AAT Tax Update - 30 November 2015

In this edition of the tax update we look at:

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1. Travel expenses: Are they deductible for tax purposes?

In an ideal tax system there should be horizontal equity. Taxpayers in similar circumstances should pay similar amounts of tax (and NIC). The UK tax system is complex and yet it lacks horizontal equity. Those who are well advised can arrange their circumstances to their best advantage and obtaining a deduction for travel expenses related to work is a clear indication of the lack of fairness or equality within the system.

Itinerant workers like the bricklayer in Horton v Young, 1971, 47TC 60 can obtain a deduction for the costs which they incur in traveling to the sites at which they work by arranging that their base of business is their home. Many advisers thought wrongly that arranging for work and administration work to be conducted at an office within the home was sufficient to allow the expenses of travel between the home (base of business) and site of work to be deductible for tax purposes

For some years, HMRC have been challenging travel expenses and doctors have featured. Pook v Owen was a case which favoured the doctor but the key finding of fact was that the doctor had started to treat the patient when he decided to visit. This meant that the expense of travel was incurred wholly and exclusively for the purposes of the professional activity and so was allowable for tax purposes.

Dr Samadian was denied the deduction for travel from his office and claimed place of business to the various hospitals because the expense incurred failed that test of “wholly and exclusively”. The Upper tribunal ruled that the expense of travel between his office and the various hospital locations was incurred because he chose to live some distance away from where he conducted his professional duties. Similarly in Dr. David Jones’ case, a self employed anaesthetist (who was also employed as a consultant anaesthetist by Gwent NHS) has been denied the expense of traveling from his home to Newport hospitals at which he performed private work.

Dr. Jones’ private practice involved him working with an operating team brought together by the surgeon in charge of the operation in question. The surgeon organised the patient’s admittance to hospital and after-care. Dr. Jones would introduce himself to the patient prior to the operation; very occasionally, he would visit the patient in the hospital after the operation if additional anaesthetic was required. On rare occasions, there was a need for Dr. Jones and the surgeon to meet prior to the surgery, at a place of mutual convenience.

Dr. Jones had no administrative or office facilities provided to him at any of the hospitals at which he carried out his private practice as an anaesthetist – no “name on the door”, no telephone, no post box facilities, no locker, no email address connected with the hospital.

The administration and management of the appellant’s private practice was carried out from his home in Cowbridge in South Wales (about 30 miles by car from Newport). Here he kept records of operations including the name and address of the surgeon and the insurance company (if applicable), surgery date, billing date and limited details of the patient (the detailed patient records were kept at the hospital); and also his accounting records. Home was also his contact address for surgeons, accountants and HMRC in relation to his private practice. Dr. Jones also carried out research at his home.

In Newsom v Robertson , 1953, 33TC352 Romer LJ memorably summarised in one sentence why commuting expenses do not satisfy the “wholly and exclusively” test: “... the object of the journeys, both morning and evening, is not to enable a man to do his work but to live away from it”.

Dr. Jones had provided a mileage log which was the evidence that he made nearly 100 journeys to and from home and one of those hospitals, St Josephs, and over 50 journeys to and from home and

the other, the Royal Gwent. The simple number of journeys in the space of a year to just two locations strongly indicates a pattern of regular and predictable attendance.

The FTT ruled at paragraph 81: "In our view, the appellant's journeys between his home and the two Newport hospitals in the 12 months in question were within the remit of well-established case law that tells us that part of the purpose of such journeys is to enable the taxpayer to live away from his work. Hence the associated travel expenses were not incurred wholly and exclusively for the purposes of the appellant's private practice."

This is an interesting decision and definitely worth a closer read if you have subcontractors in the construction industry and/or doctors who are self-employed. It remains possible to structure arrangements to obtain a tax deduction. The doctor could provide his services through a limited company which has a base of business at the doctor's home. Or, applying the Pook v Owen principle, the doctor could commence working at the home thereby ensuring that the restrictive test of "wholly and exclusively" is passed. In practice, it is likely that HMRC will challenge travel expenses because the interpretation of "wholly and exclusively has been tightened.

Case ruling

An interesting footnote to this is to record that disallowing the expense of getting to work is a form of stealth tax because it means that the worker is taxed on a profit or gain which he does not 'enjoy'. Many of the countries in the EU allow a limited tax deduction for the expense of commuting. Given the inequality and unfairness of the present interpretation and application of the law relating to work related travel expenses, now might be a good time to reconsider the tax treatment within the UK.

2. Rangers Football Club: Employee benefit trusts won by HMRC

The Court of Session in Scotland has allowed HMRC's appeal in the case of **Advocate General for Scotland v Murray Group Holdings and others [2015] CSIH 77**]. In Scotland this case has been highly controversial and many diverse opinions have been expressed on the matter. The decision in the Court of Session overturning the decisions at the First Tier Tribunal (FTT) and Upper Tribunal (UT) does not surprise me and I have to declare a conflict of interest because I read and agreed with the dissenting judgement given by Dr. Heidi Poon at the FTT.

This is a complex case involving artificial arrangements to enhance the funds available to employees of the Murray Group but the sums involved were so large that the football club was forced onto administration and liquidation by the dispute over whether PAYE should have been operated. The Rangers club (and other members of the group of companies) remunerated players and some executives through bonus arrangements under which sums were paid to a principal trust. The sums so paid were then allocated for the individual concerned in sub-trusts, with the sub-trusts onward loaning amounts to the individuals in question. The Rangers football club contended that the sums lent were not taxable on the recipient employees whereas HMRC argued that the sums were not lent but were in fact remuneration and should have been taxed under the PAYE system by the club.

This decision has major implications for all employers who have entered into similar scheme arrangements. The employer is held to be responsible for the operation of PAYE and so it is the employer which needs to pay the tax and NIC. Personally, I feel very uncomfortable with such an outcome because it seems to me to be verging on a violation of human rights and to be pushing beyond the acceptable boundaries of what are 'normal' civic duties. In other words, I am really quite concerned that this HMRC victory and the decision of the Courts is pressing the boundaries and might be a violation of human rights (Article 4 (3)(d) stretched beyond tolerance.)

The tax legislation provides that "earnings" is defined to include all profits whatsoever derived from having acted as an employee. The PAYE regulations provide that, on making a relevant payment to an employee during the tax year, an employer must deduct tax in accordance with the regulations. Under both regimes, therefore, an employer who makes a payment of earnings or emoluments to or on account of an employee is obliged to deduct tax in accordance with the PAYE Regulations.

At a fundamental level, the tax which is due is that of the employee who has received the earnings and when a dispute arises, it seems to me that HMRC should target their efforts at the person who

has to be taxed. But I can understand why HMRC proceed against the employer. Usually the employer has the deepest pockets and therefore the ability to pay but in this case the employer is in liquidation. In contrast, I believe that many of the recipient employees remain wealthy individuals.

The Court of Session judges were persuaded by a new argument led by HMRC that the rewards being paid as earnings included the sums paid to the trusts. They decided that it was competent to consider a ground of appeal that had not been considered by the power courts and that seems to me to be a significant decision of precedent (which I do not like because it lacks fairness).

Paragraph 56 is significant and it concludes: "The fundamental principle that emerges from these cases appears to us to be clear: if income is derived from an employee's services *qua* employee, it is an emolument or earnings, and is thus assessable to income tax, even if the employee requests or agrees that it be redirected to a third party. That accords with common sense. "

This led to the Judges' conclusion at Paragraph 66 : "We accordingly conclude that the primary argument presented for HMRC is correct: the payments made by the respondents to the Trustee of the Principal Trust in respect of employees were emoluments or earnings, and are accordingly subject to income tax. Furthermore, those payments were made at the time of payment to the trustee of the Principal Trust, with the result that the obligation to deduct tax under the PAYE system fell on the employer who made such a payment."

At 92 paragraphs in length, I recommend that every practitioner should have a read of this decision and its reasoning.

3. Autumn Statement

I have to declare a conflict of interest because I have been recommending to deaf ears the need to simplify our tax system and have less change. Wednesday 25 November saw the Chancellor do a U turn on his proposed restrictions to tax credits. He also announced consultations designed to close the tax gap and tackle avoidance.

In many ways I thought that the autumn statement was unimpressive. I did not like the idea of taxing large employers on apprenticeship schemes. According to the Chancellor, 98% of employers will not pay the levy because of the allowance of £15,000 which is offset against payment of the levy. However, the levy will apply in principle to all employers and will be set at a rate of 0.5% of an employer's paybill and it will be collected through the PAYE system.

The levy will come into effect from April 2017 and all employers with a paybill exceeding £3 million will be liable.

The Chancellor has to raise additional tax but I think it was wrong to do a U turn on the 3% surcharge that was due to be abolished for diesel cars. He is still proposing that this will be abolished but its abolition has been deferred from 2016 to 2021 and the justification is the recent publicity that manufacturers have been misleading the emission tests. The VW group may have been doing this but is it right that all diesel cars should be treated in the same way? Some employers may now find themselves with a higher NIC cost and disgruntled employees if diesel cars were provided to employees.

Residential property which does not qualify for the only or main residence (OMR) exemption will now require the vendor to make a payment on account within 30 days of completion of the disposal. Landlords selling residential properties will be affected by this change. A newsletter to clients potentially affected might help with the administrative difficulties of identifying qualifying capital expenditure and periods when the owner did not qualify for OMR exemption so that a reasonable calculation of the potential CGT liability can be done within what is a fairly stringent time limit.

Owners of second homes and buy to let landlords will be liable to an additional 3 % on stamp duty land tax (SDLT) from April 2016 with the introduction of higher rates of SDLT on purchases of additional residential property above £40,000. The higher rates will be 3% above the current SDLT

rates. For example, the nil rate band will increase to 3% and the top slice of SDLT will increase to 15%.

There are some good news factors and an obvious one is the extension of farmers averaging from 2 to 5 years which will help farmers whose income fluctuates dramatically. Practitioners should read the statement which is available on the **Government's website**.

Derek Allen
30 November 2015

Set your diaries for the next edition of the general tax update which will be published at the end of December 2015

The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.