A home away from home

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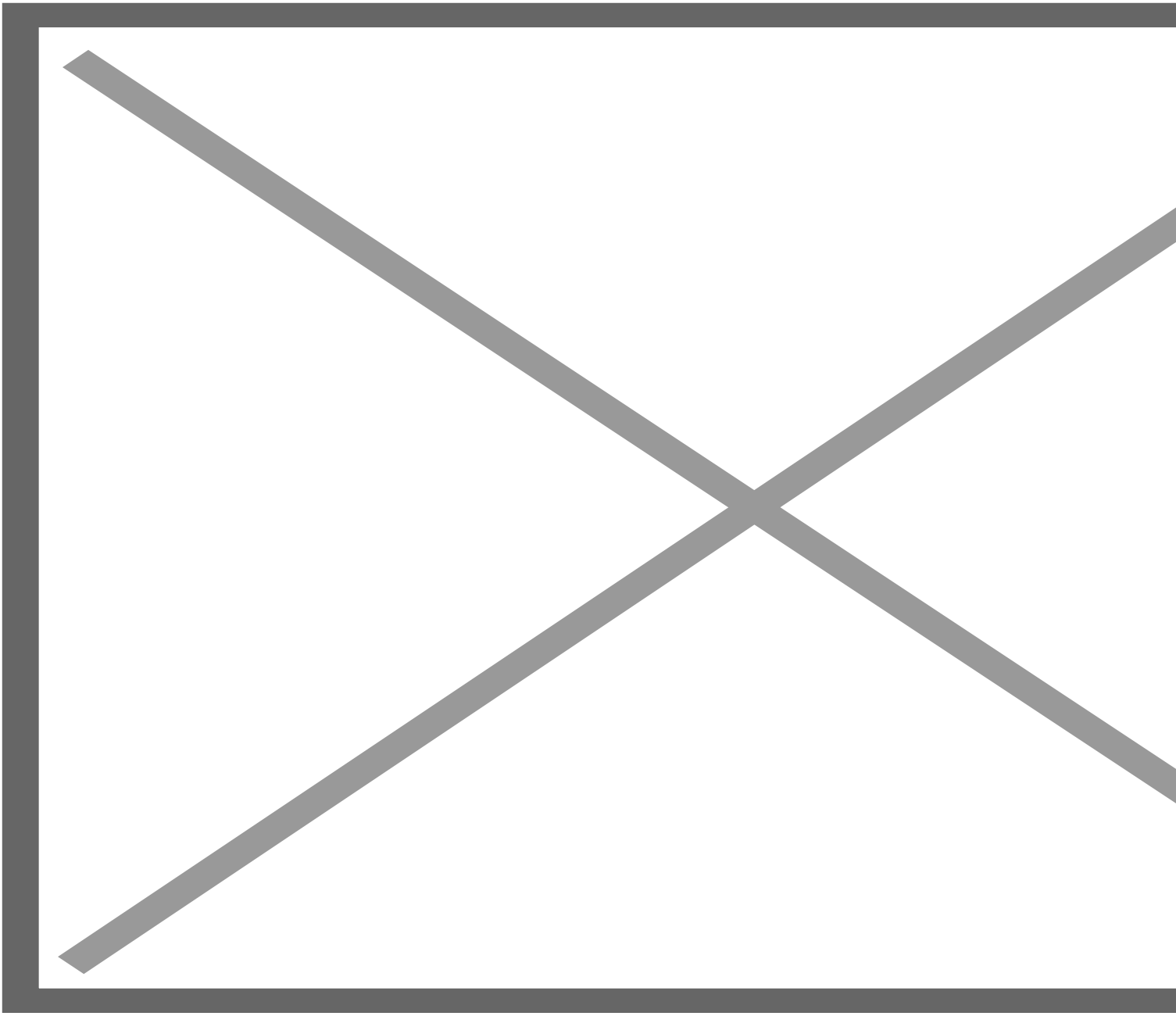

01 October 2019

Michael Steed muses on a common client question in respect of travel and subsistence costs

Key Points

What is the issue?

Can staying in a flat away from home on business, which is cheaper and more convenient than a hotel, bring adverse tax results?

What does it mean to me?

Dealing with client queries for travel and subsistence costs is a complicated and uneven landscape and requires professional care.

What can I take away?

Corporate structures can give better tax results than sole trader structures in this area.

'Yes, but staying in a flat's cheaper – surely I can get a deduction for this?'

Introduction

Imagine the following scenario: Sunil is a contractor and he has won a nine month contract for professional services in a city that's 250 miles away from where he lives. He decides immediately that he cannot commute this on a daily basis, so he considers his options. He has asked you about renting a flat on the basis that this is more convenient and less expensive than a hotel or B&B option.

Let's analyse this scenario under two different assumptions:

- that Sunil is a sole trader; and
- that Sunil has a personal services company (PSC).

Scenario 1: Sunil is a sole trader

In many ways, this analysis is straightforward. The core legal principles for sole trader deductions are now in ITTOIA 20015 s 34 and interpreted in attendant case law (the 'wholly and exclusively' rule). Section 34 is well-known and I will not analyse it here, beyond reiterating that this is a speed limit on deductibility and that dual purpose expenditure ('the fatal duality of purpose') will mainly fail the s 34 test, but that some low level 'contamination' (often private use) will not automatically fail.

Case law establishes that where the business purpose predominates and the personal element is merely incidental to the business purpose, the expenditure satisfies the 'wholly and exclusively' test.

In my analysis, the starting point is that we need to establish whether the travel is allowable as it meets the s 34 test or whether it fails under *Newsom v Robertson* (1952) 33 TC 452 and is travel between home and a base of operations.

What makes the analysis a bit more difficult is that there are few landmarks in this landscape that allow us to determine whether this is home to base of operations travel, or whether Sunil's home (by default) is his base of operation under the *Horton v Young* (1971) 47 TC 60 principle that would make him 'an itinerant worker'. Certainly, there is no obvious time limit that would allow us to deduce that, say, a nine month contract would be

OK, but an 18 month contract would not. Having said that, extreme cases such as *Timothy David Hanlin* [2011] UKFTT 213, where the tribunal noted that the appellant had been working on the same contract for seven or eight years, would clearly make the travel one of choice to a base of operation, rather than qualifying for a tax deduction.

Just to keep it simple, let's assume here that for the duration of the contract Sunil will not be regarded as travelling to a base of operation, as his contract pattern is one of regular changes with different clients.

So, let's put this 'it's cheaper' angle to bed and state the obvious: cost is not the test. The wholly and exclusively rules are the correct test, so cost is a largely a blind alley. Having said that, excessive cost is likely to breach the deductibility rules, possibly because there is a personal as well as a business use, but travelling first class rather than standard class is not going to be a problem – a full deduction should be allowed.

Staying in a flat as a sole trader can be a tricky prospect. The well-known *Tim Healy* case [2015] UKFTT 233 foundered when remitted to the First-tier Tribunal, largely because of Mr Healy's assertion that he preferred staying in a London flat for a nine month period, as inter alia he could have his friends and family to stay which was not really feasible in a hotel. He had fallen foul of the 'fatal duality of purpose'; in other words, the use by his family would fatally contaminate the s 34 rule.

One of Mr Healy's other arguments was that staying in a flat was cheaper, but that was not relevant in the case – only the wholly and exclusively tests were in play.

As a point of interest in *Healy*, the Upper Tribunal heard argument about the 'contamination' issue, including from an old Schedule E case (*Elwood v Utitz* (1965) 42 TC 482), in which a company director from Northern Ireland purchased a club membership of a members' club in London as this was cheaper than staying in a hotel. A deduction for the membership was allowed by the Court of Appeal, notwithstanding that it provided accommodation and other social advantages. The court said in that case: 'There is nothing new about the proposition that incidental effects, no matter how inevitable, do not necessarily colour the purpose or intent behind the acts that produce them.'

On the accommodation taking the form of a tenancy and more specifically on the length of that tenancy in *Healy*, it is interesting to note that the UT commented: 'We have found nothing that indicates that expenditure under a tenancy agreement that lasts for a period of nine months cannot be deductible.'

The UT went on to say: 'There is no hard and fast rule as to when the length of the assignment clearly tips the balance in favour of a conclusion that there is a dual purpose; it will be a matter of fact and degree in the particular circumstances.'

Scenario 2: Sunil has his own PSC

So let's re-analyse the scenario with Sunil having a PSC. What difference will this make? To start with the obvious, Sunil is now a director and we need to consider three angles:

- deductibility in the company for company payments (this time under CTA 2009 s 54);
- possible benefit in kind implications of these company payments on Sunil as a director; and
- whether Sunil will be able to claim any deductions from earnings under the travel rules in ITEPA 2003 ss 337 to 339 for sums spent by him personally.

Company payments

Let's start with the company payments and assume first that the company picks up the cost of the flat. The s 54 test is identical in principle to the s 34 test considered above. If the payment is wholly and exclusively for the trade, then the company will get the deduction for the payment.

An alternative scenario would be for the company to pay a round sum payment to Sunil, from which Sunil would pay for the flat. In my view these payments would also meet the s 54 tests if they were broadly equivalent to the quantum of the flat rental.

Benefit in kind

But what about the knock-on effect of the provision of the flat as a benefit in kind charge on Sunil personally? The basic shape of this is that where an employee is provided with living accommodation by an employer, then the employee is liable for income tax on the value of the accommodation provided (ITEPA 2003 s 102). There are some exemptions in ss 99 and 100, but these are not relevant here. The employer incurs NIC Class 1A on the value. The valuation rules are broadly that the cash equivalent is the higher of the 'annual value' or the rent paid by the employer. In Sunil's case, that would be the rent paid. If additional costs of the accommodation are also provided (such as heating and lighting), then these too are taxable benefits which have to be reported on a P11D and are liable to income tax. Either Class 1 or Class 1A contributions will be due depending on the nature of the benefit (ITEPA 2003 s 210).

As Sunil will only be there for nine months, the charges are proportionately reduced and the benefits in kind charge is also reduced for any rent made good by the director (not relevant here).

Deductions from earnings

The next issue is to determine whether there is any permitted deduction for business expenses under the expenses rules in ITEPA 2003 Part 5 Chapter 2 – Deductions for employees' expenses, particularly under s 338 (travel for necessary attendance).

At first sight, this section appears to offer only limited hope, as it specifically refers to expenditure by the employee. This is helpful if the employer pays a round sum to the employee out of which the employee makes payments for the accommodation, but not helpful if the employer pays for and provides the accommodation.

However, ITEPA 2003 s 333(1) broadens the scope of s 338 to include payments made on the employee's behalf by someone else (here, the employer). This rationalisation allows us to understand the examples given in EIM 31836 and EIM 31838. EIM 31836 specifically covers the issue of accommodation being provided as a cheaper and more convenient alternative to hotel accommodation; and full relief (under s 338) should be available if the expenditure is reasonable and not excessive. It continues:

'Relief should not be restricted for furnished or unfurnished accommodation that is of reasonable cost where it is also able to be used by the employee for weekends, short holidays during the period of work at the temporary workplace, or other short non-working periods. Relief should be restricted where significant non-business use is part of the purpose of providing the accommodation.'

So, the *Healy* type issues about family use for a sole trader appear to be ameliorated for a company structure. HMRC's view on the provision of a flat is also covered in HMRC Booklet 480 (2019) at 21.24, which takes a slightly different approach to the EIM and says:

‘If accommodation is provided for an employee, for example, in a flat or hotel, while the employee is on business duties away from his or her home and normal place of work, the cost of this may be allowable as a deduction under the expenses rule. For example, a company in Yorkshire may rent a London flat for an employee who has to make frequent business trips to London. The extent of any deduction will depend upon the circumstances. If the accommodation is no more than an alternative to hotel accommodation and is not available for private occupation, the whole cost of renting and running the flat may be allowed as a deduction. On the other hand, if the employee or his or her family also had the use of the flat as a private residence any allowance would be restricted. Provided living accommodation will never be included in a dispensation and so even if there’s a potential deduction under the expenses rules, the provision of the accommodation must be reported on form P11D each year.’

Conclusion

Staying in a flat as a cheaper and more convenient way to be away from home can be easier to justify through a company structure than as a sole trader.