

Making an exchange

JULIE BUTLER considers whether bartering can be a trade and its effect on claims to loss relief.

Recent tribunal cases show that HMRC has been scrutinising claims to sideways income tax loss relief. Such intense HMRC review has included rural businesses such as a tree surgery and woodmanship business – *Kevin Johnson* (TC4805). The *Johnson* case involved no monetary income, but there was ‘barter’ income. The tribunal considered the impact of this on the taxpayer’s ability to offset tax losses sideways against other income. The case reminds taxpayers and advisers of the need to show the correct ‘barter’ or ‘non-monetary’ transactions in business accounts and to disclose these correctly on the tax return. The First-tier Tribunal clarified the understanding that the activity of bartering is no less capable of being defined as a trade than one involving money. However, the barter transactions must be recorded correctly in accounts, tax returns and all submissions to HMRC.

As an aside, this subject of trading income received in non-monetary form was included in the 2016 Budget and Finance Bill 2016, cl 67. This clause confirms the existing law and practice that the value of trading income received in non-monetary form is taxable in full as trading income.

Loss relief disputes

There has been a plethora of recent tribunal tax cases in which the allowability of sideways loss relief has been questioned. There were attacks on equine loss such as in *R Murray* (TC3474), where the First-tier Tribunal dismissed the taxpayer’s appeal, finding that he ‘did not demonstrate sufficiently that his activities were carried out on a commercial basis with a view to the realisation of a profit of a trade’. And a similar decision was reached in *Ms J Thorne* (TC03851). Farming losses have come under constant attack with questions of the need to prove:

KEY POINTS

- HMRC is scrutinising sideways income tax loss claims.
- In the *Kevin Johnson* case a loss relief was made when there was no monetary income.
- Does the existence of barter income indicate a trade?
- As well as a trade, this must be carried on with a view to a profit.
- The correct recording of income is important to justify claims to inheritance tax business property relief.



- commerciality, as in *J Henderson* (TC4720); and
- a reasonable expectation of profit, as in *P Silvester* (TC4682) and *B and R Scrambler* (TC4842).

As mentioned in ‘Riding the waves’ (*Taxation*, 12 May 2016, page 16), the attack on sideways losses has not been restricted to farming and horses and has extended to yachts (*Rowbottom* [2016] UKFTT 9). So we can see that there is a continual overall scrutiny of such loss relief claims.

Bartering

In some cases there may be no monetary income, but there is barter ‘income’. In such circumstances, is there a trade?

In *Johnson*, the taxpayer set up a tree surgery and woodmanship business and registered as self-employed with HMRC in November 2010. At this time, Mr Johnson was also employed by the Royal Navy until he was made redundant in late 2011. In his 2010-11 and 2011-12 tax returns, expenses relating to his self-employment were included and deductions were made for the annual investment allowance (AIA) on plant. Mr Johnson’s turnover for both years was shown as nil, but he did not show the barter income. The loss relating to the expenses and allowances was claimed against Mr Johnson’s other income, but was disallowed by HMRC on the basis that the trade was not commercial.

Under *ITA 2007, s 66*, relief for the trading loss is available only when the trade is conducted on a commercial basis with the view to realisation of profit. Mr Johnson appealed against this decision.

The First-tier Tribunal was of the view that a business did not have to include monetary income to be defined as a trade. It was agreed that services could be provided in return for a benefit. However, the tribunal clarified that, just because a particular piece of work was capable of being a trading activity, this did not make it a trade. Simply because Mr Johnson owned

ITA 2007, S 66

Restriction on relief unless trade is commercial

- (1) Trade loss relief against general income for a loss made in a trade in a tax year is not available unless the trade is commercial.
- (2) The trade is commercial if it is carried on throughout the basis period for the tax year:
 - (a) on a commercial basis; and
 - (b) with a view to the realisation of profits of the trade.
- (3) If at any time a trade is carried on so as to afford a reasonable expectation of profit, it is treated as carried on at that time with a view to the realisation of profits.
- (4) If the trade forms part of a larger undertaking, references to profits of the trade are to be read as references to profits of the undertaking as a whole.
- (5) If there is a change in the basis period in the way in which the trade is carried on, the trade is treated as carried on throughout the basis period in the way in which it is carried on by the end of the basis period.
- (6) The restriction imposed by this section does not apply to a loss made in the exercise of functions conferred by or under an Act.
- (7) This section applies to professions and vocations as it applies to trades.

a chainsaw and carried out occasional work for a neighbour in return for wood could not, on that basis alone, mean that he should be described as a trader. The tribunal decided that it was necessary to examine the badges of trade to consider the commerciality point further and consideration was given to *Marson v Morton* [1986] STC 463 (see 'Got the badge', *Taxation*, 16 June 2016, page 14).

On the evidence presented by him, the tribunal accepted that Mr Johnson was trading. For example, by November 2010 he had acquired and distributed business cards and had begun to look for work for which he would be rewarded and received barter income. Mr Johnson was trading, but was he doing so with a view to a profit?

No expectation of profit

On the question of commerciality, the tribunal considered that there was no reasonable expectation in 2010-11 that the trade could produce a profit. Therefore, losses for that year could not be set against his other income.

As part of the trading operation, Mr Johnson dealt with third parties and put money at risk by advertising material and tools. The appeal against the 2010-11 assessment was dismissed due to lack of commerciality on his part. Although a trade can be started in a tax year, the tribunal held that losses cannot be offset sideways unless an expectation of profit could be shown. The tribunal set out the value of income achieved through barter for 2010-11 at £1,500.

It could be argued that the business was commercial. This is because there was an actual accounts profit in 2010-11 before a claim to the annual investment allowance. The business showed a profit and merely claimed capital allowances.

Organised and businesslike

By 2011-12, the tribunal considered that Mr Johnson was acting in an organised and business-like way. He had obtained assignments and was searching for jobs for which he would be paid. It was agreed that such activity was trading commercially, with an expectation of profits in later years. Therefore, the tribunal agreed that the 2011-12 losses could be set off against other income under s 66 and the taxpayer's appeal for that year was allowed. Again, the decision shows the need to have evidence of trading activity including barter and that as many of the badges of trade as possible should be satisfied. Further, it would be advantageous to have a written agreement in place for the use of wood in return for work.

The tribunal decisions on sideways loss claims mentioned above have helped to identify some clear examples of the dire commerciality problems faced by the farming industry. The profitability shown by many farms is only equivalent to the subsidy paid under the basic payment scheme (BPS). However, the trade of tree surgery has been profitable in recent years with the ability to charge reasonable sums for work. This is in contrast to farming, which has serious concerns over low commodity prices and high production costs.

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Practical points

The *Johnson* case sets out strong guidelines for small rural businesses starting to trade.

When there are questions of commerciality, the adviser should always insist that a business plan is in place to prove that profits can be achieved in future with a disciplined approach. The correct recording of barter transactions is also important in farming operations. This should show, when needed, that there is the required level of trading activity to justify claims for inheritance tax relief. Such records will also be essential to establish exactly when the business started. No matter how small the operation, the taxpayer and the business adviser must be disciplined in business recognition.

Johnson and other tribunal cases should remind tax advisers that HMRC is reviewing loss claims. Advisers should be prepared for such reviews and clients warned. The preparation of proper accounts and accompanying tax advice requires a good understanding of how a business works and this should identify what is 'not there' – barter income for example – as much as what is. ■

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