

GUIDANCE ON REVENUE OPINIONS ON CLASSIFICATION OF ACTIVITIES AS TRADING.

INTRODUCTION

The introduction of the general 12½% corporation tax regime for profits from trading activities of companies is focusing attention on what activities can be classified as giving rise to trading income. Revenue is increasingly being asked to give opinions as to the appropriate classification for tax purposes.

The purpose of this note is to give general guidance as to how Revenue approaches the subject and to outline the type of information that should accompany a request for an opinion.

Revenue Opinions

Under the self-assessment system the question of whether a company is, or would be, trading is decided initially by the company itself. For most companies it would be obvious whether or not they are trading. Where a taxpayer has a doubt about the tax treatment, he or she may take a view on the issue and express doubt under Section 955 of the Taxes Consolidation Act, 1997. A formal expression of doubt protects the taxpayer from interest and penalties in the event that Revenue, for example, in the context of an audit, take a different view of the tax treatment at a later date. In addition, the Revenue Commissioners

are prepared to give an opinion on the classification of income as trading in accordance with the guidelines issued in Tax Briefing issue 48 – June 2002 on ***Seeking Revenue Opinions on Tax Consequences of Certain Complex or Unusual Transactions***. In accordance with these guidelines an opinion will not be given, where Revenue, having considered all the documentation submitted, are of the view that the transaction (s) is part of a scheme or arrangement for the purpose of tax avoidance.

TRADING

Section 21 Taxes Consolidation Act, 1997 sets the general rate of corporation tax at 12½%. That rate applies (subject to certain exceptions set out in Section 21A) to trading income of companies taxed under Case I of Schedule D.

Section 3(1) of the Taxes Consolidation Act, 1997, describes “trade” as including “every trade, manufacture, adventure or concern in the nature of trade”. As “trade” is not specifically defined the term takes on the generally accepted meaning.

Guidance as to what constitutes “trading” is available from case law and from a set of rules drawn up in 1955 by the UK Royal Commission on the Taxation of Profits and Income. These rules known as the Badges of Trade have been approved by the Irish Courts. (See appendix for details of the Badges of Trade).

In the vast majority of cases there will be no doubt about whether a company’s

activities constitute trading. Companies manufacturing, dealing in articles or commodities and those providing services will all come within the “trading” description. The 10% tax regime for companies in the IFSC and Shannon applies only to income arising from trading activities. Therefore such activities already meeting the requirements of these regimes will qualify for the 12½% tax rate.

RELEVANT ISSUES

Whether or not, in any situation, a trade is being carried on is determined by an examination of the facts of the particular case and by interpreting those facts in the context of the badges of trade and of case law in so far as it applies. There is an infinite variety of possible factual circumstances so that no fixed formula can be applied to determine whether or not an activity can be classed as “trading”. As already pointed out in the previous paragraph, in the vast majority of cases there will be no doubt about whether the activities constitute trading. However a number of issues has emerged in the recent past from cases brought to the attention of Revenue in the context of the introduction of the 12½% rate.

The issues are explored in the following paragraphs: -

(a) Trading Presupposes Activity.

Trading presupposes that the company concerned is carrying on business activities from which its income derives. The activities will vary depending on the nature of the trade and will require people with the skill and authority necessary to carry them out.

Outsourcing of activities would not necessarily prevent a company's income being taxed as trading income. Where outsourcing is involved the company must provide details of how it conducts, manages and controls the outsourced part of its business.

(b) Distinction between Trading and Investment.

Certain types of activity are more likely to be in the nature of an investment rather than a trade. In general where a company owns an asset and the mere ownership of that asset produces an income, the company's income from this asset will not be trading income. Routine ancillary services such as invoicing or accounting would not change the nature of the income to trading income where it is primarily generated by the ownership of the asset. The ancillary activities merely involve the management of the income flow from the investment. The activities of companies whose sole activity is the management and exploitation of intellectual property can sometimes be difficult to evaluate in terms of whether there is a trade being conducted. The nature of the property of such companies varies widely and can include brand names, patents, software, process formulations and know-how. Because intellectual property is an asset the mere ownership of which yields an income, there are significant hurdles to be cleared before the income of a company from licensing such property could be regarded as trading income. The case of *Noddy Subsidiary Rights Company Ltd v. CIR*⁴³ TC 458 is often quoted as an authority in favour of the proposition that the mere

ownership of an asset and receipt of royalties can be a trade. However, in that case there was evidence of a high degree of activity associated with trying to promote the brand, seeking out and evaluating licensees and of dealing with third parties.

At one end of the scale, a company whose only activity is the licensing in of the rights to intellectual property, and the on-licensing of such rights, is unlikely to be regarded as trading. The property licensed to it is not developed in any way. The company is merely a conduit through which the rights to the intellectual property pass. At the other end of the scale, income of a company that actually creates the intellectual property by engaging in R & D, continues to develop it and bears the costs and the associated risks and actively promotes and licenses out the rights for its use to multiple third parties would invariably be regarded as trading income.

Not all of the income of a trading company will necessarily be classified as trading income. In this regard Revenue published a Guidance Note: -

Deposit Interest - Whether a Trading Receipt? on the Revenue web site. This Guidance Note clarifies the status of deposit interest earned by trading companies.

(c) Group Structures

Where a company seeking trading status is a member of a group and another group company or companies have an involvement in the conduct of the particular trade, Revenue would need to be satisfied as to the role of the various companies. In particular the company seeking trading status in respect of an activity must establish that it carries on sufficient activity to be trading in its own right. Evidence in relation to the levels of authority and responsibility across the group will clarify where the real decision-making lies, and information in relation to the deployment of assets and personnel will clarify the business activities carried on by each company. An explanation of the commercial reasoning and the business objectives behind a particular group structure will be helpful in understanding the underlying strategic business purpose and the value added by the applicant company.

Information to be Included when Requesting an Opinion

A request for an opinion should include a description of the proposed activity and contain all the information necessary to enable Revenue to reach a conclusion in relation to the issues outlined in the earlier paragraphs. Any areas of doubt should be highlighted and reasons given as to why it is considered that trading status would be appropriate in the circumstances. In particular the following details should be given: -

- Outline of the trade to be carried on. If there is potential for

viewing these activities as investments, explain why it is considered that trading should apply.

- the main activities involved in the conduct of the trade and the functions undertaken at senior level to manage the trade.
- the number of people at management level, their skills and authority level.
- the number and skill level of the other people who will carry out the functions involved in the conduct of the trade.
- In relation to a group structure that might give rise to the concerns outlined at paragraph (c) above, provide the information set out in that paragraph.

Requests for an opinion should follow the procedures set out in the practice note on ***Seeking Revenue Opinions on Tax Consequences of Certain Complex or Unusual Transactions (Tax Briefing issue 48)*** and give the additional information indicated in this note.

Requests should be addressed to: -

Ms. Marie Hurley,
Corporate Business and International Division,
Financial Services I,
2nd Floor,
New Stamping Building,
Dublin Castle,
Dublin 2.

Appendix

Note on the “Badges of Trade ”

The Tax Acts do not set out any specific rules for distinguishing between trading and non-trading income. However, a fairly well established set of guidelines have been laid down by the courts in various decided cases over the years. These are known as the “Badges of Trade”, which include: -

1. THE SUBJECT MATTER OF THE SALE.

Whilst almost any form of property can be acquired to be dealt in, those forms of property, such as commodities or manufactured articles, which are normally the subject of trading, are only very exceptionally the subject of investment. Again, property, which does not yield to its owner an income, or personal enjoyment merely by virtue of its ownership is more likely to have been acquired with the object of a deal than property that does.

2. THE LENGTH OF PERIOD OF OWNERSHIP.

Generally speaking, property meant to be dealt in is realised within a short time after acquisition. But there are many exceptions from this as a universal rule.

3. THE FREQUENCY OF SIMILAR TRANSACTION.

If realisations of the same sort of property occur in succession over a period of years or there are several such realisations at about the same date a presumption arises that there has been dealing in respect of each.

4. SUPPLEMENTARY WORK.

If the property is worked up in any way during the ownership so as to bring it into a more marketable condition, or if any special exertions are made to find or attract purchasers, such as the opening of an office or large-scale advertising, there is some evidence of dealing. When there is an organised effort to obtain profit there is a source of taxable income. But if nothing at all is done, the suggestion tends the other way.

5. THE CIRCUMSTANCES THAT WERE RESPONSIBLE FOR THE REALISATION.

There may be some explanation, such as a sudden emergency or opportunity calling for ready money that negates the idea that any plan of dealing prompted the original purchase.

6. MOTIVE.

There are cases in which the purpose of the transaction and sale is clearly discernible. Motive is never irrelevant in any of these cases and can be inferred from surrounding circumstances in the absence of direct evidence of the seller's intentions.

It is however, important to appreciate that the "whole picture" must be taken into account, so that the weight to be given to the various factors may vary according to circumstances. Furthermore, it is important to recognise that any given factor may be present to a greater or lesser degree, and that the absence (or presence) of any single factor is unlikely to be conclusive in its own right.