

## Contractor badges of trade: HMRC rules on being in business

Contractors are **in business on their own account** if they can demonstrate **HMRC's nine badges of trade**. This can be important, as being in business means that a contractor must pay tax like a business and it can also assist with **determining IR35 status**.

"HMRC has nine 'badges of trade' that it will apply to an entity or individual, such as a contractor, to determine whether it is a business," explains Emily Coltman FCA, chief accountant to **FreeAgent**. "The taxman will take a holistic view of each individual contractor, considering whether on balance the results of applying the nine factors mean that there is a business operating."

Coltman's analysis of the nine badges of trade and how they apply to contractors is as follows:

### 1. Is there an intention to make a profit?

"An intention to make a profit is a strong indication that the contractor is trading, although you could be trading and not be that worried about making a profit," continues Coltman.

If an individual was delivering their services more as a hobby and not charging commercial rates, then HMRC might say that the activity is not a trade: "You could write a one-off article about a topic you are interested in and charge a nominal fee to cover your costs, which would not be trading."

"However, if the writer was doing photo research for images to accompany the story, writing it for a magazine and going to receive a commercial fee for their work, then this is a strong indication that they are trading."

### 2. The number of transactions

If a contractor is delivering their services on a regular and frequent basis, then it is likely that they are trading. This includes, for example, engineering contractors who might only have one or two transactions a year because they are working on lengthy projects. But in the context of what they do, the transactions are 'systemic and repeated'.

"HMRC is looking for a pattern," says Coltman. "Someone who builds a website for a friend's business just the once is unlikely to be trading."

### 3. The nature of the assets

According to Coltman, several of HMRC's 'badges of trade' criteria are more relevant to product-based businesses rather than service companies, such as contractor limited companies.

This is one such factor, as Coltman explains: "When considering this factor, HMRC looks at what is being sold. If an individual is selling something that before it was sold gave personal enjoyment, then they are unlikely to be trading. So, if a contractor inherited their grandfather's record collection and then sold it on eBay, this is unlikely to be a trade."

Contractors rarely include any kind of product offering as part of their business, but if they did, then the type of asset they acquire and then sell on will form part of HMRC's holistic view of their business.

### 4. 'The existence of similar trading transactions or interests'

Contractors who sell new or additional services that are related to their core contracting activities may also be carrying on a trade. Coltman gives an example: "Take a web designer whose core services are designing and building websites. They may also decide to start developing apps for their clients. This is similar to what they already do, so HMRC would most likely consider this an extension of their existing trade."

"If, however, the web designer decided to write a book, unless it was on web design or app building, then this would be unlikely to be considered as a business."

### 5. Making changes to the asset

This is another product-based factor that is only likely to apply to a small number of contractors. If the contractor acquires an asset that they then repair or modify to make it more easily saleable, then it could be a pointer towards trading. An IT contractor who also does hardware repairs might be an example, and this could also fall into category 4 as a related activity.

But Coltman points out that not all 'changes' to an asset mean it becomes a trade: "A contractor who inherited an antique painting and cleaned it up before selling it may not be trading, because of the nature and volume of the transactions."

## 6. How the sale was carried out

Coltman confirms that the key point here is if the sale was made in the way of a trading business: "If a contractor was selling their services by uploading their CV to a job board, or a site such as [PeoplePerHour](#) or elance, then it is like that they are carrying on a trade.

"Selling a prized collection of trading cards or a classic car to generate some emergency cash, and getting paid by cheque, is less likely to be considered as trading, particularly if there is no pattern to the sales."

## 7. How was the purchase of an asset for sale financed

Although mainly geared towards product-based businesses, the source of finance badge of trade factor can still be applied to a contractor. If the asset in a product business was bought using borrowed money, and the asset then needs to be sold to repay that loan, then there is case law that points to this as being a trade.

Coltman says there is a parallel for contractors: "If an IT contractor borrowed money to fund a training course on the latest development language, then this would strongly indicate that the contractor is trading.

"However, a bookkeeper who decided they fancied learning about web design for interest is more likely to dip into savings or use a bequest to finance the training, and HMRC would be more likely to conclude that this was not an extension of trade."

## 8. Length of time between the purchase and sale

HMRC suggests that: "Assets that are the subject of trade will normally, but not always, be sold quickly. Therefore, an intention to resell an asset shortly after purchase will support trading."

"The parallel for contractors is how quickly are customers acquired and the service delivered? Do you work to deadlines, or get the work done as and when you have the time? If you are working to deadlines and turning work around quickly, then you are more likely to be trading."

## 9. How the asset was acquired

This is one badge of trade that does not really have a service related parallel for contractors. If a contractor acquired an asset, such as granddad's record collection or a classic car, as a gift of inheritance and then chose to sell it on, it is much less likely to be trading.

"HMRC will consider all of these nine badges of trade 'in the round' to determine whether a contractor's activities are a hobby or an actual trade," adds Coltman.

Coltman concludes: "If a contractor is trading, then they must ensure that their business is registered with HMRC and they are paying any income tax, National Insurance Contributions (NICs) and corporation tax due.

"Failure to declare additional trading income could lead to HMRC accusing a contractor of understating their income, that in turn could result in a potentially substantial bill for back taxes, interest and penalties."

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