



Subject: WHAT CONSTITUTES 'TRADE' FOR TAX PURPOSES: GUIDELINES FOR THE GENERAL PUBLIC

This circular is issued pursuant to Section 8(1)(t) of the Federal Inland Revenue Service (Establishment) Act 2007 which empowers the Service to carry out all necessary actions expedient for the discharge of its functions under the Act, Section 9(1)(a) of the Companies Income Tax Act (CITA) Cap C21 LFN 2004 as amended and Section 3(1) (a) of the Personal Income Tax Act (PITA) Cap P8 LFN 2004 as amended.

The purpose of this circular is to clarify FIRS position on what constitutes 'trade' or business for tax purposes. In accordance with the Companies Income Tax Act (CITA), and the Personal Income Tax Act (PITA) any trade is subject to tax under CITA and PITA, even if that trade is carried out by friendly societies, co-operative societies, charitable and ecclesiastical organizations, or trade unions.

1.0 Introduction

CITA states that "any trade or business for whatever period of time such trade or business may have been carried on" shall be subject to Companies Income Tax (Sec.9(1)(a) of CITA). The profits of certain institutions are exempt from tax under CITA, but only in so far as such profits are not derived from 'trade or business' (Sec.23). This means that the profits of any organization that are derived from 'trade' shall be subject to Companies Income Tax. This raises the question, what exactly constitutes 'trade'?

A definition of the word 'trade' cannot be found in Nigerian tax legislation although an attempt was made in PITA. The interpretation Section of the Fifth Schedule of PITA defines "trade or business" to mean "trade or business or that part of a trade or business the profits of which are assessable under this Act".

However, the issue has been addressed in several legal cases, the rulings of which provide some legal certainty regarding how the courts interpret the word (see Subheading 2.0). In line with these rulings, 'trade' can be regarded as "the business of buying and selling or bartering goods or services". Furthermore, the one-off nature of an activity in no way

invalidates that activity as constituting trade. This interpretation matches the approach in other jurisdictions, namely the UK and USA (see subheading 3.0).

2.0 Case Law in Nigeria

Although no explicit definition of 'trade' exists in the law, the issue has been addressed in several legal cases, the rulings of which provide some legal certainty regarding how the courts interpret the word. The most important case is that of *Arbico Ltd v. FBIR*, {1996} 2 All NLR 303. The plaintiff in the dispute, Arbico, had acquired a plot of land, erected a building, and sold the property at a profit. The company was subsequently assessed for tax on the proceeds of the sale of property. The Company objected to the assessment on the basis that the transaction was a one-off and therefore did not constitute 'trade'. The case was ultimately settled in the Supreme Court. In the ruling the Court laid down two important axioms:

- Firstly, that the word 'trade' should be interpreted in its widest sense, in accordance with its common everyday meaning;
- Secondly, that an isolated one-off transaction can still constitute a "trade".

In line with the ruling of the Supreme Court, the following definition seems to capture the common meaning of the word 'trade'. Trade is "the business of buying and selling or barter in goods or services"(taken from Black's Law Dictionary, Eighth Ed. (2004)).

3.0 Treatment in Other Tax Jurisdictions

In considering what constitutes 'trade' for tax purposes it is useful to consider how the issue is addressed in other jurisdictions.

In the UK, as in Nigeria, there is no statutory definition of the word 'trade'. Her Majesty's Revenue and Customs (HMRC) relies on case law to formulate a working definition. HMRC states that "Usually, trading involves the provision of goods or services to customers on a commercial basis". As in Nigerian case law, "Simply because a venture is a one-off or occasional does not mean that it will not be treated as trading for tax purposes". It is interesting to note that although the HMRC definition employs the notion of 'commercial basis', HMRC explicitly states that whether or not the profits of an activity are ultimately used for charitable purposes is not relevant for the determination of whether or not that activity constitutes a trade.

In the USA, the Internal Revenue Service (IRS) employs a similar approach to HMRC. IRS regards 'trade' as including "any activity carried on for the production of income from selling goods or performing services". It is interesting to note how IRS treats the trading activities of an organisation that also carries out tax exempt activities. IRS states that "an activity does not lose its identity as a trade or business merely because it is carried on within a larger group of similar activities that may, or may not, be related to the exempt purposes of the organizations. In other words, a single organisation can undertake both exempt activities and trading activities. This implies that an organisation cannot argue that none of its activities constitute 'trade' just because it undertakes some exempt activities.

4.0 Badges of Trade

In 1955 in England, the Royal Commission on the Taxation of Profits and Income in reaction to whether a statutory definition of trade was necessary, said that "each case must be decided on its own circumstance (1955 Cmnd.9474 para.116) and suggested badges of trade" which they considered to be the major relevant considerations that will facilitate in determining whether any profit is a taxable trading profit or not. Badges of trade refer to certain indicators that may be used in determining the factual question as whether an activity is trade or not. Case law has expanded it to 9. The badges of trade are:

1. Profit seeking motive. An intention to make a profit supports trading, but by itself is not conclusive.
2. The number of transaction. Systematic and repeated transactions will support 'trade'. An isolated transaction may also constitute a trade.
3. The nature of the asset. Is the asset of such a type or amount that it can only be turned to advantage by a sale? Or Did it yield an income or give 'pride of possession', for example, a picture for personal enjoyment?
4. Existence of similar trading transactions or interests. Transactions that are similar to those of an existing trade may themselves be trading.
5. Changes to the asset. Was the asset repaired, modified or improved to make it more easily saleable or saleable at a greater profit?
6. The way the sale was carried out. Was the asset sold in a way

that was typical of trading organisations? Alternatively, did it have to be sold to raise cash for an emergency?

7. The source of finance. Was money borrowed to buy the asset? Could the funds only be repaid by selling the asset?
8. Interval of time between purchase and sale. 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. However, an asset, which is to be held indefinitely, is much less likely to be a subject of trade.
9. Method of acquisition. An asset that is acquired by inheritance, or as gift, is less likely to be the subject of trade.

These 'badges' will not be present in every case and of those that are, some may point one way and some the other. The presence or absence of a particular badge is unlikely, by itself, to provide a conclusive answer to the question of whether or not there is a trade. The weight to be attached to each badge will depend on the precise circumstances.

5.0 FIRS Position

A definition of the word 'trade' cannot be found in Nigerian tax law. However, the issue has been addressed in several legal cases, the rulings of which provide some legal certainty regarding how the courts interpret the word. In line with these rulings, 'trade' can be regarded as "the business of buying and selling or bartering goods or services". Where one or more of the criteria on the badges of trade apply, FIRS will treat such transaction as trade. Furthermore, the one-off nature of an activity in no way invalidates that activity as constituting a trade. This interpretation matches the approach in other jurisdictions, namely the UK and USA. The following decided cases are relevant in this regard:

- i In the case of *Marlin Vs Lowry* (1955)3 All ER 48; 11 TC 297), a person without previous knowledge of linen trade bought a surplus stock of aeroplane linen from government which he sold to the public in small lots. He engaged employees for the re-packaging and embarked on sales" promotion through extensive adverts and campaigns. It was held that he was trading.

- ii In Murray Vs I.R. Comrs (1951, 32 TC 238), where a timber merchant who bought standing timbers in two plantations and could not cut them due to labour cost, sold the rights to cut the timbers to meet his indebtedness. He was assessed to tax on the profit from the transaction. He contended that the sale was a capital transaction since it was not in the normal course of his business but it was held that the transaction was part of his normal trading as a timber merchant.

- iii In Burge Vs Pyne (1969, All ER 467), a club proprietor providing facilities for bar, dancing, cabaret, fruit machines and gambling, appealed against the inclusion of his winnings in his assessment. The appeal was dismissed on the ground that the winnings formed part of his regular income from the trade of running the club.

From the foregoing and in accordance with the provisions of CITA, any friendly society, cooperative societies, charitable and ecclesiastical organizations or trade unions that carry out trade as defined and described above would be liable to tax on income derived from such trade.

6.0 Enquiries

All enquiries on any aspect of this circular should be directed to the office of:

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