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THE NEW TAX RULES ON EMPLOYEE TRAVEL AND SUBSISTENCE

This is the second of two articles about the taxation of employees' travel expenses. The December 1997 article described the changes in the tax rules on employee travel and subsistence which will be brought forward in the 1998 Finance Bill to take effect on 6 April 1998 (please see the box below). This article provides examples to illustrate some of the bigger changes and to enable Tax Agents to help their clients get tax relief for the proper amount to which they are entitled.

Readers can obtain a copy of the draft legislation free of charge from the Inland Revenue Information Centre, South West Wing, Bush House, Strand, London WC2B 4RD, or by telephoning 0171 438 6308, Monday - Friday 9.00 am - 5.00 pm. Readers should of course bear in mind that the changes to be brought forward in the 1998 Finance Bill are not yet law.

The 24 month rule - detached duty and other short term sites

In response to requests for further guidance the Inland Revenue has provided a practical test which will help employers apply this rule.

The new rules give relief for journeys to or from a place an employee has to attend in the performance of his or her duties, but not for journeys which are ordinary commuting or private travel. (Private travel is explained later in this article).

Ordinary commuting is any journey between an employee's home, (or any other place he or she attends for reasons other than work), and a permanent workplace.

A **permanent workplace** is a place which the employee regularly attends in the performance of the duties of the employment and which is not a temporary workplace.

A **temporary workplace** is a place which the employee attends in the performance of the duties of the employment for the purpose of performing a task of limited duration or for some other temporary purpose.

Readers who do not have a copy of the December 1997 issue of Tax Bulletin can obtain a copy by sending a cheque for £4 to the Inland Revenue Finance Division. The address is on the back page of this issue.

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An employee seeking tax relief for travel between home and a site or other place will always need to consider whether the place is or is not a temporary workplace. The draft legislation points to the first step in answering this question being to consider whether the attendance is "for the purpose of performing a task of limited duration or for some other temporary purpose". However, the 24 month rule then restricts the situations in which attendance can be regarded as being of limited duration or for other temporary purpose. So, in practice, it will usually be easier to begin by considering whether the 24 month rule applies.

The 24 month rule applies where an employee's attendance at a particular site forms part of a "period of continuous work". It says that a place is not a temporary workplace if the employee's attendance is in the course of a period of continuous work at that place lasting more than 24 months or comprising all or almost all of the period for which the employee is likely to hold the employment, or it is reasonable to assume that attendance will be in the course of such a period. A period of continuous work at a place is a period over which the duties of the employment fall to be performed to a significant extent at that place. The practical test is that the Inland Revenue will regard duties as performed to a significant extent at a place where an employee spends 40% or more of his or her working time at that place.

Example 1

Wayne has worked for the same employer for 7 years. He is sent by his employer to work full-time on a site for 26 months. Wayne expects to spend more than 40% of his working time at the site, so his attendance there falls in a period of continuous work. He expects to be there for 26 months, so the period of continuous work is expected to be for more than 24 months. This means that the site is not a temporary workplace, it is a permanent workplace. Wayne's journey from home to the site is therefore an ordinary commuting journey for which he is not entitled to relief.

Example 2

Sue has worked for the same employer for 5 years. She is sent to work full-time in an office for 15 months. Sue expects to spend more than 40% of her working time at the office, so her attendance there falls in a period of continuous work. She expects to be there for 15 months, so the period of continuous work is expected to be for less than 24 months. This means that the office is not a permanent workplace. Sue's journey from home to the office is not, therefore, an ordinary commuting journey and she is entitled to relief.

Example 3

Bjorn is a Swedish national and employed as a design engineer by a Swedish company. He has worked for that company for 12 years. The company sends him to perform full-time duties in Oxford representing them on a joint UK/ Swedish project. The project is funded for 16 months. He flies from Stockholm to Birmingham on Monday morning and returns on Friday evening. During the week he stays in an hotel in Oxford. Bjorn expects to spend more than 40% of his working time in Oxford so his attendance falls in a period of continuous work. He expects to be there for 16 months, so the period of continuous work is expected to be for less than 24 months. Bjorn is therefore entitled to relief for the cost of travel between his home and Oxford and for his hotel accommodation. (There are also special rules which provide relief for foreign travel - see Chapter 7 of Booklet 490 "Employee Travel - A Tax and NICs Guide for Employers" (see below))

What happens when employees do not work at a place full-time?

Where an employee spends less than 40% of his or her working time at a place the employee's attendance does not form part of a period of continuous work so the 24 month rule cannot be used to decide whether that workplace is a temporary workplace. An employee is not entitled to relief for travel between home and a place simply because he or she spends less than 40% of his or her working time there. In these circumstances the question of whether the place is a permanent or a temporary workplace, and, therefore, whether travel between home and the place is ordinary commuting, has to be answered by reference to the basic definitions of permanent and temporary workplaces mentioned above.

The following examples, some of which are taken from Booklet 490, show how the 24 month rule applies where employees do not work at a place full-time:

Example 4

Effie is employed as a food scientist by a manufacturer of ice cream cones. She lives in Porthmadog and works in Dolgellau. Her employer opens a new plant in Llandrindod Wells. Effie is sent to work there 4 days a week and expects to be there for 30 months. She is not entitled to relief for travel from home to Llandrindod Wells because she is spending more than 40% of her time at the new plant and expects to be there for more than 24 months. It is therefore a permanent workplace. Effie is not

entitled to relief for travel from home to Dolgellau for the one day a week she goes there because the Dolgellau plant remains her permanent workplace.

Example 5

Ita is employed as a quality inspector in a toffee factory. She lives in Cambridge and works in Bishops Stortford. Her employer opens a new factory in Ely and announces plans to close the Bishops Stortford factory in 3 years' time. Ita is sent to work in Ely 4 days a week but continues to work of the Bishops Stortford factory for the remaining day of the week for the 3 years during which it is to be run down prior to closure. Once the Bishops Stortford factory is closed she expects to work full-time in Ely. Ita is not entitled to relief for travel from home to Ely because she is spending more than 40% of her time at the new plant and expects to be there for the rest of her employment. It is not therefore a temporary workplace; it is a permanent workplace. Ita is entitled to relief for travel from home to Bishops Stortford for the one day a week she goes there because it is a temporary workplace.

In both example 4 and example 5 the employee continues to attend the original location for one day a week, but the two cases are different for tax purposes. Both employees spend less than 40% of their working time at the original location, so the 24 month rule does not apply and in both cases the basic definitions of permanent and temporary workplace have to be considered. Effie's attendance in Dolgellau is neither of limited duration nor for some other temporary purpose. She continues to go to Dolgellau in the same way as she always has; the only difference is that the number of days she spends there has been reduced. So Dolgellau is a permanent workplace and her travel between there and home is ordinary commuting for which she is not entitled to relief. In contrast, in Ita's case the plans to close the factory in 3 years time mean that her attendance in Bishops Stortford is for the purpose of performing a task of limited duration, Bishops Stortford is therefore a temporary and not a permanent workplace.

In cases where the 24 month rule does not apply it is important to remember that the definition of a temporary workplace means considering whether attendance is for the purpose of performing a ***task*** of limited duration. A place will not be a temporary workplace simply because an employee's attendance is expected to be of finite duration, for example because he or she is expected to leave the employment at some point. So, in example 4 if Effie was 62 years old and obliged to retire at 65 her attendance at Dolgellau would still not be for the purpose of performing a task of limited duration. In these circumstances Dolgellau would still be a permanent workplace.

Whether attendance is for the purpose of performing a task of limited duration is a question of fact. Where tax relief is obtained as a result of employers or employees describing a posting as of limited duration when it is in fact open ended, the Inland Revenue will seek recovery of tax, together with interest and penalties where appropriate.

Example 6

Elwyn is employed as a speech therapist at a hospital in Devizes. His employer sends him to Reading for 3 days a week to supervise a new department there. He expects to be in Reading for 18 months. Elwyn is entitled to relief for his travel from home to Reading. Although he is spending more than 40% of his time in Reading he does not expect to be there for more than 24 months so Reading is a temporary workplace.

Example 7

Emily is employed as a seal doctor at a zoo on the South coast. She is sent to Morecambe to supervise a seal sanctuary for one day each month. She has done this for 5 years. Although Emily goes to Morecambe for more than 24 months she does not spend more than 40% of her working time there and she retains a permanent workplace on the South coast. So she is entitled to relief for her travel from home to Morecambe.

Example 8

Adam is employed as a technical expert on aspects of the brewing process. He lives in Redditch and works at a brewery in Dudley. Occasionally problems arise in his employer's other brewery in Evesham and he has to go there to examine fermentation. On average Adam goes to Evesham once a week but he never knows when he will have to go and he always goes to deal with a specific problem. He has been doing this for 15 years. Adam is entitled to relief for the cost of his travel between home and Evesham because it is a temporary workplace.

Example 9

Sally is employed as a librarian. She lives in Preston and each week she works Monday - Wednesday in Blackburn, Thursday in Lancaster, Friday mornings in Blackpool and Friday afternoons in Blackburn. She has been doing this for 8 years and expects to continue this pattern of work as long as she remains in her present job. Sally

is not entitled to relief for travel between home and any of these workplaces. Blackburn is not a temporary workplace because she spends more than 40% of her working time there. Her attendance therefore falls into a period of continuous work and she expects to be working there for more than 24 months. Sally does not spend more than 40% of her time in either Lancaster or Blackpool so the 24 month rule does not apply. However, her attendance is not for the purpose of carrying out a task of limited duration, nor is it for some other temporary purpose. So neither Lancaster nor Blackpool is a temporary workplace.

Example 10

Fitz is a make-up artist employed by a large chain of chemist shops. He works 5 days each week but spends each day in a different shop in a different town. He works in the same shop on the same day each week.
Fitz is not entitled to relief for his travel from home to any of the shops. That is because he travels regularly to each shop and his work is neither of limited duration nor for a temporary purpose. So each shop is a separate permanent workplace.

In examples 7 - 10 the employees are all spending less than 40% of their time at various places but while Emily and Adam are entitled to relief Sally and Fitz are not. The tax treatment is different because the purpose of the visits is different. Emily and Adam attend places for temporary purposes. Each visit is self-contained. In contrast, Sally and Fitz attend places for ongoing purposes; the tasks they perform are continued over from one visit to the next.

Example 11

Emmett lives in Knaresborough and has a part-time job working two days a week in Harrogate as a telephonist for an insurance company. He is asked to spend one of his two working days covering for a colleague at a branch in Ripon for a period of 32 months. Emmett is not entitled to relief for travel between home and Ripon because, while he spends only one day a week in Ripon, this is more than 40% of his working time and he expects to be there for more than 24 months. Emmett is not entitled to relief for the journey he makes between home and Harrogate on the other day he works because Harrogate remains a permanent workplace.

A period of continuous work can remain continuous even where there is a break in attendance.

Example 12

Erica is employed as a computer consultant. She works full-time at a site for 18 months developing a new computer system. The work is then extended for another 18 months at the same workplace, for the roll-out of the new computer system. The roll-out is subject to a separate contract between the employer and client. As long as Erica did not expect to be working on the site for more than 24 months she is entitled to relief for the cost of travelling from home to the site. Once her employer enters into a new contract Erica expects to be working on the site for more than 24 months. From that point she is not entitled to relief for her journey from home to the site.

Example 13

Ernest is employed to work full-time on a construction project which is expected to last for 6 years. Each time Ernest gets close to having worked on the site for nearly 2 years his employer moves him to another workplace for a week before returning him to the long term project site. Despite these moves, Ernest is spending a significant amount of his working time (more than 40%) at one site and the period during which he is doing so is greater than 24 months. So Ernest is not entitled to relief for his travel from home to the site.

In considering all the above examples it is important to remember that the 40% practical test mentioned above is concerned only with whether attendance falls into a period of continuous work. The Inland Revenue has also stated that where an employee has one permanent workplace and spends 40% of their working time at a second location, given the frequency of the visits it is unlikely that each visit to that second location would be to perform a task of limited duration or for some other temporary purpose (see Booklet 490 "*Employee Travel - A Tax and NICs Guide for Employers*" Section 3.22). This means that where an employee has a permanent workplace and regularly spends more than 40% of his or her working time at a second place, that place is likely to be a second permanent workplace. However, the 24 month rule must always be considered where an employee is travelling regularly from home to a second workplace because where the employee expects to be attending the workplace for 24 months or less he or she will usually be entitled to relief.

Short term employments / fixed term appointments

The December article explained that the 24 month rule does not mean that

someone with an employment (as opposed to a temporary posting) which is expected to last 24 months or less has no permanent workplace and is therefore entitled to relief for all his or her journeys from home to work. No relief is available for travel from home to a place which is the only place the employee expects to attend in the course of an employment, even if that employment is expected to last 24 months or less. The December article also included examples explaining how to deal with cases where an employee's expectation about the length of a particular posting changes. A similar approach should be taken to cases where an employee's expectation about a fixed term employment changes.

Example 14

Nira is employed on a 3 month contract to do research in the motor industry. She is based at a factory in Leeds. After 2 months there is a fire at the factory and she is transferred to a different plant in Wakefield to complete her contract. When Nira went to the plant in Leeds she expected it to be the place she attended for all of the period for which she held the employment. Leeds is not therefore a temporary workplace, it is a permanent workplace and Nira's journey from home is ordinary commuting for which she is not entitled to any relief. When Nira goes to Wakefield she again expects it to be the place she attends for all of the remaining period for which she holds the employment so Wakefield is also a permanent workplace and she is not entitled to relief for her journey from home.

Example 15

Rick lives in Exeter and is employed by a fashion house working in Bristol. Initially he expects the job to last only 13 months. After 12 months his employer is so impressed with his designs that his employment is made permanent and he is told that at the end of his 13 months in Bristol he will be posted to London. For the first 12 months Bristol is the place where Rick expects to spend all of the period of his employment. It is not therefore a temporary workplace; it is a permanent workplace and he is not entitled to relief for the cost of travel between home and Bristol. In the last month Bristol is no longer the place where Rick expects to spend all of his employment. Rick expects to be there for less than 24 months in total and so for the last month Bristol is not a permanent workplace and Rick is entitled to relief for the journey from home to Bristol. When Rick moves to London that is a permanent workplace and he is not entitled to relief for the cost of his travel between home and London.

The rule on fixed term appointments can be used to deny relief for the journey from home to the final posting of any employee's employment even if that posting is for 24 months or less. The Inland Revenue has made it clear that it will not use this rule to deny relief for the final posting in any case where an employment has lasted for 5 years or more. This approach gives employers and employees certainty in these circumstances.

Example 16

Katie has been employed for 35 years in the construction industry. She has worked on sites all over the UK. She is sent by her employer to a site in Dundee where she expects to work for 15 months. At the end of this posting Katie plans to retire. When Katie goes to Dundee it is the place where she expects to spend all or almost all of the period for which she will hold her employment. Strictly therefore Dundee is not a temporary workplace, it is a permanent workplace, and Katie is not entitled to relief for the cost of her travel between home and Dundee. However, the Inland Revenue would not seek to deny Katie relief for travel between her home and this final posting.

Example 17

Colin lives in Tonbridge. He is employed on a 10 month contract as an insurance adviser. He is required to spend the first 8 months of his contract in Brighton and the remaining 2 months in Canterbury. Brighton is the place where Colin expects to spend all or almost all of his period of employment. It is not therefore a temporary workplace; it is a permanent workplace, and Colin is not entitled to relief for the cost of his travel between home and Brighton. When Colin goes to Canterbury it is the place where he expects to spend all or almost all of the period for which he will hold his employment. It is not therefore a temporary workplace and Colin is not entitled to relief for the cost of his travel between home and Canterbury.

24 month rule - transitional cases

The 24 month rule replaces the current rule which gives relief for travel to temporary sites where an employee expects to be there for 12 months or less and to return to his or her normal place of work at the end of the period. The 12 month rule will continue to apply up to and including 5 April 1998; the 24 month rule will apply from 6 April 1998. The following examples show how this will affect employees who are at temporary sites for periods which span 6 April 1998:

Example 18

On 1 February 1998 Esther, who had worked for her current employer for 2 years, was sent to perform full-time duties at a workplace for 4 months at the end of which she expects to return to her normal place of work. Esther is entitled to relief for the cost of her journey from home to the temporary workplace for the period from 1 February to 5 April 1998 because the 12 month rule applies and she expects to be away for less than 12 months and to return to her normal place of work at the end of that period.
Esther is also entitled to relief for the cost of her journey from 6 April 1998 to the end of the period on 30 June 1998 because the 24 month rule applies and her attendance falls into a period of continuous work which is expected to be for less than 24 months.

Example 19

On 6 May 1997, Euan who had worked for his current employer for 15 years, was sent to perform full-time duties at a workplace for a period of 18 months. No relief is available for the cost of travel to and from the workplace for the first 11 months - because the 12 month rule applies until 5 April 1998 and he expected his attendance to be for more than 12 months.
However, relief is available for the full cost of travel during the 7 months from 6 April 1998 - because then the 24 month rule applies and his attendance is expected to be for less than 24 months.

Example 20

On 1 October 1997, Freda who had worked for her current employer in Bedford for 3 years, was sent to perform full-time duties at a workplace in Watford for 10 months at the end of which she expects to move to another workplace in Barnsley for 5 years.
Freda is not entitled to relief for the cost of her journey from home to Watford between 1 October 1997 and 5 April 1998 because the 12 month rule applies and while Freda expects to be in Watford for less than 12 months she does not expect to return to her normal place of work in Bedford at the end of that period.
Freda is entitled to relief for the cost of her journey from home to Watford from 6 April 1998 to the end of the period on 31 July 1998 because the 24 month rule applies and Freda's attendance falls into a period of continuous work which is expected to be for less than 24 months. Under the 24 month rule an employee does not have to show that he or she expects to return to a normal place of work at the end of the period.

Private travel

There is no relief under the new rules for private travel. Private travel is:

- travel between an employee's home and any place which is not a workplace; and
- travel between two places which are not workplaces.

A workplace is somewhere the employee has to attend in the performance of the duties of the employment. This rule makes it clear that there is no relief for the cost of an employee's journey from home to visit a relative, or from home to a holiday cottage - even in the unusual circumstances (described in the December article) where an employee's home is a workplace for tax purposes. This rule also makes it clear that there is no relief for journeys from an employee's home to a temporary workplace where the employee does not have to be at the workplace but merely attends as a matter of personal choice.

Example 21

As part of her duties as a supervisor for a chain of supermarkets, Hannah has to visit different outlets. She gets tax relief for her travel. However, in addition, Hannah is usually invited to the Christmas parties held at these outlets. She cannot get relief for this travel because it is not for work purposes.

Journeys which are substantially ordinary commuting

As explained in the December article an employee is not entitled to relief for travel between home and a workplace where that journey is ordinary commuting or a journey which for practical purposes is substantially ordinary commuting.

The Inland Revenue will not normally seek to argue that a journey to or from a temporary workplace is substantially ordinary commuting where the journey is 10 miles or more longer each way than the ordinary commuting journey. This approach is intended to provide certainty for employers and employees where the journey in question is significantly different from the ordinary commuting journey. But this does not mean that travel between home and a temporary workplace which involves less than 10 extra miles in each direction will necessarily be substantially ordinary commuting. The application of this rule will depend on the particular circumstances of each case and all aspects of the journey need to be considered. In response to requests for further guidance the

following examples show how this rule applies to journeys in metropolitan areas.

Example 22

Noam lives in Twickenham and commutes daily by train to London Bridge. He does not have a season ticket. One day he has to visit a client in Kentish Town and he travels there direct from home. Noam's journey to Kentish Town is just 4 miles longer than his ordinary commuting journey and costs him £1.00 more but it takes him in a completely different direction and involves a different train from the one he normally uses and a short bus journey. Despite being only 4 miles longer than his ordinary commuting journey, Noam's journey to Kentish Town is not for practical purposes substantially ordinary commuting and he is entitled to relief for the cost of his travel.

Example 23

Zelda lives in Mayfair and is employed as an interior designer in Knightsbridge. She does not have a season ticket. One day she is asked to visit a customer in Hampstead and travels there direct from her home. Zelda's journey to Hampstead is just one mile longer than her ordinary commuting journey but it involves a different taxi/tube/bus route to the one she normally takes to work. Despite being only one mile longer than her ordinary commuting journey Zelda's journey to Hampstead is not for practical purposes ordinary commuting and she is entitled to relief for the cost of her travel.

Example 24

George lives in Staines and is employed in Bloomsbury as an expert in art. He travels by train into Waterloo each day and on to Russell Square making one change on the tube. He does not have a season ticket. One day he is sent to value a painting for a client at Canary Wharf. He travels there direct from home. George still travels by train into Waterloo but he makes a different tube journey again changing once. George's journey to Canary Wharf is 3 miles longer than his ordinary commuting journey and costs him £1.00 more. Most of his journey is the same as his ordinary commuting journey; his journey starts in the same place and finishes just 4 miles from his permanent workplace in Bloomsbury. George's journey to Canary Wharf is substantially ordinary commuting and he is not entitled to relief for the cost of his travel from home.

Example 25

Linda is employed to run a pub on Fleet Street. She lives in Sevenoaks and travels by train daily to Blackfriars. She does not have a season ticket. One day she is asked to work at a pub in Farringdon, just 800 yards from her own pub. Instead of making her usual journey Linda travels by train from home to Cannon Street. Her journey is 3 miles longer and costs her £2.00 more than her ordinary commuting journey and involves travelling along different track. However, Linda's journey starts in the same place and finishes just 800 yards away from her permanent workplace. Her journey to Cannon Street is substantially ordinary commuting and she is not entitled to relief for the cost of her travel from home.

Journeys which are substantially private travel

The new rules also deny relief for journeys which are for practical puposes substantially private travel. This means journeys where the business purpose of a journey is merely incidental to some private purpose or the journey is made substantially for private purposes rather than business purposes.

Example 26

Lew is harbour master at Larne. One day he travels to Belfast to visit his elderly mother but while there calls in at a colleague's office to deliver some new charts of the Irish Sea. His purpose in going to Belfast was private so he is denied relief because his journey was substantially private travel.

Example 27

Lucille works in a dry cleaners in Carlisle. Her employer sends her to the Darlington branch to repair a machine which has been damaging clothes. While there she visits her ex-husband to discuss maintenance arrangements. She spends a lot longer dealing with her private affairs than in fixing the machine. She is entitled to relief for her travel from home to Darlington because her primary purpose in going there was business. The discussion with her ex-husband, although time consuming, was merely incidental to her business travel.

Example 28

Luke lives in Banbury and is employed as a systems analyst at an office in Aylesbury. Luke has a three week holiday in the USA. At the end of the holiday he flies back from New York to Heathrow. Instead of going home Luke drives direct from Heathrow to visit a client who needs to see him urgently in Warwick. The total cost of Luke's journey from New York to Warwick is £2,500. Luke is not entitled to relief for

the cost of this journey. While he had to visit the client the reason for the greatest part of his journey, and its cost, was private - his return from holiday. His journey was therefore substantially private travel.

The Inland Revenue will not use this rule to deny relief where comparatively small sums and short distances are involved.

Example 29

Mandy lives in Cannock and has a permanent workplace in West Bromwich. One weekend she goes to visit her grandmother in Lichfield. On Monday morning she drives from Lichfield direct to visit a client she has to see in Stafford.
Mandy is entitled to relief for her journey from Lichfield to Stafford. While she started out in Lichfield for personal reasons, and her journey is 6 miles longer than it would have been if she had travelled from her home in Cannock, the journey is substantially for business purposes. It is not therefore substantially private travel.

Personal incidental expenses (PIEs)

As explained in the December article, some of the expenses which employees incur when away on business are private and should not be included when working out the cost of a business journey for tax purposes. For example, the cost of private telephone calls, newspapers and laundry. However, there is a separate tax rule which gives relief where the employer meets these personal expenses and pays or reimburses no more than:

- £5 for every night spent away on business in the UK;
- £10 for every night spent away on business outside the UK.

Where the employer pays more than these amounts, unless there is an established policy which requires employees to repay any excess over these amounts (and repayment is made within a reasonable time), the employee is taxed on the full amount paid by the employer and is not entitled to any relief to set against that amount. The £5 and £10 limits should be applied to the whole period an employee spends away on business, not to each night separately.

The following examples show how the rules on PIEs work in practice:

Example 30

Petula stays in an hotel in Peterborough for 3 nights as part of a business trip. During that time she spends a total of £4.50 on personal telephone calls and £1.50 on newspapers. Her employer reimburses these expenses. Petula is not entitled to relief for these expenses under the general expenses rules but she is entitled to relief under the separate rule for personal incidental expenses.

Example 31

Philip stays in an hotel in Sheffield for 1 night as part of a business trip. His employer gives him an allowance of £6 to spend on personal expenses. Philip is taxable on the whole of the £6. He is not entitled to any relief under the separate rule for personal incidental expenses because his employer has paid him more than £5 a night.

Example 32

Rachel stays away on business in Exeter for 3 nights. Her employer reimburses the following personal expenses:

night 1	£5.50
night 2	£6.00
night 3	£2.50
total	£14.00

Rachel is entitled to relief for all these expenses. Her employer reimbursed more than £5 on nights 1 and 2 - but over the period of 3 nights Rachel's employer did not reimburse more than £15 in total.

Guidance on the new rules

Comprehensive guidance on the new rules on employee travel and subsistance is provided in Booklet 490 "Employee Travel - A Tax and NICs Guide for Employers". Copies of Booklet 490 and forms for employers who need to apply for a dispensation were sent to all Tax Agents and to employers with 50 or more employees in January. All employers can order a copy of Booklet 490 from the Employer's Annual Pack Orderline (telephone 0345 646 646, calls are charged at local rates. The Orderline is open from 2 February to 25 July 1998 Monday - Friday, 8.00 am - 8.00 pm and Saturday, 10.00 am - 1.00 pm). Booklet 490 is available on the Internet on the Inland Revenue's web site at: http://www.open.gov.uk/jw/pd fs/ 490.pdf.

There is also a short guide, IR161 "Tax relief for employees' business travel" which explains the new rules to employees. Copies of IR161 are available from local Tax Offices and Tax Enquiry Centres. Employers and Tax Agents who have questions about the new rules which are not answered by Booklet 490 should telephone the Employer's Helpline on 0345 143 143. Calls are charged at local rates. The helpline is open Monday - Friday, 8.30 am - 5.00 pm. Please remember that the helpline is for employers. This number should not be given out to employees.

The changes in the rules from April 1998 represent a major overhaul of the tax treatment of employees' travel expenses. The Inland Revenue want to do all they can to explain the new rules and to ensure that employees get relief for the proper amount to which they are entitled. With that in mind, readers wanting to suggest aspects of the new rules on which they would like to see further Tax Bulletin articles should write to Tony Gray in Personal Tax Division, Room S11, West Wing, Somerset House, The Strand, London WC2A 1LB.

TAXATION OF COMMISSION, CASHBACKS AND DISCOUNTS

On 27 November 1997 the Inland Revenue published the Statement of Practice SP4/97. The Statement sets out the views of the Inland Revenue on the correct tax treatment of commission, cashbacks and discounts. It entirely replaces SP 5/95 and is applicable to all open cases.

SP 5/95 was issued on 31 March 1995 and dealt with the treatment of commission and discounts arising from insurance policies, life annuity contracts, capital redemption policies and personal pension schemes. The scope of the new Statement extends beyond insurance and pensions to all commercial sectors where inducements are offered to retailers and prospective customers, for example the holiday and motor industries.

According to SP 5/95, commission received by policy holders in respect of their own policies was taxable. Where there was no trade, profession or vocation to which the receipt could be attributed the commission was said to be taxable under Case VI of Schedule D. In October 1995 the Inland Revenue announced in a press release that commission refunded by insurance brokers to "ordinary policy holders" would not be taxed under Case VI. The press release acknowledged that this represented a partial change of view.

The use of the term "policy holder" was consistent with the limited scope of SP 5/95 but it is not suitable to the broader commercial context covered by the new Statement. Instead this now refers to "ordinary retail customers".

However, SP4/97 has the same message as the October 1995 press release for most taxpayers. Any person who enters into a transaction as an ordinary retail customer will have no tax to pay under Case VI on either rebated commission or cashbacks.

Where individual arrangements do not fall wholly within the terms of the Statement - for example, something called a "commission", "cashback" or "discount" may be outside the definitions in paragraph 3 - or where the receipts or payments form part of a scheme of tax avoidance, the text of the Statement will not be conclusive and the taxation consequences will depend on the precise nature of the arrangements entered into.

As with SP5/95 the new Statement does not apply to trustees and the tax treatment of any commission, cashbacks or discounts received by trustees will depend on the particular facts of each case.

Schedule D Cases I, II and VI

Paragraphs 11 to 21 of the revised Statement of Practice set out our view on the treatment of commission, cashbacks and related expenses under Cases I, II and VI of Schedule D. In this part of the article we set out the differences between the view we took in the original Statement (SP5/95) and that in the replacement. We also explain the legal basis behind our current approach.

Legal Basis-Cases I and II

Receipts

Subject to the concession described below, there has been no change in our view of the circumstances in which commission and cashbacks should be taken into account as a receipt of a trade, profession or vocation under Case I or II of Schedule D. Commission and cashbacks are taxable receipts of a trade, profession or vocation ('trade' for short) if:

- they arise from the trade, **and**
- they are sums which the trader receives or to which he or she becomes entitled.

Does a sum arise from the trade?

This is the statutory test in Section 18 Income and Corporation Taxes Act (ICTA) 1988.

In the case of a trade such as an insurance or travel agent it is clear that the commission received from the insurer, tour operator etc. for persuading customers to purchase their services arises from that trade. But commission may also be earned on services (or goods) the agent or his family purchases for their own use or enjoyment. For example, a travel agent may obtain commission for booking a package holiday for himself and his family with a tour operator whose holidays he sells to the public.

We consider that commission earned in this way arises from the trade just like ordinary commission the trader earns. It represents consideration for placing a particular piece of business the way of a concern which provides the trader with his ordinary trading receipts. The service provided by the trader to the payer of the commission is the same whether the service relates to a transaction with ordinary customers of the trader or with the trader himself.

But a concession on this point has now been authorised: there may be excluded from taxable profits so much of any

commission earned in this way as does not exceed the maximum amount the trader or professional person could reasonably have been expected to pass on to an arm's length customer buying the same service or product. A trader etc. who under this concession excludes any commission from a return should be able to demonstrate that the amount excluded is appropriate by reference to amounts of commission actually passed on to arm's length customers purchasing the same or comparable goods or services.

The effect of this concession is to remove any fiscal incentive which may otherwise have existed for a trader to put the purchase of goods or services for his own private purposes the way of a competitor rather than to carry out the transaction in the ordinary course of his own business. The concession also ensures a greater degree of parity in the tax treatment of an employee and a self-employed person in respect of commission earned on private transactions.

Paragraph 15 of the Statement of Practice gives further examples of circumstances where commission should be taken into account in computing trading profits.

Is the sum one which the trader receives or to which he becomes entitled?
This is the test in Section 59(1) ICTA 1988. A sum cannot be regarded as a taxable receipt unless the trader either receives it or else becomes entitled to it (whether actually received or not).

Whether or not a sum has been **received** in any particular circumstances will normally be a straightforward matter. It will include the situation where an intermediary deducts his commission from a payment received from a customer the balance of which is passed on to the supplier.

Before a trader is regarded as becoming **entitled** to a sum he or she must have an enforceable legal right to it. Paragraphs 14 and 6 of the Statement of Practice give further guidance.

Expenses
Unlike SP 5/95 the new Statement gives guidance on the treatment of related expenses. Paragraph 17 of the Statement sets out the circumstances in which commission passed on to a customer is deductible in computing trading profits. As paragraph 17 states, the test is whether the commission is incurred wholly and exclusively for the purposes of the trade. Our published internal guidance (paragraph 601 onwards of the Inspector's Manual) explains how this test should be applied generally.

Tax returns
Paragraph 18 sets out the circumstances in which insurance agents (and similar businesses) may record commission in their Tax Returns net of sums passed on to customers.

Legal basis - Case VI

Receipts
Commission received comes within Case VI where in summary:

- the sum in question does not fall under any other head of charge; and
- there is a separate enforceable contract under which
- the taxpayer must provide some significant service or facility in exchange for the payment.

On an analysis of the contractual position it may be that commission or a cashback received by a customer as consideration for the purchase of goods or services is paid under an enforceable contract which is separate from the contract for the supply of the goods or services themselves. But we now accept that, even where there is such a separate contract, the decision of an ordinary retail customer (see below) to take his or her business to one concern rather than another will not amount to the provision of a sufficient service or facility by the customer to satisfy the third test.

But, as indicated in paragraph 19 of the Statement, where the commission is paid to a person as consideration for introducing some other customer to the supplier of goods or services the third test will be satisfied. Liability under Case VI will then arise if the first two conditions are also satisfied.

The phrase "ordinary retail customer" should be given its ordinary meaning. It will not however include a person who enters into the transaction giving rise to the commission or cashback in connection with any taxable business that he or she runs.

Commission may also be received by individuals when their approved personal pension funds are transferred from one provider to another. There is a detailed account of this type of arrangement in Pension Schemes Office Update 33. The service or facility provided by individual pension holders to the payer of the commission in these circumstances is likely to go beyond that provided by the ordinary retail customer in the circumstances described in the Statement. It is therefore necessary to consider in detail the application of the three bulleted conditions set out above to the facts of each such case to determine whether the commission is taxable under Case VI.

Expenses
Paragraph 21 gives guidance on the circumstances where a deduction may be given in computing the Case VI profit where commission is passed on to the customer.

In Way v Underdown (49 TC 215) it was held on the facts that, in computing an intermediary's profit taxable under Case VI in respect of insurance commission, a deduction could not be made for commission passed on to the policyholder. This was

on the grounds that the intermediary was under no legally binding obligation to do so.

But in practice, where the circumstances make it clear that the commission would not have been earned by a recipient if he or she had not been willing to pass on all or part of it, we accept that a Case VI deduction is due.

Schedule E

This article only deals with the liability which may, in the situations discussed, arise under Section 19 ICTA 1988 and under the benefits legislation in Chapter II of Part V, ICTA 1988. The benefits legislation applies to directors (with certain exceptions - see Section 167(5) ICTA 1988) and to employees with emoluments at the rate of £8,500 or more a year. Sometimes liability to tax under Schedule E may arise under other provisions, such as the vouchers legislation or Section 148 ICTA 1988. These provisions are not within the scope of this article but will have to be considered where there is no liability under the main provisions considered here.

Commission "received"
A commission which is an emolument from employment is always chargeable under Schedule E. Where a benefit is provided by reason of employment, a Schedule E charge arises if there is a cost in providing that benefit. Such commission may occur in connection with sales to a third party or in connection with an employee's own transaction. Liability may arise on products sold by the employer or by a third party, such as another company within the same group as the employer.

Own transactions - Commission and discounts which are available to the general public
An employee who receives a commission provided on the same basis as is available to members of the public, will not receive that commission "from" employment and the commission will not be a taxable emolument. For example, where a washing machine manufacturer offers a refund of £50 to every purchaser of a new machine and, under that general offer, an employee of the manufacturer buys a new machine and receives a £50 refund, the refund would not be an emolument "from" employment. Similarly, if an employee pays a lower price, adjusted for commission or discount due under arrangements that are available to members of the general public, no chargeable benefit in kind will result.

Invested commission
Where an employee is entitled to commission from his or her employment the commission is not always paid. Instead the employee can allow, or request that, the commission be invested, for example, in the policy that caused the commission to be paid (or in any other policy or investment), whether or not it is the employee's own policy or investment. When this happens the commission is said to have been "applied". The full amount of the commission applied remains chargeable on the employee as an emolument (Parker v Chapman 13 TC 677).

An employee's commission from his or her employment which is invested as a requirement of the employer, or of the person from whom it is due, is similarly chargeable (Smyth v Stretton 5 TC 36).

If the employee is not entitled to commission as such but receives rights from his or her employment which can be realised or turned to account, the charge will be the money's worth of those rights (Abbott v Philbin 39 TC 82).

Exceptionally, where an employee within the benefits legislation receives rights which are not of the type mentioned above, there may still be a liability to Schedule E tax under Section 154 ICTA 1988. A commission invested by the employer will be deemed to be provided by reason of the employment (Section 168(3) ICTA 1988) and so will give rise to a charge. A commission invested by a third party will only give rise to a charge if it is provided by reason of the employment. Usually, the charge in either case will be the amount of commission invested by the employer or third party.

Where commission is invested for the benefit of a member of the family or household of an employee and the employee is within the benefits legislation, the employee will be liable to a charge under Section 154 in the same way as if the investment had been made for his or her own benefit.

Discounts in connection with goods, investments or services
Where, in connection with his or her own purchase or policy, a discounted price or premium is paid to an employer by an employee within the benefits legislation, a benefit under Section 154 ICTA 1988 must be considered. Any benefit is deemed, in the circumstances, to arise by reason of his or her employment (Section 168(3) ICTA 1988), and its measure is the amount by which the cost of providing it exceeds the actual price or premium paid.

For example, an employee is allowed by her employer to purchase a non-transferable air fare at the discounted price of £200. If the cost to the employer of providing that air fare was £250 a benefit of £50 will arise.

In the case of a discounted insurance policy it is accepted that where the discount is no greater than the sum of:

- the commission which would have otherwise been paid by the insurer on selling the policy to a third party, and
- the anticipated profit on the policy

then no taxable benefit arises.

Where an employee makes arrangements for an unconnected third party to pay a discounted price or premium, and nothing in money or capable of being turned into money is received by the employee there may still be a tax liability under Section 154 ICTA 1988. This can arise if the employee is within the benefits legislation and the employee or a member of his or her family or household is provided with any benefit. In these circumstances there will always be a charge under Schedule E where the benefit is provided by the employer, but when it is provided by anyone else the charge will depend on whether the benefit is provided by reason of the employment. The measure will be the cost of providing the benefit. This does not include the discounted price or premium paid.

Cashbacks
The Statement defines "cashback" as "an inducement to enter into a transaction for the purchase of goods, investments or services and received as a direct consequence of having entered into that transaction". A cashback received by an employee, which is also available on like terms to the general public, will not give rise to any Schedule E charge.

Deductions
Where a sum within the scope of this Statement is assessable under Schedule E a claim for deduction may be appropriate. A claim in respect of amounts shared with, passed on to, or invested for the benefit of some other party, will be admissible if the employee is obliged to expend the sum wholly, exclusively and necessarily in performing the duties of the office or employment. When a commission sharing transaction etc. falls within the normal framework of the employer's business, and is a transaction undertaken by independent parties acting at arm's length, it is likely that the necessary statutory test for relief will be satisfied.

Qualifying life insurance policies

It will normally be to the advantage of the policy holder for the commission in respect of a life policy to be paid under a separate contract and in practice the Revenue will not seek to read two contracts as one in a way which could lead to the loss of a policy's qualifying status.

The advantage arises because one of the statutory conditions that a policy has to meet before it can be a qualifying policy is that the annual premiums may only fluctuate within a limited range. It follows that if the amount of a premium is reduced by the amount of any commission paid or passed on to the policy holder, the qualifying status of a policy could be jeopardised. But the qualifying rules within Schedule 15 refer to premiums payable, not to premiums paid. Where commission arises not under the contract of insurance but under a separate contract, that commission cannot affect the amount of the premium payable under the insurance contract. The qualifying status of the policy will be unaffected.

On the other hand a discounted premium is paid under the contract of insurance itself which is why the discounted amount is the premium payable. This reduction of the premium payable by way of a discount can cause the premiums payable to fall outside the permitted range and if this happens the policy cannot be a qualifying policy.

Chargeable event gains

In paragraph 38 the Statement provides several examples of ways in which a policy holder can benefit from commission when they take out policies. In each case it explains what amount of premium should be taken into account when calculating the chargeable event gain.

Tax relief in respect of personal pension contributions

Tax relief on personal pension contributions is available by reference to a contribution paid by the individual (Section 639 ICTA 1988). It is to be expected that the payment of commission will arise under a contract separate from the personal pension arrangement. If rebated commission is provided for as part of the pension contract the rebate would be regarded as an unapprovable benefit leading to the withdrawal of tax approval of the personal pension arrangement. The examples given in the Statement therefore assume that a separate contract is in operation.

The examples should be taken to apply to retirement contracts. Although no new contracts have been sold since 30 June 1988 it may perhaps be possible for further commission to be generated on existing contracts.

The maximum limits of tax relief will always apply by reference to actual contributions. Any value added to a pension fund by way of discount (see fourth bullet in paragraph 39 of the Statement) or additional units (fifth bullet) will not affect the limits of relief.

Where a financial intermediary receives commission on their own pension arrangement and he or she deducts commission from a pension contribution, tax relief will only be given on the actual (netted-off) contribution as described in the third bullet. However, as the commission in this situation will be taxable as a business receipt (paragraph 11 of the Statement) the intermediary may decide instead to pay the full amount of the contribution without netting-off and obtain additional tax relief. Alternatively, (and this could apply for policy holders who are not financial intermediaries) where an amount of commission is subsequently invested in a personal pension scheme, that

amount will be accepted as a "contribution paid by the individual".

Wherever possible, the form PPCC (evidencing initial contributions) and contribution receipts issued by the personal pension scheme should show the actual contribution upon which tax relief is properly available, taking into account the use of the commission. Where this is not possible, the contributor should have the records which explain the position and which can be produced to the Revenue if required. Relief claimed on tax returns should show the position after taking into account the treatment on commission.

SELF ASSESSMENT: PROVISION OF INFORMATION FROM TAXPAYER STATEMENTS OF ACCOUNT TO AUTHORISED AGENTS

Taxpayer statements of account are advisory statements issued to taxpayers within Self Assessment, to notify them in advance of tax payments about to fall due, and of any amounts that remain unpaid. For example, many taxpayers will have received a statement of account in late December 1997 or early January 1998, showing the amounts, if any, already paid on account for the year, and the amount of the final balancing payment due for 1996-97, by 31 January 1998. All statements include a payslip.

Statements of account were intended to be personal statements, sent to the taxpayer alone, even where the taxpayer has authorised an agent to act on their behalf in dealings with the Revenue. In our view this was not unreasonable given that taxpayers generally retain financial control of their tax affairs, even where an agent is acting. Taxpayers could elect for the statement of account to be sent to their agent instead. And agents registered for the Electronic Lodgement Service would get electronic copies of any statements. But there were no plans to issue copies of statements to agents in other circumstances.

We received strong representations from the Self Assessment Consultative Committee (SACC) on this issue during the early part of 1996, on the basis that agents would need copies of the statements if they were to help their clients comply with their obligations under Self Assessment. After discussing the issue with SACC we agreed to provide agents with summary details of the relevant information contained in the statements of account, at certain key dates in the year. First details of this arrangement were announced in a Press Release of 29 July 1996, and last November information was provided to agents in advance of the first payments on account falling due, on 31 January 1997.

In a recent Press Release, of 12 December 1997, we gave details of the information that we will be providing in February and April 1998, and in subsequent years. This information will only be supplied for those taxpayers for whom the Inland Revenue has the taxpayer's authority (on form 64 -8) to copy information to the agent. It is not necessary for agents to ask clients to complete a new form 64-8 in order to receive this information.

In **February 1998**, the Inland Revenue will provide agents with summaries of information for each of their clients. The summaries will focus on the details agents need to know if they are to take any action on behalf of their clients before surcharge for late payment is imposed at the end of February. The summaries will be despatched in three groups as follows:

- **group 1** will identify all those clients for whom a 1996-97 Self Assessment return has been received and processed, and who have no outstanding 1996-97 tax liabilities (agents will not need to take any action for these clients);
- **group 2** will identify all those clients for whom a 1996-97 Self Assessment return has been received and processed, but who still have amounts due for 1996-97 outstanding. Each such amount will be identified;
- **group 3** will identify all those clients for whom either:
  - a 1996-97 Self Assessment return has not been received, or
  - a 1996-97 return has been received but it has not yet been fully processed, and therefore it is not yet clear whether the 1996-97 tax liability has been paid in full.

The current credit balance, if any, on the taxpayer statement of account will be identified, as this will be available to allocate against any 1996-97 liability established subsequently.

Taken together the three groups of summaries will identify all those taxpayers within the Inland Revenue's Self Assessment database who are identified as being represented by a particular agent. This will allow agents to identify whether they have clients for whom they should have received details but did not. These might be clients who should have a Self Assessment computer record, but for some reason do not, or clients whose computer record has not been updated to show that they are represented by the agent in question.

Summaries in Groups 2 and 3 will be issued in mid February 1998. Summaries in Group 1 may be issued slightly later. **Details for a particular group will only be issued if the agent has clients in the relevant category. For example, if all clients fall in group 1, nothing will be issued when the summaries for groups 2 and 3 are issued.**

This information will be provided in the form of a separate note for each taxpayer the agent represents. In addition to the information from the taxpayer statement of account the note will contain details of:

- the agent's name and address;
- the taxpayer's name and address;
- the agent's client reference;
- the taxpayer's tax reference.

In **April 1998** Agents will receive details of relevant information, but in a different format. The April 1998 issue will identify all the entries on the taxpayer statement of account for each client back to November 1996, when the accounts were first established. For example, each summary will show details relevant to 1996-97 (i.e. whether the tax due has been paid in full, or whether there is still tax outstanding) and the level of the payments on account, if any, due for 1997-98.

The same arrangements will apply in subsequent years.

SELF ASSESSMENT:

NEW EXTRA STATUTORY CONCESSION: INTEREST ON UNPAID TAX AND BUSINESS CESSATIONS 1997-98 AND 1998-99

A new extra statutory concession has been introduced for those people who cease trading in 1997-98 or 1998-99 and whose liability for earlier years is subsequently revised as a result of the Self Assessment transitional rules (Inland Revenue Press Release of 9 February 1998). It concerns the interest charge that may arise on either their revised liability or their payments on account as a direct result of those adjustments.

Where someone with an established business (one that commenced before 6 April 1994) ceases to trade in 1997-98 or 1998-99, the Revenue may direct that the years 1995-96 and/or 1996-97 be revised to an 'actual' basis of assessment (para 3, Schedule 20, Finance Act (FA) 1994) This is one of the transitional rules introduced in respect of the move to a current year basis of assessment for business profits and replaces similar, but mandatory, revisions under the old preceding year basis.

Where the 1995-96 or 1996-97 liabilities are revised it is possible for an interest charge to arise under S86 Taxes Management Act 1970. However, prior to ceasing business the taxpayer will normally have returned the profits assessable for those years on the basis of a continuing business, under either the preceding year basis (1995-96) or under the SA transitional rules (1996-97). Should these years subsequently be revised because of a para 3, Schedule 20 direction interest will not normally be sought on either the additional liability arising as a result of the direction or on the adjustments to the subsequent year's payments on account for the years covered by the concession, provided that the extra liability is paid by the due date of the relevant assessment or amended self assessment.

The concession means that S86 interest will not normally be sought where adjustments are made to:

- the 1995-96 or 1996-97 liability as a result of a cessation in 1997-98 or 1998-99;
- the 1996-97 payments on account because of an adjustment to the 1995-96 liability resulting from a cessation in 1997-98;
- the 1997-98 payments on account because of an adjustment to the 1996-97 liability as the result of a cessation in 1997-98 or 1998-99.

It should be noted that the concession is not a general waiver of interest nor does it alter or fetter in any way an Inspector's right to issue a direction. It will not apply to:

- interest charged on any additional profits assessed to correct an error or omission by the taxpayer or
- to adjustments to 1995-96 and 1996-97 following a discovery by an Inspector;
- interest on tax paid late as a result of the cessation adjustments, once the amount of the adjustment and the additional tax payable on it are known;
- adjustments to earlier years following a cessation in 1996-97. Any such adjustments are mandatory adjustments, as in earlier years, and unlike the discretionary para 3 Schedule 20 FA 1994 adjustments, can be considered and planned for, with certainty, as soon as the profits for the relevant periods are known. The interest consequences of any such adjustments will be exactly the same as in earlier years.

Copies of the concession are available from:

Christine Jordan
Inland Revenue Information Centre
Ground Floor
South West Wing
Bush House
Strand
London
WC2B 4RD

Telephone 0171 438 7772

It will in due be incorporated into the Inland Revenue booklet IR1 which lists Extra-Statutory Concessions.

GILT INTEREST: GROSS PAYMENT MADE SIMPLE

From 6 April 1998 all existing gilt holders will be able to receive their interest gross rather than after deduction of tax at the lower rate. This can be done by completing one of the forms provided by the Registrar's Department of the Bank of England in Gloucester, (subsequently referred to as "the Registrar's Department"), and returning it to that department.

This simplification was announced in last summer's Budget and is designed to make the gilt market more attractive, thus contributing to the Government's objective of reducing the cost of future public borrowing.

The purpose of this article is to explain the effect of the changes as far as gilt holders are concerned.

Background

At present gilt interest is generally paid after deduction of income tax at the lower rate, that is "net of tax".

This does not apply to:

- Interest on gilts which are the subject of a Treasury direction specifying that the interest is to be paid gross, unless an option for net of tax payment is made.

  (A list of these gilts was provided in Tax Bulletin Issue 29 (June 1997, page 437), to which should now be added 6.5% Treasury Stock 2003. Holders of such gilts, whether they receive the interest gross or net of tax, will not be affected by the change.)

- Interest on gilts which are strippable. This has been paid gross since 7 June 1997, subject to an option for net payment. The change does not affect this.

- Interest on gilts held on the National Savings Stock Register. This has always been paid gross without option for net payment. This has not changed.

Some holders are entitled to receive their gilt interest gross by using the STAR account arrangements introduced on 2 January 1996 to facilitate the gilt repo market (which caters for companies and UK exempt bodies), and other arrangements which cater for those entitled to exemption on either FOTRA (Free Of Tax to Residents Abroad) gilts, or to relief under double tax treaties.

These arrangements will come to an end with effect from 6 April 1998.

The changes will not affect the quarterly accounting mechanism (introduced on 2 January 1996 in tandem with STAR accounts) under which companies have to account for income tax on certain gross gilt interest which they receive.

At present most companies holding gilts choose to receive their interest net of tax and thus avoid getting involved with quarterly accounting. This arrangement will continue unless companies specifically choose to start receiving gross interest on existing gilt holdings.

Gross gilt interest received by companies on or after 6 April 1998 will continue to be subject to the quarterly accounting mechanism for collecting tax until 1 April 1999, when it will be abolished.

New arrangements

From 6 April 1998 onwards, gilt interest on all new holdings will be paid gross, subject, in most cases, to an option for payment net of tax. The Registrar's Department will provide on request the forms for making net of tax options.

Transitional provisions will ensure that existing holdings of gilts on which interest is paid net of tax will not be affected by the change, unless the holder chooses to switch to gross payment.

It is also possible to change from gross to net of tax payment, or vice versa, at any time. All requests for such changes should be sent to the Registrar's Department and not the Inland Revenue.

Individuals

Outlined below are the four main situations which are most likely to arise, together with the consequences of receiving gilt interest gross instead of net of tax.

1. **Where the tax allowances are more than the total taxable income and therefore no tax is due at all**.

If interest is received gross, it will no longer be necessary to make an annual claim to receive repayment of the tax which has previously been deducted by the Bank. If the individual has no other sources of income paid net of tax and no source of earned income which requires a PAYE code number it will no longer be necessary to complete any tax forms.

2. **Where the tax allowances are less than the total taxable income, but a refund is due of some but not all of the tax deducted from the income**.

If interest is received gross, any tax refund will be reduced accordingly. If however the tax deducted from other sources of income is not enough to meet the total tax due, the individual will have to pay the difference to the Revenue. This means it will be necessary for an annual form to be filled in giving details of all sources of income.

3. **Where the taxpayer is liable at either the lower or basic rate of income tax and is not entitled to an annual repayment**.

If interest is received net of tax, there will be no further tax to pay. If interest is received gross, the tax due on that interest will have to be paid direct to the Revenue. Depending on the amount of tax involved, it may be possible to collect this through a restriction in a PAYE code if the taxpayer is an employee or an occupational pensioner. Otherwise, it will be necessary to complete a Self Assessment Tax Return every year and account for the tax due under that system.

4. **Where the taxpayer is liable to pay tax at the higher rate on all or part of the gilt interest**.

If interest is received net of tax, the difference between the tax due at the higher rate and the tax deducted by the Bank at the lower rate will be collected through the Self Assessment system. The difference between the two rates is currently 20%. If interest is received gross, all of the tax due (40%) will be payable under the Self Assessment system.

Individuals - general information

The overall tax liability of any individual gilt holder will not be increased or reduced by the change. The only exception would be individuals not resident in the UK who may not be entitled to repayment of tax on non-FOTRA interest if they receive it net (see "Non-residents" below).

For individuals who are not liable to pay tax, it may be advantageous to receive interest gross so that it is no longer necessary to claim annual repayments from the Revenue.

For individuals who are liable to pay tax, it may be more convenient to continue receiving interest net of tax, especially if they are only basic or lower rate taxpayers.

Any person who opts to receive interest gross on which they are liable to pay tax, must notify the Revenue by 5 October following the end of the income tax year in which the interest first arose, unless they have already completed a tax return for that year.

Companies

Companies which presently receive gilt interest net of tax will probably find it most convenient to continue doing so, because by switching to gross payment they will become subject to the quarterly accounting rules which were described in Tax Bulletin Issue 19 (October 1996, page 250). These quarterly accounting rules will remain in place until they are abolished on 1 April 1999 (see last 2 paragraphs before the heading New arrangements on page 491).

Charities

Charities that do not pay tax on their investment income will probably find it more convenient to switch to gross payment, if they have not already done so. This will mean that they will no longer need to complete repayment claims to recover the tax deducted from their gilt interest.

Non-residents

Non-residents receiving non-FOTRA interest and non-residents receiving FOTRA interest but who do not qualify for FOTRA exemption may well benefit from switching to gross payment. This will mean that they no longer need to complete repayment claims in relation to tax on their FOTRA interest.

Non-residents receiving non-FOTRA interest but who do not qualify for FOTRA exemption may well benefit from switching to gross payment. If they receive interest net of tax they can make repayment claims only in limited circumstances, for example, under the terms of a double taxation agreement.

Trusts

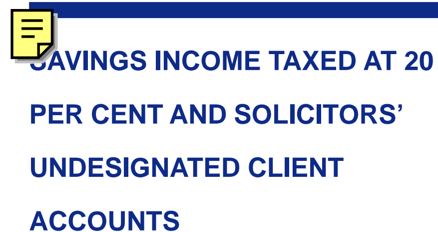
Trustees who switch to gross payment will, as now, be responsible for including the interest on their Self Assessment return unless it arises on FOTRA gilts and they qualify for exemption.

Further information

Further information is contained in the mailshot to gilt holders which is scheduled for issue in early February by the Registrar's Department.

Local Tax Offices will be able to answer general requests for information about the consequences of receiving interest gross, but they cannot give specific advice on the course of action to be taken by any gilt holder.

The Inland Revenue's Financial Intermediaries and Claims Office (FICO) at Nottingham will be able to provide general information for non-residents who receive gilt interest but will not be able to give specific advice to gilt holders about whether they should opt to receive interest gross. Enquirers should telephone 0115 974 2000. (Callers from outside the UK should dial their international access code then 44 115 974 2000.)



SAVINGS INCOME TAXED AT 20 PER CENT AND SOLICITORS' UNDESIGNATED CLIENT ACCOUNTS

Since April 1996 savings income received by an individual, the estate of a deceased person or an interest in possession trust (liferenter trust in Scotland) has normally been taxable at the lower rate rather than the basic rate. Individuals are still liable to the higher rate of income tax on any savings income falling above the higher rate threshold. The relevant legislation is in Section 73 Finance Act 1996 which

inserted a new Section 1A into the Income and Corporation Taxes Act (ICTA) 1988.

The article "Deduction of Tax and Tax Relief at Source" in Tax Bulletin Issue 21 (February 1996) explained how this new system of taxing savings income operates. However it has become clear that there is some uncertainty about whether payments made by solicitors to clients in lieu of interest earned on undesignated client accounts is savings income for the purposes of Section 1A ICTA 1988.

Savings income for the purposes of Section 1A ICTA 1988 is defined as:

- income within Case III of Schedule D, such as interest, but **excluding**
  - annuities, other than "purchased life annuities"
  - other annual payments
  - any mineral rents and royalties, or payments in respect of electric line wayleaves, which would otherwise be chargeable under Case III.
- dividends and other distributions (Section 31 Finance Act (No. 2) 1997 makes changes from 6 April 1999.)
- equivalent income within Cases IV and V of Schedule D, but **excluding**
  - income taxed on the remittance basis
- any payment in respect of a "limited interest" in the foreign estate of a deceased person during administration.

Solicitors' undesignated client accounts

Solicitors often hold money on behalf of their clients and invest this money in interest earning accounts. The money will be held in either a designated or an undesignated account. Designated accounts are individual accounts opened specifically to hold funds on behalf of a particular client. Undesignated accounts are general accounts which can hold funds on behalf of a number of different clients.

If interest earned on a designated account is passed on to the client, the client will be in receipt of interest within Case III of Schedule D and hence potentially within Section 1A ICTA 1988.

At present payments made by solicitors to their clients in respect of money held in undesignated client accounts are treated under an established practice as falling within Case VI of Schedule D. They cannot therefore fall within Section 1A ICTA 1988. The practice of taking a Case VI charge arose because the payments were treated as payments "in lieu" of interest, rather than payments of actual interest. However, following a review of this point we have concluded that as a matter of practice such payments can in future be treated as payment by time for the use of money representing interest within Case III of Schedule D. Therefore with effect from 6 April 1998 such payments should be treated as within Case III and the lower rate charge on savings income, in Section 1A ICTA 1988, can apply where appropriate.

For 1996-97 and 1997-98 such payments will continue to be treated as within Case VI of Schedule D and should therefore still be included in Box 13.3 of the self assessment return for individuals and in Box 8.35 of the trust and estate self assessment return.

Solicitors making such payments from 6 April 1998 in respect of undesignated client accounts should be aware of the provisions of Section 349 ICTA 1988. This Section directs that under certain circumstances where any "yearly interest" is paid then the person by, or through whom, the payment is made must deduct income tax from the payment. For solicitors this is most likely to occur when making payments to a person whose usual place of abode is outside the United Kingdom (Section 349(2)(c)) in the (relatively unusual) case where payments in respect of money held on undesignated client account is "yearly interest".

The content of this article has been agreed with the Law Society.

interpretations

SCHEDULE A: BASIS PERIODS - CASE I/II PARTNERSHIPS WITH ANCILLARY LETTING INCOME

In Tax Bulletin Issue 21 (February 1996 pages 283 to 285), we published an article on Schedule A basis periods for trading or professional partnerships with ancillary letting income. That article - which is reproduced at Appendix 3 to IR150 ("Taxation of Rents - A guide to property income") - dealt primarily with situations where "old" (pre-6 April 1994) trading or professional partnerships had ancillary letting income.

Tax Bulletin Issue 24 (August 1997 pages 450 to 456) provided comment on various partnership transitional issues. But we have been asked specifically what adjustments should be made for Schedule A purposes where, in the case of a trading or professional partnership:

- the non-statutory accounts basis was used for years up to 1994-95 inclusive; and
- the statutory current year fiscal basis was used for 1995-96 and 1996-97 (Section 21(2) ICTA 1988); and
- the statutory current year accounts basis applies - as it must for *all* trading and professional partnerships - for 1997-98 onwards (Section 111(7) Income and Corporation Taxes Act (ICTA) 1988).

Current year accounts basis used for 1996-97 onwards

Where the current year accounts basis has been used by concession for 1996-97 (see Tax Bulletin Issue 21 - February 1996 - and Appendix 3 to the IR150), that basis should be used for all subsequent years and no further transitional adjustment is required.

Current year fiscal basis used for 1995-96 and 1996-97

Where the strict current year fiscal basis has been used for 1995-96 and 1996-97, it is necessary to consider what adjustments are needed following the change to the current year accounts basis for 1997-98 since some Schedule A profits may otherwise be taken into account twice.

Example

ABC is a trading partnership with the following ancillary Schedule A profits (divisible equally between the three partners A,B and C):

1994-95: accounts basis for year ended 30/09/94	£10,000
1995-96: year ended 05/04/96	£12,000
1996-97: year ended 05/04/97	£14,000
1997-98: accounts basis for year ended 30/09/97	£15,000

For years up to 1994-95 inclusive, the current year accounts basis had been accepted for Schedule A. And the strict current year fiscal basis was adopted for 1995-96 and 1996-97.

For 1997-98, new Section 111 ICTA 1988 applies and the partners' shares of Schedule A income are assessable on a current year accounts basis. This means that there is an overlap between the Schedule A basis periods for 1996-97 and 1997-98. And the Schedule A profits for the period 01/10/96 to 05/04/97 are brought into account twice. So the profits of this overlap period (£7,000, ignoring odd days, divisible equally between the partners) are treated as "overlap profit" giving rise to "overlap relief" in due course.

Overlap relief

General guidance on overlap relief may be found at paragraphs 1.81 onwards of SAT 1 (1995) and the same principles may be applied to the ancillary letting income of trading and professional partnerships. Overlap relief will be given in two situations:

- at a change of basis period given by Section 62(2)(b) ICTA 1988; or
- on cessation of the trade or profession (*not* the cessation of the Schedule A business) when the basis period is given by Section 63 ICTA 1988.

Losses

Where Schedule A losses occur, Section 63A(4) ICTA 1988 applies (by virtue of Section 111(8) ICTA) ensuring that the losses cannot be relieved more than once. If, in the above example, the accounts for the year ended 5 April 1997 showed a loss of £14,000 and the accounts to 30 September 1997 showed a loss of £15,000, the loss attributable to the period 1 October 1996 to 5 April 1997 of £7,000 (ignoring odd days) will have already have been taken into account for 1996-97.

The Schedule A loss for 1997-98 (based on the accounts to 30 September 1997) must therefore be reduced from £15,000 to £8,000 (the Schedule A losses brought forward from 1996-97 amount to £14,000).

miscellaneous

1998 EMPLOYERS ANNUAL PACK AND ORDERLINE

In January 1997 the Employers Annual Pack was issued nationally for the first time as a joint venture with the Inland Revenue. Results from an NOP survey show that it was well received both by businesses and accountants. The 1998 Pack will be issued from 28 January 1998, and by adopting customer feedback it will contain fewer stationery items and be more user friendly.

The Orderline will operate from Monday 2 February 1998 through to Saturday 25 July 1998, with weekday opening hours extended by an hour from 8am until 8pm and 10am until 1pm on Saturdays. This year the number of stationery items available on the Orderline has been increased by more than 20 to over 50 items. The Orderline number remains as **0345 646 646**, all calls being charged at local rate.

It is crucial that everyone who operates PAYE/NIC schemes opens their Pack immediately upon receipt so they can order any stationery needed.

In order to avoid penalties resulting from late submission, employers should also remember that certain forms need to be completed and returned to their PAYE Tax Office to arrive by certain dates. These are:

- **19 May 1998** - P14 (OCR) Individual End of Year Summary (accompanied by form P35 End of Year Return)
- **6 July 1998** - P9D and P11D Returns of Expenses and Benefits (where appropriate).

Last year the Orderline received over 600,000 calls in its 6 months operation. The busiest times were at the start of

the new tax year, especially between 10am and 12 noon. To try to spread the calls throughout the day the opening times of the Orderline have been extended on weekdays. If you have difficulty getting through at a particular time it may be better calling at a different time of the day.

Extra Packs can be obtained from the Orderline, as can the new improved version of the CD ROM.

From February 1998 the whole Pack will also be available on the Internet. You will also be able to order additional stationery items through the Internet as an alternative to the Orderline. The address is http://www.open.gov.uk/jw/jw.htm.

The Annual Pack Orderline number is - 0345 646 646.

The Orderline opens for business on Monday 2 February 1998 and remains open until Saturday 25 July 1998.

Calls will be charged at local rate.

It will be open from 8am to 8pm, Monday to Friday and 10am to 1pm on Saturdays.

TAX TREATY UPDATE

Singapore, Malaysia, The Falkland Islands and Lesotho

The UK Parliamentary process for four new tax treaties was recently completed when the Privy Council made Orders in Council for Double Taxation Agreements (DTAs) with Singapore, Malaysia, The Falkland Islands and Lesotho on 17th December 1997. The Statutory Instrument numbers are:

The Falkland Islands: 1997 No 2985
Lesotho: 1997 No 2986
Malaysia: 1997 No 2987
Singapore: 1997 No 2988

The DTA with the Falkland Islands entered into force on 17th December 1997 and that with Singapore on 19th December. We will make a further announcement when the DTAs with Lesotho and Malaysia enter into force.

The text of all four Orders and the House of Commons Official Report of the debate in Committee on 29th October 1997 are available from the Stationery Office. The Official Report can also be found on the Internet at http://www.parliament.the-stationery-office.co.uk and the text of the Orders at http://www.hmso.gov.uk.

1998-99 Treaty programme

We have recently completed a consultation exercise in the context of our annual review of the UK's treaty network, with a view to updating treaties which have become outdated, and to negotiating new ones where appropriate. As before, we consulted a wide range of interested parties. The closing date for responses was 30th January. We are grateful for all the responses received and are studying them carefully. The results will inform our programme for 1998-99 which will be referred for approval by Ministers shortly.

Representations generally about new treaties or suggestions about changes to existing treaties are always welcome and should be addressed to:

Eilish Vaughan
Inland Revenue
International Division
Room 314
Strand Bridge House
138-142 The Strand
LONDON
WC2R1HH

Telephone: 0171 438 6333

Questions about a particular double taxation agreement and its effects on a taxpayer's affairs should be addressed to the local Inland Revenue office responsible for that taxpayer.

Double taxation issues arising from estates, inheritances and gifts are regulated by separate treaties. Representations for new or revised agreements for estates, inheritances and gifts should be addressed to:

David McDonald
Inland Revenue
Capital and Valuation Division
Room 309
22 Kingsway
LONDON
WC2R 1LB

Telephone: 0171 438 7741

CONTRIBUTIONS AGENCY HOLDS NATIONWIDE EVENTS FOR NATIONAL INSURANCE GUIDANCE

The Contributions Agency will be holding events across England, Scotland and Wales throughout 1998 to educate and raise awareness of National Insurance issues.

From workshops and advice days to exhibitions and seminars, companies and the general public are invited to meet the experts in their own locality and have their National Insurance questions answered.

Directors from the Agency will be opening many events, and staff from many business areas including International Services and Contracted Out Employment Group will be on hand to offer advice and guidance.

The Inland Revenue and Customs and Excise will also be taking part in some of the events as part of the Agency's Joint Working programme.

For further information on the events please contact Gill Ord:
External Communications, on
0191 22 55263 or fax on
0191 22 59396.

Inland Revenue Statements of Practice and Extra-Statutory Concessions issued between 1 December 1997 and 31 January 1998

There have been no Extra Statutory Concessions or Statements of Practice issued in this period.

CONTENT

The content of Tax Bulletin gives the views of our technical specialists on particular issues. The information published is reported because it may be of interest to tax practitioners. Publication will be six times a year, and include a cumulative index on an annual basis.

- You can expect that interpretations of the law contained in the Bulletin will normally be applied in relevant cases, but this is subject to a number of qualifications.
- Particular cases may turn on their own facts, or context, and because every possible situation cannot be covered, there may be circumstances in which the interpretation given here will not apply.
- There may also be circumstances in which the Board would find it necessary to argue for a different interpretation in appeal proceedings.
- The Bulletin does not replace formal Statements of Practice.
- The Board's view of the law may change in the future. Readers will be notified of any changes in future editions.

Nothing in this Bulletin affects a taxpayer's right of appeal on any point.

Letters on any article appearing in Tax Bulletin should be sent to the Editor, Jeremy Sherwood, Room 402, 22 Kingsway, London WC2B 6NR. We are sorry though that neither he nor our contributors will normally be able to enter into correspondence about Tax Bulletin or its contents.

SUBSCRIPTION

The subscription for 1998 will be £20. If you would like to subscribe to Tax Bulletin please send your name and address together with your cheque to Inland Revenue, Finance Division, Barrington Road, Worthing, West Sussex BN12 4XH. Cheques should be crossed and made payable to "Inland Revenue".

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