This technical query paper was submitted to Revenue via the TALC Direct/Capital Taxes sub-committee following a discussion on the matter at the September 2020 TALC Direct/Capital Taxes sub-committee meeting. This technical query paper was subsequently discussed at the February 2021 TALC Direct/Capital Taxes sub-committee meeting and the discussion is reflected in the Minutes.

ITI Submission

Clarification on the application of section 626B to companies that provide professional services

24 November 2020

Introduction

At the TALC Direct / Capital Taxes sub-committee meeting on 3 September 2020, the Institute sought confirmation from Revenue concerning the application of Section 626B of the Taxes Consolidation Act 1997 (TCA 1997) on the disposal of shares in a company that provides professional services.

At the meeting on 3 September, Revenue noted the relevance of the definition of "trade" in sections 3, 4 & 5 TCA 1997 and stated that the definition does not include professions. Revenue indicated that, due to the definition of "trade" in section 4 TCA 1997, a company that provides professional services may not fall within the definition of an investee company for the purpose of section 626B TCA 1997 and, therefore, they were unable to provide the confirmation sought.

In this note, we have set out our additional comments and clarifications on the application of section 626B TCA 1997 to companies that provide professional services.

Legislation

The references in section 626B(2)(c) TCA 1997 relate to investee companies whose business consists "wholly or mainly of the carrying on of a trade or trades".

Section 626B TCA 1997 applies to the following "investee companies":

*(i) the investee company is a company whose business consists **wholly or mainly of the carrying on of a trade or trades**, or*

(ii) the business of –

I. the investor company,

II. each company of which the investor company is the parent company, and

*III. the investee company, if it is not a company referred to in clause (II), and any company of which the investee company is the parent company, taken together consists **wholly or mainly of the carrying on of a trade or trades**.*

Section 3 TCA 1997, the interpretation of the Income Tax Acts, defines "trade" *as every trade, manufacture, adventure or concern in the nature of a trade".*

Section 5 TCA 1997, the interpretation of Capital Gains Tax Acts, states "trade" *has the same meaning as in the Income Tax Acts* i.e. section 3 TCA 1997.

Section 4 TCA 1997, the interpretation of the Corporation Tax Acts, states that "trade" *includes vocation and includes also an office or employment.* However, this definition of "trade" in section 4 is not an exhaustive definition. It merely states that the word '"trade" "includes" vocation and an office or employment. Further support is found for this view in TDM 01-00-06. The stated purpose of this guidance is to provide a consistent Revenue approach to interpreting legislation for direct and capital taxes. The guidance expressly states that "includes" is an interpretation. Therefore, the non-exhaustive definition of "trade" in section 4 should not be treated as conclusive of the matter at issue.

Section 128F TCA 1997, dealing with the Key Employee Engagement Programme (KEEP) scheme, references professional services as activities carried on in the course of a trade or as being trading activities. The section provides that a company must carry on a "qualifying trade", meaning "trading activities other than excluded activities". Excluded activities means inter alia "professional services companies". Professional services are defined as:

a) services of a medical, dental, optical, aural or veterinary nature,
b) services of an architectural, quantity surveying or surveying nature, and related services,
c) services of accountancy, auditing, taxation or finance,
d) services of a solicitor or barrister and other legal services, and
e) geological services.

Furthermore, Revenue's interpretation, if correct, would have significant implications outside the confines of section 626B. For example, the failure to reference professions in section 25 TCA 1997 would suggest that any non-resident companies providing professional services in Ireland through a branch would not be within the charge to Irish tax. In addition, the corporation tax loss rules in Chapter 3 of Part 12 TCA 1997 are set out wholly in terms of trades. For example, the rule for "trade charges" in section 396(7) TCA 1997 refers to "payments made wholly and exclusively for the purposes of a trade carried on by the company". Similarly, the share buyback provisions contained in Chapter 9 of Part 6 TCA 1997 are framed in terms of companies carrying on a trade or trades.

Companies - Professions

It is the view of the Institute and its members that it is not possible for a company to carry on a profession (see supporting case law below).

It should be noted that HMRC are also of this view. This view is expressed in BIM33510, wherein it is stated "a company cannot carry on a profession". There is further UK commentary on the position in Annex 1 of the Explanatory Notes on Corporation Tax Act 2009, where it is noted that it has "long been the Inland Revenue/HMRC's view that a corporate body cannot carry on a profession for corporation tax purposes." These comments originate from a discussion paper prepared by the Tax Law Rewrite Project. The discussion paper arrived at this conclusion having undertaken a comprehensive review of the issue.

Therefore, the point at hand is whether a company that is in the business of providing professional services is a trading company or not. In the UK, the discussion paper prepared by the Tax Law Rewrite Project notes that "where a corporate body carries on a business consisting of the provision of professional services the practice is

to treat it as carrying on a trade." It is therefore suggested that if a company engaged in the provision of professional services is considered to be carrying on a trade, then section 626B TCA 1997 should apply.

Badges of Trade

The Royal Commission on the taxation of profits and income, which reported in the UK in June 1955, identified a number of "badges of trade" or factors which were likely to have greater or less significance when deciding whether or not a transaction was in the nature of a trade. Revenue have quoted with approval these "badges of trade" (e.g. TDM 02-02-06).

It is not proposed that each of the badges of trade be outlined in detail, however the respective "badges" can be summarised as follows:

(i) The subject matter of the realisation.

(ii) The length of period of ownership.

(iii) The frequency or number of similar transactions by the same person.

(iv) Supplementary work on or in connection with the property realised.

(v) The circumstances that were responsible for the realisation.

(vi) Motive.

Clearly, the concept of "adventure or concern in the nature of trade" is much wider than that of a trade and it is generally accepted that it is a question of fact as to whether an activity should be regarded as a trading activity. A trade is normally understood to be a carrying on of business or engaging in activities on a regular basis and normally with a view to realising profit. The business of the provision of professional services by a company (where the relevant badges of trade criteria are met) would, in the view of the Institute and its members, be regarded as a trading endeavour / adventure or concern in the nature of trade.

We are of the view that a company engaged in a business consisting of the provision of professional services for profit that satisfies the Badges of Trade is carrying on a trade. It is a question of fact whether the company is trading or not. We are not aware of any case law or commentary that excludes a company that provides professional services from satisfying the badges of trade.

Case Law

There is strong case law which sets out the position that a company cannot in itself carry on a profession as a profession requires intellectual skill (historically, a profession meant the three learned professions namely the Church, Medicine and the law).

The case of *Esplen (William) & Son and Swainston Ltd v IRC* [1919] 2 KB 731, 89 LJKB 29, is particularly relevant (whilst *IRC v Maxse* [1919] 12 TC 41 refers to professions and trading, that case is relevant to individuals only, a clear distinction applies in the case of companies). The *Esplen* case was a decision of the King's Bench Division from 1919 and it related to a group of appellants who carried on a naval profession in partnership. There were three partners. There was no doubt - on an unincorporated basis - that the individual partners were engaged in a profession. The partners took the decision to incorporate and sought excise profit duty exemption for professions on the basis that the incorporated company was carrying on a profession.

At the time in the UK, there was an exemption from excess profits duty for, *"any profession the profits of which are dependant mainly on the personal qualifications of the person by whom the profession is carried on and in which no capital expenditure is required….."*

The Respondent's position was that the company was carrying on a trade or business, it could not be said to be carrying on a profession and thus the exemption did not apply. Rowlatt J agreed and found that the company was not carrying on a profession for the purpose of that provision. His reasoning was (at p. 734) that *"it is of the essence of a profession that the profits should be dependent mainly upon the personal qualifications of the person by whom it is carried on, and that can only be an individual. There can be no professional qualifications except in an individual".*

Rowlatt J further stated *"'it may be said that the company as such is not carrying on a profession. A company never does anything of itself; it has to employ persons. In this case it is quite clear that the concern which is carried on is carried on by the company, and the question is whether the company is carrying on a profession."*

In relation to the work carried out, Rowlatt J. said *"[a] company such as this can only do a naval architect's work by sending a naval architect to its customers to do what they want done. As I think the company is not carrying on a profession the appeal must be dismissed."*

It was also noted in the case that if work is done negligently, it is the company that is liable not the individuals employed by it, claims made by creditors would be made against the company, not the individuals employed by it. It is the company which makes the profits, not the individuals.

The decision in the *Esplen* case was referred to by Scrutton L J in his UK Court of Appeal judgement in *Brighton College v. Marriott* (1925) 10 TC 213. He said on page 226;

> *"It is clear that a private schoolmaster would be assessed as carrying on a profession, but it has been decided in Esplen's case, (1919) 2 K.B. 731, that a limited company employing professional men to do professional work does not carry on a profession; it must be assessed, if at all, as carrying on a trade....."*

And on page 227:

> *"The question then is: Do the Company in carrying on the school carry on a trade? In my view, when any person habitually and as a matter of contract supplies money's worth for full money payment, he "trades" within the meaning of Schedule D."*

Also, in *CIR v. Peter McIntyre* (1926) 12 TC 1006 at page 1014 the Lord President (Clyde) made the following noteworthy comments:

> *"It follows from what has been said that the profits of a profession may, or may not, fall within the statutory exemption, according as the person who carries it on is an individual on the one hand, or a corporate person on the other hand. For a professional business may be carried on by a company as well as by an individual; but, if by a company, it is difficult to see how the profits can be dependent on the company's personal qualifications, for the simple reason that a company is incapable of personal qualifications. That is all, as I understand, that was decided by Mr. Justice Rowlatt in William Esplen, Son and Swainston, Ltd. v The Commissioners of Inland Revenue, (1919) 2 K.B. 731, and I respectfully think his decision was right."*

There is also case law from other common law jurisdictions which has found that corporate bodies cannot carry on a profession. In an Indian case, *Income Tax Officer v. Ashalok Nursing Home (P) Ltd* (19 May 2006), the following comments were also made.

> *"A company being an artificial person cannot be said to possess any personal skills. A company being an artificial person does not have a mind or a body and, therefore, cannot be engaged in any profession. It can neither have an intellectual skill or any manual skill. We are also of the view that even taking a broader and a more comprehensive meaning of the term profession one cannot extend the same to the case of an incorporated company as being capable of carrying of a profession. The skill involved in carrying out professional activity is predominantly mental or intellectual rather than physical or manual. We are, therefore, of the view that the requirement of [specific Indian legislation] cannot apply to a person which is an incorporated company."*

Therefore, based on the above caselaw, it is clear that corporate bodies cannot carry on a profession for corporation tax purposes - when they provide professional services they are carrying on a trade; it is not the company which conducts the profession. Whilst it is true that a company may employ professional men or professional women, the activity of the company is a different matter. According to Rowlatt J. in *Esplen*, *"there can be no professional qualifications except in an individual"*. A company can only provide a service by sending a professional individual to do the work. A company cannot itself carry on a profession and a company cannot be a member of a professional body.

Surcharge on service companies

Under section 441 TCA 1997, undistributed income of service companies is liable to a corporation tax surcharge. A service company is defined as a close company, where that close company derives the principal part of its income from, inter alia, the carrying on of a profession or the provision of professional services. While the provision refers to the carrying on of a profession, it also refers to a company providing professional services, and to "trading income" in subsection 4.

The context in which section 441 TCA 1997 was introduced is important. The legislative code for the taxation of income has developed over time to remove loopholes in the tax regime and to respond to the behaviour of taxpayers. The enactment of this particular provision in the 1970s was one such response. The section was introduced to counter the creation of service companies in order to avoid subjecting certain professionals to the higher rates of tax applicable to their professional incomes by virtue of the Income Tax Act. It is this special legislative context in which the provisions must be interpreted.

The position remains that a company cannot carry on a profession and, therefore, it is anticipated that the wording used in section 441 TCA 1997 was to ensure that it was drawn in the widest possible terms but it captures all 'professional companies' in this space in any event by reason of the reference to companies providing professional services. Section 441 TCA 1997 is a distinct and separate provision from section 626B TCA 1997 and therefore should have no particular bearing on the question as to whether a company carries on a trade for the purposes of section 626B TCA 1997 which is ascertained on its own merits by reference to the analysis provided above.

Conclusion

In light of conclusions set out above, it is the view of the Institute and its members that where a company providing professional services can demonstrate that it is carrying on a trade, it should not be precluded from relief under section 626B TCA 1997. We would welcome Revenue's confirmation on the point.