to be a trade. Within the decision the judge stated:

‘Even if the house was purchased with no thought of trading, I do not see why an intention to trade could not be formed later. What is bought or otherwise acquired (for example, under a will) with no thought of trading cannot thereby acquire an immunity so that, however filled with the desire and intention of trading the owner may later become, it can never be said that any transaction by him with the property constitutes trading. For the taxpayer a non-trading inception may be a valuable asset: but it is no palladium. The proposition that an initial intention not to trade may be displaced by a subsequent intention, in the course of the ownership of the property in question, is, I think, sufficiently established...’

This is only a summary of the badges of trade and leading tax cases. As in all cases, each situation must be judged on its own merit.

62 The Street Ashted Surrey KT21 1AT

Tel: 01737 844322 Fax: 01737 844162 Email: david@dbeckman.com

This fact sheet is for information only. It provides an overview of the regulations currently in force and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore, no responsibility for loss occasioned by any person or refraining from action as a result of this material can be accepted by the authors or the firm.