

Taxation of legal expenses

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The logo for the Association of Accounting Technicians (AAT), consisting of the lowercase letters 'aat' in a green, sans-serif font, with a horizontal line through the top of the 't'.



Coverage

- Why it matters
- Reasonable Care in a difficult area
- VAT input tax recovery
- Direct tax treatment
 - Business
 - Individual
 - CGT
- Legal position 31 December 2015
- Questions and answers
- Notes , slides and Q&A sent at end



Reasonable Care

- Legal and Professional fees are a risk area
- Never negligence if wrong but tenable view taken
- VERY IMPORTANT! If it can be shown that the taxpayer took reasonable care then there is no penalty due.
- IMPORTANT that there is a clear 'audit' trail
- Leave big FOOTPRINTS!!!
- Disclosure and transparency after Veltema ,
- Discovery – now 4 years



Employees

- Legal expenses are unlikely to pass s 336 ITEPA 2003
- W E & N in performance
- Two major exceptions
 - Qualifying legal expenses related to relocation
 - Legal advice on termination
- Employer can deduct expense as if remuneration item



It ain't what you do



It's the way that you do it

- Dual purpose can be fatal to a tax deduction
- Incidental benefit to another can be ignored if the primary purpose is for the benefit of the trade
- *Bentleys, Stokes & Lowless v Beeson* (1952) 33 TC 491
- *Romer L J* at pages 503 -504

Romer L J

- If the activity be undertaken with the object both of promoting business and also with some other purpose, for example, with the object of indulging an independent wish of entertaining a friend or stranger or of supporting a charitable or benevolent object, then [ITTOIA 2005, s. 34(1)(a)] is not satisfied though in the mind of the actor the business motive may predominate. For the statute so prescribes. Per contra, **if in truth the sole object is business promotion, the expenditure is not disqualified because the nature of the activity necessarily involves some other result**, or the attainment or furtherance of some other objective, since the latter result or objective is necessarily inherent in the act.'



VAT input tax

- Expense with a view to a taxable supply s 24
- Non business or private purpose no recoverable
- Ian Flockton developments Ltd – racehorse to promote image and sales
- Remember credibility – it must be probable
- Stuart Smith J at page 28:

Stuart Smith J

- *'The test is, were the goods or services which were supplied to the taxpayer used or to be used for the purpose of any business carried on by him? The test is a subjective one: that is to say, the fact-finding tribunal must look into the taxpayer's mind as it was at the relevant time to discover his object...'*
- *In a case such as this, where there is no obvious and clear association between the company's business and the expenditure concerned, the tribunal should approach any assertion that it is for the company's business with circumspection and care, and must bear in mind that **it is for the applicant to establish its case and the tribunal should not simply accept the word of the witness, however respectable. It is both permissible and essential to test such evidence against the standards and thinking of the ordinary businessman in the position of the applicant.** If they consider that no ordinary businessman would have incurred such an expenditure for business purposes that may be grounds for rejecting the applicant's evidence, but they must not substitute that as the test.*



Unsuccessful litigation

- Bill lost and was ordered to pay Ben's costs
- Dispute business related and for making taxable supplies
- Bill can recover his input VAT on his legal costs
- He cannot recover any VAT on Ben's legal costs 1992 Turner case
- Act Of Sederunt in Scotland if taxation of costs applies _ auditor of the Court
- Ben may be able to recover VAT (see notes)



Other legal expenses

- Employee accident in company car? No
- Partner as individual ? No
- Director ? No – P&O ferries 1992
- Bank customer to pay bank's legal advice – No
- Farmhouse and NFU treatment 70%
- Redrow 1999 – customer legal fees incurred to make zero rated sale of new house
- Chain Telecommunications 2012 – no VAT for other group company's legal expenses



Disbursements

- Difficult to establish contractual arrangement to act as an agent, especially under Scottish Law
- Solicitors
 - General disbursements like postage, public transport – add VAT
 - Agency disbursements – expense of the client like stamp duty
- Barratt, Goff and Tomlinson 2011



Any VAT Questions?

Direct Business legal expenses

- Capital – abortive, intangible (lease, rights, planning), property
- Not wholly and exclusively
 - Duality will be fatal in dispute so remember Bentleys case
 - Purolite disallowed share of group legal expense
- Not purpose (tax dispute but SP16/91) Smith's Potato Estates and Allen v Farquharson Bros & Co (1932) 17 TC 59 established a general principle that the costs of pursuing an appeal against an assessment are not allowable



Legal expenses Policy ban

- Fines – Alexander Von Glehn
 - Spofforth
 - McKnight
- Capital buying and selling – even getting rid of burden (lease)
- Capacity – remoteness
 - Strong & Co v Woodifield (1906) 5 TC 215
 - Partnership agreement
 - Personal benefit



Legal expenses Allowed

- Southern v Borax consolidated Ltd
 - Linslade Post office 2012 reaffirms
- McKnight v Sheppard 1999
- Newspaper defamation defence
- Debt recovery
- Advice on ordinary trading activity and legal contracts for ordinary trading activities (supply and sale)

Update for 2015

- Market South West Holdings – planning application to open longer on different days
- ‘toolkit’ issued in June 2014, entitled ‘Capital v Revenue Expenditure Toolkit: 2013–14 Self Assessment and Company Tax Returns’,
- HMRC have warned that:
 - *‘Incidental expenditure incurred when acquiring or disposing of an asset should be treated as capital expenditure. The most common example of such expenditure is legal and professional fees incurred in acquiring or disposing of an asset. Incidental expenditure may also include the cost of such items as the transportation and installation of the asset.’*



Thank you for listening

Any Questions?