Internet trading : a risk factor for returns – podcast notes

HMRC's campaign on e-trading closed in September 2012.

HMRC uses technology like web robots to search the web and identify frequent vendors. The use of such technology means that HMRC owns a massive amount of data on internet selling.

HMRC is using the data gathered to support the campaign to identify those who should have come forward but chose not to. As at 30 November 2012, 56 completed investigations have recovered more than £670,000. The identification of cases suitable for checking by HMRC and for criminal investigation is on-going. The success of the campaign to date suggests that many people have been making mistakes about reporting the tax consequences of their selling items.

This podcast has been prepared on the basis of the UK legislation which is in force at 31 August 2013. In tax, the law can change with Finance Acts, Statutory instruments and decisions of precedent which includes not only decisions of the British Courts but also the European Courts.

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It can be difficult to decide whether or not an activity of selling on say e-Bay amounts to a trading activity or has a tax consequence. Even the disposal of a single item could have implications for VAT, income tax or capital gains tax. If a person is already registered for VAT then a sale which has occurred as a trading activity, even though totally different and unconnected with their 'normal' business activity may produce a VAT liability. This is because a trader must account for VAT on any sale made in the course or furtherance of any business activity. So it is important commercially to get this right as finding the sale price at e-Bay auction was inclusive of VAT may make the difference between the activity being profitable of loss making.

Many people sell on e-Bay, Gumtree and sites for vending but they are not trading. Car boot sales and similar types of vending opportunities mean it is easier to find a market and sell things.

Multiple sales of similar items may suggest trading. If the posting says, for example, that there are 100 items being sold and the bid is for one item, this suggests that the vendor has treated the acquisition and sale as being like a commodity. If the period of ownership between buying and selling is short, this suggests that the activity is that of a trade. But note that I have used the word "suggest" rather than determines. If the vendor sells the same thing frequently, it suggests trading.

If person is VAT registered but thinks it is non-business they may be generating VAT problems. If turnover of VAT taxable goods and services supplied within the UK for the previous 12 months is more than the current registration threshold of £79,000, or you expect it to go over that figure in the next 30 days alone, you must register for VAT. If registered and something is sold in the course or furtherance of any business activity, VAT needs to be charged.

Even if activities have some or all the characteristics of a business, they may not be considered a business for VAT purposes if they are essentially a recreation or hobby, or an isolated transaction. So if a client only makes occasional VAT taxable supplies, or their supplies are minimal, it may be that client does not need to register for VAT. The one-off or infrequent sale of personal belongings at a car boot sale or auction, for example, would fall into this category - but buying goods for resale on a regular basis is definitely a business activity.

Case law provides some clarification of where the watershed lies between a trading activity and merely selling things as a hobby. I have summarised some of the leading cases at the end of this note should you wish to read more.

HMRC now deploy their resources using risk assessment and this would suggest that those who sell frequently are most likely to be targeted by HMRC.

Although the campaign has closed, it is possible to make a voluntary disclosure and obtain the 'benefit' of considerably mitigated penalties.

Ask the client whether they sell on e-Bay and Gumtree etc

Establish the facts on what is sold and with what frequency. A friend with whom I play golf regularly has bought and sold about 30 golf clubs this year in around 60 plus transactions, mainly putters and drivers. Such a frequency might suggest a trading activity but in reality he is pursuing his hobby of golf and trying to reduce his handicap. The cases which indicate that frequency is trading include Leach v Pogson (1962) 40 TC 585. The taxpayer started a driving school and later sold it at a profit. If he had only sold his business once, the sale of the business would undoubtedly have been a capital transaction but he then set up and sold some 30 driving schools. The High Court held that the subsequent sales had tainted the first, so that it too was a trading transaction. In Pickford v Quirke (1927) 13 TC 251, the taxpayer bought and asset stripped a spinning mill business. Then, in partnership with friends, he repeated the transaction four times. Rowlatt J said that one transaction does not usually give rise to a finding of trading but systematic repetition raises an inference of trading.

If something has been bought and sold as if it were a commodity, it suggests the activity was trading. In IR Commrs v Fraser (1942) 24 TC 498, a woodcutter bought whisky in bond and later sold it at a profit. This was held to be trading. In Martin v Lowry (1927) 11 TC 297, there was a single purchase of 44 million square yards of linen followed by setting up a sales organization and selling all over a 7 month period. In Rutledge v IR Commrs (1929) 14 TC 490, Mr Rutledge allegedly bought a million rolls of toilet paper and sold them on a single transaction, claiming this was capital but losing that argument. He bought and sold a commodity and it was trading.

Modification of the asset suggests a trading activity. In IR Commrs v Livingston (1926) 11 TC 538, a ship repairer, a blacksmith and an employee of a fish salesman bought a cargo ship. They had never done anything like this before but to make it more marketable they converted it into a steam drifter which was then sold at a profit. They were trading. In Cape Brandy Syndicate v IR Commrs (1921) 12 TC 358, the taxpayers were all involved in the alcohol trade but were members of different firms. They bought three lots of brandy, shipped it to London where it was blended, mixed and packaged before being sold by the taxpayers at a considerable profit. The Court of Appeal held this to be trading.

The late Norman Wisdom was undoubtedly an astute individual. He predicted the devaluation of the pound sterling and to protect his wealth decided to invest in bullion silver. He borrowed on short term loans to finance the acquisition and this suggested that he intended to sell quickly. The profit he made was trading. (Wisdom v Chamberlain (1968) 45 TC 92).

A telling point in the late Mr. Wisdom's case was that the judge ruled that owning silver bullion does not give any pride of possession. This could be important. A friend bought an American classic muscle car on e-Bay. He explained to me that he knew it was a snip and he was confident that he could get at least his money back if he sold it again. But he had always wanted to own a car like this since his teenage years. He sold the car after a few years for three times what he had paid for it making a substantial profit. This was not trading because his ownership did give pride of possession and when he bought the car he did so intending to drive it. He knew it was a bargain but he did not buy with the intention of selling at a profit.

Mr X had been in business for many years and decided to move office to a more modern building. He sold his antique desk and chairs at auction receiving a very good price. The chairs were a set and the proceeds exceeded the chattels exemption and his annual allowance creating a liability to capital gains tax. He was not trading when he sold his antique furniture but there was tax to pay.

If a client tells you that they have been selling things regularly, I suggest that you consider whether it is a business like activity and if so what are the tax consequences (individual income tax and VAT if trading, CGT if chargeable assets). Is it material? If it is and there is a need to report additional tax liabilities, I recommend that voluntary disclosure is best.

Cases mentioned in this podcast which are helpful in clarifying the watershed of what is or is not a trading activity include:

Cape Brandy Syndicate v IR Commrs (1921) 12 TC 358 blending was trading activity
IR Commrs v Fraser (1942) 24 TC 498, whisky in bond was trading
IR Commrs v Livingston (1926) 11 TC 53 modification to sell profitably is trading
Leach v Pogson (1962) 40 TC 585. Frequent repetition was trading
Martin v Lowry (1927) 11 TC 297 – single purchase of vast quantity of linen was trading
Pickford v Quirke (1927) 13 TC 251 Repitition suggests trading
Rutledge v IR Commrs (1929) 14 TC 490 Isolated transaction of a single purchase & single sale was trade
Wisdom v Chamberlain (1968) 45 TC 92 – bullion silver financed on borrowings