CHAPTER 20

EXPENSES OF EMPLOYMENT

20.1 Introduction

In this chapter we shall look at the expenses that are allowed as a deduction in arriving at net taxable earnings. Before we do so, let's remind ourselves where they fit into the earnings proforma.

Cash remuneration	X
Benefits	X
	X
Less: exempt income	(X)
Taxable earnings	X
Less: allowable deductions	(X) ←
Net taxable earnings	X

We start with cash remuneration such as salary and bonuses. We also need to add any expenses reimbursed to the employee by the employer. All expenses paid by an employer to an employee are treated in the first instance as cash earnings – i.e. money received by the employee. To this we add any benefits.

At this point we can take a deduction for any allowable deductions. Taxable earnings less allowable deductions gives net taxable earnings for the year. It is this figure that goes into the income tax computation as non-savings income.

Allowable deductions broadly fall into five main categories.

a) Expenses deductible under **s.336 ITEPA 2003**.

b) Travel expenses (s.337 – s.340 ITEPA 2003).

c) Payments made by an employee **to an occupational pension scheme** - the detailed rules with regard to pension contributions will be dealt with in a later chapter.

d) **Professional fees or subscriptions** paid to an organisation approved by HMRC.

e) **Donations** made by an employee to **charity** under the Payroll Deduction Scheme.

20.2 Section 336 – "deductions for expenses: the general rule"

Section 336 lays out the general rules for deductions to be made from taxable earnings. A deduction under the general rules is allowed if: ITEPA 2003, s.336

a) the employee is **obliged to incur and pay the expense** as holder of the employment; and

b) the amount is incurred "**wholly, exclusively and necessarily**" in the performance of the duties.

In order to ascertain whether an expense is deductible, we therefore need to look closely at the terms **"wholly, exclusively and necessarily"**.

The word "necessarily" is the biggest obstacle to us when trying to persuade HMRC that expenses are allowable. The question HMRC will ask us is "could the employee do his job without incurring that particular expense?".

If the answer to this question is "yes" – i.e. he could do his job if that expense had not been incurred – HMRC will argue that the expense is **not absolutely necessary and is not therefore deductible** from taxable earnings.

However, if the answer is "no" – i.e. he **cannot do his job without incurring that expense** - the expense will be necessary for the performance of the duties and will therefore be allowable.

HMRC is very strict in applying this rule and it is **notoriously difficult for employees to get relief for expenses under Section 336.** HMRC has been successful more often than the taxpayer and most disputed claims for expenses have been disallowed. We will look at cases which have examined the deductibility of expenses at the end of the chapter.

20.3 Travel expenses

Sections 337 and 338 deal with the deductibility of travel expenses. Under general principles a deduction for the employee's travel costs will be allowed if the expenses are: ITEPA 2003, s.337 -338

(i) **necessarily incurred** on travelling in the performance of the duties of the employment; or
(ii) attributable to the employee's **necessary attendance** at any place in the performance of the duties of the employment.

Section 338 specifically denies a deduction for "**expenses of ordinary commuting**". "Ordinary commuting" in this context is defined as travel between either:

a) the employee's **home and a permanent workplace**; or
b) a place that is not a workplace (e.g. a hotel or someone else's home) and a permanent workplace.

This means that if an employee incurs travel expenses in going from his **home** to his **normal place of work,** these expenses will **not** be allowable, as they constitute expenses of ordinary commuting. You will be aware of this already as your employer does not reimburse you for home to office travelling and you do not get tax relief for these costs.

No deduction is allowed for travel between any two places that is, for practical purposes, **substantially ordinary commuting**. This means that if an employee, for instance, is required to attend a training college and the journey to the college is substantially the same as that to the usual place of work (and at a similar expense), no deduction will be allowed for travel costs to the college.

However, once at work, if an employee incurs expenses in travelling from his normal place of work to **visit a client**, that is not "ordinary commuting" but is instead travel in the performance of the duties and as such these expenses will be deductible. Therefore, **office to client travel is allowable**.

But what if the employee travels directly from his home to a client's premises and doesn't go into the office first? HMRC accepts that these travel expenses are allowable as they are not ordinary costs of commuting but only providing that the client's premises constitute a "**temporary workplace**".

A "temporary workplace" is defined as a place which the employee attends in the performance of his duties in order **to perform a task of limited duration** or for some other temporary purpose. ITEPA 2003, s.339

A workplace will **not** be "temporary" if **the employee attends for a period of continuous work lasting more** than 24 months. A period of continuous work is a period over which the duties of the employment are performed to a significant extent at that workplace. HMRC consider the duties to be performed to a significant extent if the employee spends 40% or more of their time at that place. Therefore, if an employee is visiting a client for a day, or a few days or even a few months, the client premises will be a "temporary workplace" and travel to and from that workplace will be deductible expenses.

A "temporary workplace" may become a "permanent workplace" if either:

a) the employee has worked at that location for a continuous period of 24 months; or
b) it becomes apparent that the absence from the original permanent workplace will exceed 24 months.

In these instances, travel costs up to the point of "change" are deductible, but costs after that date are not.

Illustration 1

Judith, who lives in Didcot, has worked for her employer for the past 5 years in Oxford. She is sent by her employer to work full time in Bracknell for 18 months, after which time she will return to Oxford.

Judith cannot claim a deduction for the cost of travel between her home in Didcot and her workplace in oxford because Oxford is her permanent workplace. No relief is available for the expenses of ordinary commuting.

The workplace in Bracknell may be a temporary workplace as Judith's attendance there is for a limited duration. The time in Bracknell will be a period of continuous work as Judith will spend over 40% of her time there, so the 24 month rule needs to be considered. As the period will not exceed 24 months, Bracknell will be a temporary workplace and the costs of travel will be allowable.

If after 12 months, the secondment is extended to 28 months, Judith will be able to deduct the costs of travel for the first 12 months. After that point, the secondment is expected to exceed 24 months and so Bracknell is now a permanent workplace. No further relief for travel costs will be available.

Illustration 2

Rainer lives in Cleckheaton and works in Leeds 5 days a week. His employer sends him to work in the Manchester office 1 day a week for 3 years.

Leeds is Rainer's permanent workplace and he cannot claim for the costs of travel between Cleckheaton and Leeds. Manchester may be a temporary workplace as Rainer's attendance there is for a limited duration. In addition, we do not need to consider the 24 month rule as Rainer's attendance in Manchester is not in the course of a period of continuous work as he does not spend 40% or more of his time there.

As a result, Manchester is a temporary workplace and the costs of travel between Cleckheaton and Manchester will be deductible.

An "area" could be regarded as a permanent workplace and travel costs to and from that area would not be deductible. An "**area based employee**" is one whose employment duties are defined by reference to an "area" (rather than a specified site or building) and where the employee attends different places in the area in the course of his job.

ITEPA 2003, s.339(8))

Certain **"site based" employees** will have no permanent workplace and will travel to various different "sites" to perform their duties. Providing that a job at a particular site is not expected to last more than 24 months, costs of travelling from home to site (and back again) will be deductible.

An employee whose employment contract is for less than 24 months is by definition not travelling to and from a temporary workplace. Deductions for travel costs in these instances will be denied.

ITEPA 2003, s.339(5)(a)(ii)

The cost of business travel also includes subsistence costs attributable to the journey in question. Similarly, where an employee has to stay away overnight on business, the cost of the accommodation is part of the cost of business travel. Therefore, the full cost of meals and accommodation whilst travelling or staying away on business is allowable as part of the costs of travel.

Illustration 3

David is required to spend 2 months working at his employer's Edinburgh office. He usually works in the Cardiff office. David flies to Edinburgh on Monday morning and stays in a hotel, travelling home Friday afternoon. He has his meals either in the hotel or a local restaurant.

Edinburgh is a temporary workplace so the costs of the journey to and from Edinburgh are allowable, as are the costs of the hotel accommodation and meals.

Some expenditure that an employee might incur whilst making a business journey is not expenditure attributable to the journey. For example, private phone calls, newspapers and laundry. However, if the employer pays or reimburses no more than £5 per night for UK trips and £10 per night for overseas trips, such payments are not subject to tax. If the employer pays more than these amounts, the amounts are taxable in full. ITEPA 2003, s.240

20.4 Professional fees and subscriptions

A deduction from taxable earnings is allowed for an amount paid by an employee in respect of a **professional fee**. The deduction is allowed provided that the **employment involves the practice of the profession to which the fee relates** and the payment of the fee is a **condition** which must be met if that profession is to be practiced. ITEPA 2003, s.343

Section 343 contains a list of deductible fees and these include practice fees for doctors, dentists, opticians, vets, lawyers, architects and teachers.

A deduction from taxable earnings is also allowed for **annual subscriptions** paid to an "approved body". HMRC has a published list of such bodies. The subscription will be deductible as long as the activities of the body are of direct benefit to, or concern the profession practiced in, the performance of the duties. ITEPA 2003, s.344

For example, a subscription by a company director to the Institute of Directors would be deductible because the subscription relates to the employment and is to an approved body. However, if the same director then paid a subscription to his local golf club, this would not be deductible as this has nothing to do with the employment.

HMRC would not accept an argument that it is "necessary" for this employee to be a member of the golf club, even though he may meet clients and do some business at the club. This was tested in the tax case of *Brown v Bullock* (1961) where a bank manager's Gentleman's Club fees were disallowed by the courts on the grounds that they were not absolutely necessary. He could do his job as a bank manager without being a member of the club. The fact that his club membership occasionally won him some business was held to be irrelevant. However, in *Elwood v Utitz (1966)* a taxpayer subscribed to a London Club to enable him to obtain cheaper accommodation when visiting London for business purposes. The subscription was allowable as the only reason the taxpayer was a member of the Club was for the purposes of employment.

20.5 Charitable donations

ITEPA 2003s. 713

There are two methods of obtaining tax relief on charitable donations.

As we have seen already, the first is via the **Gift Aid scheme**. Gift Aid payments are made net of basic rate tax and we give higher and additional rate relief by extending the basic and higher rate bands by the gross amount of the donation.

The second way in which a taxpayer can get tax relief on a donation to charity is by using the Payroll Deduction Scheme. You may also see this referred to as the **Give As You Earn (GAYE) scheme**.

Donations are made **gross** – i.e. there is no withholding of basic rate tax at source. This gross donation is **deducted from taxable earnings** for the year.

In practice, the gross donation is deducted by the payroll department before the tax due under PAYE is calculated thereby giving the employee tax relief as he goes along. The employer will then pass on the amounts withheld to the relevant charity.

20.6 Employee liabilities and indemnity insurance

ITEPA 2003, s.346

If an employee pays a premium under a qualifying insurance contract, that premium is deductible from taxable earnings. A qualifying insurance contract is essentially a contract which provides for the employee to be indemnified against any costs or damages arising from action taken against him.

Most employers will have their own Professional Indemnity Insurance which covers the actions of their employees, so few employees will need to consider taking out an indemnity policy for themselves.

20.7 Entertainment Expenses

ITEPA 2003, s.356

Special rules apply in respect of entertaining expenses. Before we can apply the normal test under s.336 ITEPA 2003, we need to establish whether s.356 ITEPA 2003 prevents the employee obtaining a deduction in the first instance.

Relief for expenses incurred in connection with entertainment are not allowed, by virtue of s.356, unless the expense has been paid or reimbursed by the employer and has been disallowed in arriving at the employer's taxable profit. Client entertaining is not an allowable deduction for the employer. In this case, relief will be available for the employee, provided that he or she is required for genuine business reasons to entertain clients in the course of performing the duties of the employment. In other words, the expense meets the 'wholly, exclusively and necessarily' test.

Relief for entertaining colleagues is not prevented under s.356 unless it is incidental to the entertainment of others, such as clients. However, the expense of entertaining other employees of the same company is unlikely to have been incurred wholly, exclusively and necessarily in the performance of the duties and therefore relief will not be available.

20.8 Reimbursed business expenses

Most allowable business expenses incurred by employees will be reimbursed by their employers at a later date when the employee makes an expense claim. Remember a business expense will be allowable if it is either **wholly, exclusively & necessarily incurred** in the performance of the duties, or if it is a **qualifying travelling expense** or it is a professional fee or subscription. In these cases, the expense can be deducted from taxable earnings.

As far as the tax computation is concerned, we need to do two things.

First we **treat the expenses reimbursed by the employer to the employee as earnings from the employment** - i.e. we include this payment to the employee's taxable earnings. The amount reimbursed should be reflected by the employer as a benefit on the employee's P11D.

Having treated the reimbursed expense as income, we can then make a claim to **deduct** the expense in order to arrive at next taxable earnings.

As a result, in the case of genuine business expenses, the amount which goes into the computation as income and the amount that is deducted as an allowable expense, will cancel out leaving nothing taxable.

However, this will not be the case if the expense is not wholly, exclusively & necessarily incurred in the performance of the duties. In this case, no deduction will be allowed for the expense and the amount reimbursed by the employer will be subject to tax. This will be the case if personal expenses are paid or reimbursed by the employer.

20.9 Dispensations

ITEPA 2003, s.65

A "dispensation" is a notice provided by HMRC to an employer agreeing that **no additional tax will be payable** by an employee who receives certain payments or benefits. The payments in question will be **genuine business expenses** reimbursed by the employer to the employee.

In the absence of a dispensation, business expenses reimbursed to an employee will be entered on form P11D. The employee will then be left to claim relief for the expense via his self assessment return.

If an employer makes an application for dispensation, this unnecessary "paper chase" can be avoided.

Illustration 4

Chris makes a business trip to Edinburgh and his return train ticket costs £75. When he returned to the office, he made an expense claim and his employer, Online Tutors Ltd, reimbursed this £75.

Chris is employed on a salary of £25,000. Strictly what should happen is that the employer should produce a form P11D for Chris including this £75 as a benefit. Chris's total earnings for the year will now be £25,075.

As far as Chris is concerned, the £75 is a qualifying travelling expense and is therefore deductible from his taxable earnings. He will make a claim under s.337 on his tax return and the £75 will be deducted, leaving Chris with taxable income of £25,000. This is exactly the same as the salary figure so you will see that the two entries of £75 have cancelled each other out.

ITEPA 2003, s.337

	£
Salary	25,000
Add: reimbursed expense	75
Taxable earnings	25,075
Less: travel expenses	(75)
Net taxable earnings	£25,000

What we have achieved is to create a lot of paperwork with no end result. The company has to prepare a P11D to show a benefit of £75 and Chris has to prepare a tax return to claim this amount as an expense of his employment.

This is a waste of time, so in these circumstances HMRC will issue a notice of nil liability or dispensation to the employer in respect of the business travelling expenses. This means that the employer here can ignore these travel expenses when preparing P11Ds.

Employers **must apply to their local Tax Office for dispensations**, and dispensations are issued in respect of specific categories of expenditure – business travel being the most common.

Note that if an employer does **not** have a dispensation for a particular type of expense, such expenses reimbursed to employees **must be reflected on the P11D** and the employee will then make a claim for relief via his tax return.

20.10 Round Sum Allowances

A round sum allowance is a general allowance – usually a fixed amount of cash – paid to the employee in advance to cover his or her expenses for a particular period. For example, Online Tutors Ltd could pay a round sum of £1,000 to Chris to cover forthcoming expenses.

A **round sum allowance** should be treated in the first instance as salary and the employer should **withhold tax under PAYE**. This will normally happen automatically as the payment is often made via the payroll system. There is no way around this as the HMRC will not issue dispensations for round sum allowances.

Chris will spend the money on various items and will claim a deduction, via his end of year tax return, for any amounts spent for business purposes – i.e. any expenses incurred wholly, exclusively & necessarily in the performance of his duties.

However, if Chris spends part of his round sum allowance on client entertaining he will not be allowed to claim a deduction as the expense will not have been disallowed in arriving at the employer's taxable profits. If the allowance is a specific entertaining allowance, it will be disallowed for the employer and therefore the employee can claim a deduction. The allowance will be reported on the employees P11D.

ITEPA 2003, s.356

20.11 Case Law

There have been a number of cases which have examined whether or not an expense is an allowable deduction from employment income.

In the case of *Smith v Abbott and others (1994)* the taxpayer was employed as a journalist by Associated Newspapers Ltd. He received an allowance to purchase newspapers. The allowance was treated as an emolument and the taxpayer claimed a deduction under (what is now) s.336 ITEPA 2003.

However, the Court of Appeal found that the expenditure should be disallowed as it was not for the performance of his duties, but to qualify him to perform those duties.

The case of *Hillyer v Leeke (1976)* found that no deduction was allowable in respect of wear and tear on the suits that a taxpayer was required by his employer to wear for work. The taxpayer wore the suits for a private purpose (warmth and decency) as well as a working purpose.

In *Humbles v Brooks (1962)* a history teacher claimed a deduction for the cost of attending weekend lectures to improve his knowledge.

Again, it was held that no deduction was allowable because the expenditure was not incurred "in performance of" his duties.

Finally, in the case of *Lucas v Cattell (1972)* an NHS clerk installed a telephone at home so that he could be reached after office hours. It was agreed that one-twelfth of the calls were connected with his employment. He was reimbursed by his employer the cost of the calls made by him but no part of the rental payment. The Revenue initially allowed one-quarter of the rental payment but the taxpayer claimed the whole of his telephone rental as a deduction.

However, it was found that no part of the rental was allowable as it was not wholly and exclusively referable to the performance of the taxpayer's duties.

Example 1

Mr Broker (a City analyst) incurs the following expenses:

a) Tube fare to work
b) Taxi fare from office to client
c) Payment to company pension scheme
d) Financial Times to read on the tube
e) Subscription to the Institute of Stockbrokers
f) Pinstripe suit and braces for office.

Which of these expenses are deductible in arriving at net taxable earnings?

Answer 1

	Allowable	*Not Allowable*
a) Tube fare to work		X
b) Taxi fare to client	✓	
c) Pension payment	✓	
d) Financial Times (see Note 1 below)		X
e) Subscription to Institute of Stockbrokers	✓	
f) Pin stripe suit and braces (see Note 2 below)		X

Note 1

Mr Broker's newspaper costs will not be allowed. Mr Broker would argue that, as a stockbroker, it is necessary for him to read the Financial Times on a daily basis, but a similar claim has already been heard and rejected by the courts.

In the case of **Smith v Abbott**, a journalist for a national daily newspaper argued that it was necessary for him to buy and read the daily newspapers of his competitors in order to do his job.

The courts agreed with HMRC and disallowed this expense as it was held not to be absolutely necessary as it was possible for this journalist to do his job without incurring that expense.

The courts said that the expenditure simply enabled the employee to do his job better and this was not enough to pass the stringent tests laid down in s.336.

Note 2

HMRC have again been successful before the courts in arguing that the costs of clothing suits etc are not allowable on the grounds that the expense is not exclusively for the performance of the duties.

The courts have said that we buy clothing not just for business purposes but also to provide us with warmth and decency and hence the expense has a duality of purpose and is not allowable.

Deductions will only be available for such things as protective clothing or costumes or uniforms – i.e. clothing which could not be worn in an everyday context.