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Tax Relief For Travel Expenses – Avoid This Trap!

The tax treatment of travel expenses, like many other things in tax, can be finely balanced. The terms and conditions in documents such as employment contracts may be crucial.

Travel expenses

An employee can generally claim tax relief from their earnings for travel expenses if certain conditions are satisfied. The tax legislation provides that a deduction is allowed if the employee is obliged to incur and pay the travel costs as an employment holder, and the expenses are for the employee's necessary attendance at any place in the performance of the employment duties (ITEPA 2003, s 338(1)).

However, an employee cannot claim tax relief for the cost of 'ordinary commuting', such as travel between home and a permanent workplace. As a general rule, a 'permanent workplace' is a place which the employee regularly attends in the performance of employment duties, which is not a temporary workplace. The tax legislation states that a workplace is permanent as opposed to temporary if either it forms the base from which employment duties are performed, or if the tasks to be carried out in the performance of those duties are allocated there.

In addition, a workplace is not regarded as temporary if (among other things) the employee works there continuously for more than 24 months, or for all (or almost all) of the period of the employment (ITEPA 2003, s 339).

Temporary or permanent?

The question of employee travel expenses and whether workplaces were 'permanent' was considered in a recent First-tier Tribunal case, Ratcliffe v Revenue & Customs [2013] UKFTT 420 (TC). In that case, Mr Ratcliffe claimed tax relief for travel expenses relating to journeys made in his own car. He worked for the same employer, doing the same type of work, at different power stations in the UK, under two different types of contract for the period in question:

- 'Retainer contract' – requiring Mr Ratcliffe to work at various sites designated by his employer; and
- Short-term contracts – specifying the power stationwhere he was to report for work.

Mr Ratcliffe claimed tax relief for the cost of journeys between home and his lodgings near the power stations, and between his lodgings and the relevant power station. HMRC took the view that he attended a temporary workplace under a retainer contract (i.e. tax relief claims for travel expenses were allowed), but attended a permanent workplace under the short-term contracts (i.e. tax relief was denied). Mr Ratcliffe appealed to the tribunal.

The tribunal held that each contract should be treated as a separate contract of employment, rather than a continuous one with the same employer. The short-term contracts required Mr Ratcliffe to work at a particular power station. He worked at one power station for the duration of the short-term contract.

The power station specified in each short-term contract was therefore his 'permanent workplace'. An employee's travel expenses between home and a permanent workplace are not allowable for tax purposes. Consequently, Mr Ratcliffe's travel expenses relating to the retainer contract were allowed. However, his travel expenses in respect of the short-term contracts were not allowed, and his appeal was dismissed.

It's all in the contract

Can the terms of a contract really determine whether travel expenses are allowable? Based on the tribunal's judgment in Mr Ratcliffe's case, it can. It would seem that if Mr Ratcliffe's short term contracts had been 'retainer contracts' instead, his travel expenses would have been allowable. The tribunal said:

"Although we accept that the essence of the type of work performed by the Appellant under retainer contracts and short term contracts was the same, this is a case where the contractual provisions in each type of contract determines the tax treatment as a matter of tax law."

Decisions of the First-tier Tribunal do not generally create a binding legal precedent. In addition, HMRC sometimes argue that a case (on which a taxpayer is seeking to rely) is not relevant because it was decided on its own specific facts. However, the Ratcliffe case is likely to be persuasive when arguing for a deduction of travel expenses in similar circumstances involving short-term contracts and various unspecified sites or workplaces.

Practical Tip:

When working for the same employer: (a) under short term contracts and (b) at different sites, if travel expenses are incurred, ensure that the contracts do not specify a particular site or workplace. On the basis of the Ratcliffe case, the contracts should allow the employer to designate whichever sites or workplaces it chooses from time to time; and each contract should provide that any previous employment does not count as part of a continuous period of employment.

(Note - the Ratcliffe case can be accessed via the British and Irish Legal Information Institute website: www.bailii.org/uk/cases/UKFTT/TC/2013/TC02814.html).

IN THIS ISSUE

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Extracting Cash FromThe Family Company – Income Or Capital?

When it comes to extracting funds from a family company, all routes are not equal and there are various options available. Careful tax planning is essential to ensure that the most tax-efficient strategy is adopted and professional advice should be sought in advance.

Income extraction

In the main, the income extraction debate centres on whether to attract profits in the form of a salary/bonus or in the form of a dividend. Dividends come with an associated tax credit of 10% and in the hands of the shareholder do not suffer a further tax charge until the basic rate band has been used up. Thereafter, a higher rate taxpayer pays tax at 32.5% on the grossed-up dividend. For an additional rate taxpayer, the rate is 37.5%. A further advantage associated with paying a dividend is that no National Insurance contributions (NICs) are payable by the employee or the employer.

However, dividends must be paid out of retained profits, so the company does not benefit from a corporation tax deduction, and must have sufficient retained profits to pay the dividend. The dividend must also be paid in accordance with the shareholdings.

By contrast, profits paid out by way of a salary or bonus are taxable at normal income tax rates once the personal allowance has been utilised (i.e. 20%, 40% or 45%) and are also liable to Class 1 NIC (i.e. employee and employer). However, the company benefits from a corporation tax deduction for both the salary or bonus payments and the employer's NIC.

A popular strategy is to pay a small salary (of between the Class 1 NIC lower earnings limit (£109 per week) and secondary threshold (£148 per week), and thereafter dividends until the remainder of the personal allowance and basic rate limit has been utilised).

It may also be worthwhile to consider alternatives, such as pension contributions or tax-free expenses and benefit, or (to the extent that this is possible) capital.

Capital extraction

The benefits of extracting capital rather than income stem from the fact the rates of capital gains tax (CGT) (at 18% and 28%) are much lower than the rate of income tax (at 20%, 40% and 45%). A further advantage is that the availability of the CGT annual exemption, currently set at £10,900, makes it possible to extract capital up to this limit without triggering a CGT bill.

However, despite the obvious attractions associated with extracting capital, options for capital extraction are severely limited if the company is on-going. While selling shares back to the company is a possibility, there are pitfalls and advance clearance that the capital treatment will be forthcoming should be sought from HMRC.

Practical Tip:

Professional advice should be sought to help achieve an optimal extraction policy. Whilst capital extraction can be attractive in theory (particularly once dividends have been extracted to the basic rate limit), in practice options for capital extraction while the company is ongoing are severely limited.

However, if the company is to close, the options for taking capital are wider. A further benefit is the availability of entrepreneurs' relief (which reduces the rate of CGT to an attractive 10% on gains up to £10 million) provided that the associated conditions are met.

Where a company is to be closed down it is also possible to extract accumulated profits as capital rather than as a dividend. However, it is now only possible to take this route if retained profits are not more than £25,000 without formally liquidating the company, as the capital distribution treatment is capped at £25,000 on the dissolution of the company in the absence of a formal winding up.

Letting Property Below A Market Rental – The Tax Implications

A landlord may allow a tenant to occupy a property and pay less than the market rent because either the tenant is a friend or relative, or the tenant has something to offer worth more than the rent.

Friends and Family

If you allow someone to occupy a property and, for personal reasons, charge them a rent significantly lower than you could get on the open market, then strictly speaking this letting is separate from any other properties you may own, because this letting is not being done for business reasons. It is therefore not part of your UK property business.

HMRC take the view that this means you have no right to claim expenses against the rental income, but by concession, they are prepared to accept claims for expenses up to the amount of the rent received. In other words, they will not accept that the 'friendly' letting of this property can create losses to set against other property income.

By the same token, if there are no expenses and there is a profit on this letting, then it must be treated as taxable – losses from other properties cannot be used against it.

Other reasons for low rentals

If you can make a business case for agreeing to reduce the rent, then different rules apply.

The three commonest reasons, other than personal ones, for agreeing to a low rental are:

- The tenant agrees to carry out work on the property at his own expense in return for a reduced or nil rent.
- The tenant is occupying by way of being a caretaker, living in the property whilst work is being done on it when a normal tenant would not agree to do so at a full rental.
- The tenant is a prestigious name (think of Marks & Spencer, or a high street bank), who will attract other quality tenants to your development.

Tenant does work on the property

The treatment here depends on whether the work is normal repairs and maintenance, in which case all that is happening is that the tenant is paying his rent in kind rather than cash and the property can be included as part of the normal rental business, or whether the work is capital in nature and as such could not be claimed as an expense by the landlord.

In such a case the landlord is treated as if he had been paid a premium for the grant of the tenancy, equivalent to the difference between the value of the property with no repairs, and the value (when the tenant moves in) of the property as a result of the agreement to do repairs. This can be a quite complex calculation – for example, you have to take account of the fact that the landlord cannot benefit immediately from the increased value because he has a tenant there, and you will need professional advice on this.

Caretaker tenant

Providing you can show that there is a real benefit from having someone there – the property is in a high crime neighbourhood, for example – then this is a commercial arrangement and the property can be included as part of your rental business.

'Flagship'tenants

Provided the only inducement to the tenant is a rent free or low rent period, then as with the caretaker tenant, there is a commercial reason for the agreement and the property (and its expenses) will be part of the normal property business.

Practical Tip:

If you agree to a reduced rent for personal reasons then this will affect what expenses you can claim on the property in question; if the low rent is commercially justifiable, it will not affect the claims for expenses on the property.

Personal Tax

Choose Non-Cash Benefits To Save Employee NICs

Even if a benefit is not exempt from tax and National Insurance, it can still be beneficial from the employee's perspective to choose the benefit rather than cash salary as this will save employee Class 1 National Insurance contributions.

Most taxable benefits provided to employees earning at a rate of at least £8,500 a year or to directors, are liable to Class 1A National Insurance contributions rather than to Class 1. Class 1A National Insurance is only payable by the employer – there are no employee Class 1A contributions.

By swapping cash salary for a non-cash benefit, the National Insurance liability switches from Class 1 (payable by both employees and employers) to Class 1A (employer only) saving employee National Insurance contributions.

If the employee earns at a rate of less than £8,500 (a P9D employee), the employer will also escape National Insurance contributions as Class 1A National Insurance is not payable on benefits provided to P9D employees, even if those benefits are taxable.

Case Study:

George receives a cash salary of £30,000 a year and private medical insurance of £600 a year. He pays no National Insurance on the private medical insurance. As a result he is £72 per year better off than if he had received an additional £600 in salary and paid for the medical insurance from his net pay.

The employer pays Class 1A National Insurance of £82.80 on the benefit – which is the same as the employer Class 1 contributions payable on salary of £600. Although the employer is not better off, the employer enjoys a cash-flow advantage as Class 1A contributions are paid after the end of the tax year whereas Class 1 contributions are payable during the year.

Property Tax

Use Of Vehicles In Lettings Business

If a van is used in the letting business to travel between properties or from office to property, the purchase cost of the van is allowed in full under the Annual Investment Allowance (AIA).

AIA is not available for a claim on cars; cars attract a writing down allowance (WDA) of 18% per annum, or 8% if the vehicle's CO2 emissions exceed 160g/km.

For capital allowances claims, the claim can only represent a proportion of business use of the asset – private use being disallowed.

However, if a car owned by a company is required to be garaged on company premises overnight with private use essentially being forbidden, then the whole WDA is allowed against the company's profits.

It is difficult to claim the full WDA successfully on a car owned by an individual because HMRC will normally argue that the car must be used privately to some extent.

Case Study:

David purchased a car a couple of years ago and in April 2013 started to use it in his business – the car's value is £5,000 with CO2emissions of 165g/km. He calculates that the car is used 75% of the time on business.

The WDA claim for 2013/2014 is calculated as £5,000 x 8% x 75% = £300. The amount carried forward to 2013/2014 = £4,600(i.e. £5,000 – £400, being the total WDA before restricting for private use).

Business Tax

Deduct Incidental Costs Of Business Loan Finance

Many businesses need to secure finance at some point in their lifecycle, whether to fund the initial start-up or in order to grow the business.

The incidental costs of acquiring finance can be deducted in computing the profits of the business and should be claimed. Costs which may be allowable include:

- Legal and professional expenses associated with negotiating the loan and preparing the documents;
- underwriting commissions, brokerage and introduction fees;
- land registry fees;
- search fees;
- valuer's fees;
- commitment fees for making a loan available;
- commission(s) for guaranteeing a loan.

Case Study:

Hamish takes out a bank loan to fund the expansion of the business. He incurs professional fees of £500 in connection with the loan and pays an arrangement fee of £200.

He is able to deduct £700 in respect of these expenses when computing his business profits.

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