[2021] UKFTT 0458 (TC)

TC 08342A/V

Income tax – legal expenses – whether or not incurred wholly and exclusively for the purposes of the trade

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2020/00845

BETWEEN

TR, SP AND SR ROGERS **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE SARAH ALLATT
MR DAVID BATTEN

The hearing took place on 8 November 2021. With the consent of the parties, the form of the hearing was video with all parties attending remotely on the Video Hearings System. A face to face hearing was not held because at the time of the listing, remote hearings were the default method of hearings due to the ongoing pandemic, and rearranging to a face to face hearing would have involved further delay to hearing the case. The documents to which we were referred are the main hearing bundle, the authorities bundle, and skeleton arguments for each party submitted on 5 November 2021.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Simon Rogers for the Appellant

Kevin Brooke, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. *Whether expenses incurred defending one of the partners to the partnership against a specific criminal charge was incurred wholly and exclusively for the business of the partnership.*

BACKGROUND

2. The business in question is a scrap metal business run at the time in partnership between Mr Simon Rogers, who appeared before us representing the partnership, and his parents. The business traded as T R Rogers and Sons, and is based in South Oxfordshire.

3. A Police Operation known as Operation Symphony was conducted by Thames Valley Police, which involved undercover police attempting to sell (and in some cases selling) property which the police implied was stolen property but which in fact was not stolen, as it was the property of the police.

4. As a result of this operation criminal charges were brought against Mr S Rogers, Mr T Rogers, and a number of employees. Mr T Rogers was found not guilty at the first trial. Mr S Rogers was found guilty of one count of attempting to conceal, disguise or convert criminal property.

5. Mr S Rogers appealed his conviction and was successful at the Court of Appeal.

6. The legal costs to defend the criminal charges brought against Mr T Rogers and Mr S Rogers were £543,091 in the tax year ending 5 April 2014 and £61,240 in the tax year ending 5 April 2015.

7. These amounts were claimed as a deduction in the partnership accounts as being wholly and exclusively for the purposes of the trade.

8. HMRC opened enquiries into the tax returns, and after correspondence where an agreement to the position could not be reached, HMRC issued a Closure Letter on 18 August 2019 disallowing the expenses.

9. The Appellant requested a review of the decision, which was issued by HMRC on 31 January 2020, and then the Appellant appealed to the Tribunal.

ISSUES TO DETERMINE

10. The Tribunal is asked to decide whether HMRC were correct to disallow expenses within the Appellant's 2014 and 2015 Partnership Tax Returns which related to professional costs incurred in defending criminal charges under POCA 2002 brought against partners of the Appellant.

11. This point will require consideration as to whether HMRC are correct in their interpretation of Section 34 ITTOIA 2005, specifically whether the expenditure by the Appellants was incurred wholly and exclusively for the purposes of the trade of the Appellant.

12. The Tribunal will also need to consider whether HMRC are correct in their decision to deny the opportunity to apportionment of the costs and allow some of the expenses to be claimed on the Partnership Tax Return.

THE LAW

13. Chapter 4 ITTOIA 2005 sets out the rules restricting deductions from trade profits.

14. S34 ITTOIA 2005 states that:

(1) In calculating the profits of a trade, no deduction is allowed for –

(a) expenses not incurred wholly and exclusively for the purposes of the trade, or

(b) losses not connected with or arising out of trade

(2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part……which is incurred wholly and exclusively for the purpose of the trade.

15. We were referred to a number of cases where the meaning of wholly and exclusively has been considered, and where an expense which has 'intrinsic duality' is not incurred wholly and exclusively for the purposes of the trade.

16. The most famous case concerning these meanings is that of Mallalieu v Drummond [1983 BTC 380], where a barrister claimed the cost of her court clothing as an expense incurred wholly and exclusively to practice her profession, and the court held that '(1) the object of a taxpayer in incurring expenditure is not inevitably limited to the particular conscious motive in mind at the moment of such expenditure; (2) it was inescapable that one object of the taxpayer was the provision of clothes that she needed as a human being; (3) accordingly the only proper conclusion was that her object was both to serve the purposes of her profession and also to serve her personal purposes.'

17. We were also referred to the case of Vodaphone Cellular Ltd &Ors v Shaw (HM Inspector of Taxes) [1997] BTC 247. That judgement also considered whether or not a payment was made 'wholly and exclusively for the purposes of the taxpayers trade' and made the following comments in the judgement

(1)The words 'for the purposes of the trade' mean 'to serve the purposes of the trade'. They do not mean 'for the purposes of the taxpayer' but for 'the purposes of the trade', which is a different concept. *A fortiori* they do not mean 'for the benefit of the taxpayer'.

(2)To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment.

(3)The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment.

(4)Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made.

To these propositions I would add one more. The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the commissioners, not for the taxpayer.

18. We were also referred to the case of McKnight (HM Inspector of Taxes v Sheppard [1999] BTC 236, a decision of the House of Lords about whether expenditure incurred by a stockbroker in defending the allegations of infringements of Stock Exchange rules was deductible from his profits for the purposes of income tax. Here the finding of the special commissioners that legal expenses were deductible were approved by the House of Lords, who said

> The special commissioner found that the taxpayer was a sole trader and that expulsion or a period of suspension would have destroyed his trade. He found that his exclusive purpose in laying out the legal costs was the preservation of his trade. The well-known case of Morgan (HMIT) v Tate & Lyle Ltd [1955] AC 21; (1954) 35 TC 367 is authority for the proposition that money spent for the purpose of preserving the trade from destruction can properly be treated as wholly and exclusively expended for the purposes of the trade within the meaning of s. 130(a). The special commissioner so found.
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> My Lords, on an appeal from the special commissioner by way of case stated, the only question, as Nourse LJ pointed out in the Court of Appeal, is whether, on the facts as the commissioner found them, this conclusion was open to him as a matter of law: see Edwards (HMIT) v Bairstow [1956] AC 14. Mr Grabiner QC, who appeared for the Revenue, advanced two arguments as to why it was not.
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> First, he said that the facts found by the special commissioner led inescapably to the conclusion that the taxpayer had two purposes in paying the legal expenses. One was the preservation of his business and the other was the preservation of his personal reputation.
>
> It followed that he had a dual purpose and the trade purpose thus lacked the necessary exclusivity: see Mallalieu v Drummond (HMIT) [1983] BTC 380; [1983] 2 AC 861.
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> I do not think that the special commissioner's careful findings of fact lend support to this criticism. He recorded the taxpayer as saying in evidence that he 'did not care about his personal reputation'. While accepting the taxpayer as an honest witness nine years after the event, he did not accept that this correctly reflected his attitude at the time. He said that the taxpayer would have had to be 'extraordinarily thick-skinned not to have experienced feelings of personal distress' at the effect of the charges upon himself and his family. But he went on to make the following important finding:
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> 'However, the fact that I do not accept that the taxpayer was wholly unconcerned with his personal reputation does not necessarily mean that his purpose in laying out the legal costs was not exclusively concerned with preserving his trade. Purpose and effect are not the same'(See *Mallalieu v Drummond (HMIT)* at pp. 383; 870–871 per Lord Brightman.)
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> The special commissioner is here saying that although he does not accept that the taxpayer was unconcerned about the advantages which a successful defence would have for his personal reputation, he does accept that this was not the purpose for which the money was spent.

19. We were also referred to the case of Duckmanton v Revenue and Customs Commissioners [2013] BTC 1933 where the Upper Tribunal upheld the decision of the First Tier Tribunal that extensive expenditure incurred by a businessman in the preparation and

conduct of his defence against a manslaughter charge should be disallowed because it was not incurred wholly and exclusively for the purposes of his trade.

REPRESENTATIONS OF BOTH PARTIES

20. The sole ground of appeal is that HMRC are wrong to disallow the expenses, and that the expenses were incurred solely for the purposes of the trade.

21. Mr Rogers presented his own case and set out the following points:

22. The scrap metal trade is highly regulated. It requires not only a scrap metal licence from the local council, but also other licences such as from the Environment Agency. The correct planning permission is also required for the land where the business is carried out.

23. An application for a scrap metal licence requires disclosure of any relevant offence. There is no dispute that the offences that are the subject of the legal fees in question were relevant offences. Mr Rogers was in no doubt that had the conviction stood, he would not have been granted a scrap metal licence.

24. Mr T Rogers is the father of Mr S Rogers and retired from the business in 2018. He had set up the business 50 years ago and both were extremely proud of the reputation of the business.

25. The police operation on the business was covered on the day by local news. The day after the police operation the agent to the landlord of the business phoned up Mr S Rogers and went through clauses in the lease that would allow them to terminate the lease for conduct such as they had been accused of.

26. Mr Rogers produced evidence in the form of a letter from the agent to their landlord, confirming that had the conviction stood, their lease would have been terminated.

27. Very shortly afterwards Barclays, the bank with which the business had their business bank account, also requested a meeting. It was not clear whether the meeting went ahead but Mr Rogers was told both by the bank and by his lawyers that it was possible that the business assets could be frozen and the bank account closed down.

28. Insurance is also necessary for the business and there are a limited number of providers that offer this. Their insurers agreed to keep cover in place pending the outcome of the court case and subsequent appeal, but it was clear that a conviction would make them uninsurable.

29. Mr Rogers produced evidence in the form of a letter from the insurance company to show that a conviction would have had extreme difficulty in finding insurance cover and that this may not have been possible to find.

30. Some longstanding suppliers of scrap metal also ceased to deal with the partnership. Oxford Instruments requested that bins, used to place scrap metal to be sold to the partnership, were to be removed after they became aware of the police operation.

31. It was therefore immediately clear to the Rogers partnership, from the first day after the police operation, that a conviction would lead to the loss of their scrap metal licence, the loss of their site, the loss of their bank account and no insurance. Mr Rogers was clear that this would have meant the end of the business.

32. Although the business managed to continue operating during the period between the police operation and the final overturning of the conviction by the Court of Appeal, this was done only on the basis that the conviction was being appealed, in addition to the goodwill and reputation the business had built up.

33. Mr Rogers said that his legal team were continually telling him he was likely to win the case. At first his lawyers expected that the case would be not be brought to court, and then that it would be dropped at every hurdle. He did not have a clear estimate of the costs of the defence on day 1, and after that as the bills came in it was still the only way to keep the business alive. He said 'all we were looking at was surviving'.

34. Mr Rogers acknowledged that HMRC's view was that there was a duality in the expense as he also had a personal interest in his own reputation. He maintained that he did not see that a Court of Appeal case would go very far to change his personal reputation as the police operation had been widely covered in the local news on day 1. However he was clear that for the business it mattered very much due to the number of relationships, both customers and licence etc providers, that would be affected by the conviction.

35. HMRC made the following points:

36. In order to be deductible, the costs must be incurred wholly and exclusively for the purposes of the trade.

37. HMRC submit that these costs have an intrinsic duality to them. They submitted there were 3 reasons to defend the accusation and conviction, namely – prevention of a prison sentence, defence of personal reputation, and for the benefit of the trade.

38. HMRC pointed to the cases of *Mallalieu* and *Duckmanton* as authority that such expenditure has instrinic duality, and to the case of Vodafone to show that the motive to be examined is not limited to conscious motives but can include unconscious motives.

39. HMRC showed that the crimes in question carried the possibility of a prison sentence (s334 Proceeds of Crime Act 2002).

40. HMRC further submitted that as Mr T Rogers was acquitted at first instance, and as Mr S Rogers had the conviction overturned at the Court of Appeal, they were accused of crimes that they did not commit. HMRC submitted that it is a natural human instinct to defend yourself against a charge where you are innocent.

41. HMRC said it was not possible to split personal and professional reputation, and that the expenses were incurred in the defence of both. HMRC acknowledged that Mr Rogers had said that the damage done to his reputation personally would not be repaired by victory in the Court of Appeal, but HMRC disagree that the impact on one's reputation is the same whether one is found guilty or not guilty, and therefore one's personal reputation would be improved by the overturning of the conviction.

42. HMRC do not believe that a custodial sentence was not a concern, as the legislation clearly provides for such a sentence and no evidence has been provided that this was not a possibility.

43. HMRC do not believe that it is automatic that a licence to deal in scrap metal would be denied to a person who has a conviction. They refer to the statutory guidance for local authorities which states 'A conviction for a relevant offence should not automatically lead to the refusal of a scrap metal dealer's licence. You may consult your local police force for further details about the offence including both the seriousness of the offence and the date of when it was committed. Once you have this, you should consider it alongside any other information you have regard to when determining suitability.'

44. HMRC submit it was far from being a foregone conclusion that the business would lose its licence, and that little evidence has been produced to show the business would not be able to continue.

DISCUSSION

45. The question for us to consider is whether the expenditure on the legal fees was incurred wholly and exclusively for the purposes of the business. 'Wholly' refers to the quantum on the fees. Neither side addressed us on this and no detailed breakdown exists, so the relevant term here is 'exclusively'.

46. HMRC have advanced 3 reasons they submit are intrinsic to the decision to incur expenses on legal fees. These are 'defence of liberty', 'defence of personal reputation' and 'defence of trade'. Further, they submit that the trade could have been carried out even had criminal convictions stood, and so the defence of trade was possibly a weak reason to incur the costs.

47. HMRC submit that even if Mr Rogers did not consciously weigh some of these factors in the balance when deciding to incur the costs, they were nevertheless present.

48. We disagree with HMRC that 'defence of liberty' was ever a concern here. Upon conviction, Mr S Rogers was given a fine of £1,500. Although HMRC produced evidence of a scrap metal dealer going to prison, that was in relation to the purchase of hundreds of memorial plaques, which bears no relevance to the case here. In fact, in the operation, the police tried to sell a memorial plaque to Mr Rogers which he refused to buy. We find it extremely unlikely that, given we accept that Mr Rogers had been told by his lawyers he had a strong case, and the purported crime related to one purchase, that Mr Rogers ever considered that he would go to prison.

49. We disagree with HMRC that a conviction would not have had a significant impact on the business, and that the Rogers partnership would have been able to continue trading. It is clear from the evidence produced that the lease would have been terminated. Finding a new site for the business would have been extremely difficult. We also disagree that it is likely the Scrap Metal Dealer's licence would have been granted had the conviction been upheld. Although the possibility is provided for, we feel it unlikely the police would have thought it acceptable to continue the licence for a partnership where the main partner had recently been convicted, and we accept that the police would have been consulted by the local authority in this matter.

50. We note that as Mr T Rogers was retiring, the main concern was over the conviction of Mr S Rogers.

51. We therefore conclude that the purpose of incurring the expenses was defence of the trade. We then have to decide whether this was the exclusive reason, or whether there was a subsidiary and intrinsic reason of 'defence of personal reputation'.

52. We agree with HMRC that the Court of Appeal decision had an effect on the personal reputation of Mr S Rogers. It is undoubtedly better for a person to be found innocent than to be found guilty. However, it is important to distinguish the fact that this was an effect, from the question of whether this was the reason that the expenditure was incurred.

53. We also note the following about the conviction and the appeal:

54. In so far as personal reputation is concerned, the judge in the first case, notwithstanding Mr Rogers was found guilty, made the following comments '...you are regarded as an extremely good person. I take into account that during this operation there was no actual loss, there were no stolen goods and I also accept very much in your case that the damage done to the business is a great burden for you to bear.' It is clear from this that, to the extent that personal reputation was damaged by this case, it was not a significant damage, and it is also clear that Mr Rogers was making clear from the outset that the reputation of the business was paramount.

55. Turning to the Court of Appeal Judgement, the appeal turned on the fact that the items in question were not, in fact, stolen. With respect to Mr Rogers, it would be possible to read the Court of Appeal judgement and still have a negative opinion of him, namely that if the goods *had* been stolen he would have knowingly bought them. We must make it clear that is not our belief.

56. Again, these observations, being effect of the cases and not necessarily the reason they were brought, are not conclusive for the purposes of this decision. Nevertheless, they point to the facts that it was clear that Mr Rogers was extremely concerned about the business, and also that personal reputation formed very little part of the Court of Appeal case.

57. We agree with Mr Rogers that the damage done to personal reputation was primarily done at the time of the police operation, covered on local news. This happened simultaneously with the damage to professional reputation, which was shown very clearly by the evidence produced.

58. We consider that in this matter, professional reputation, far more than personal reputation, was concerned with the technicalities of this case. The question relevant to a large number of the parties was 'Was there a relevant conviction?' This has a binary answer Yes/No. If there was a relevant conviction, professional reputation and standing was damaged beyond repair. If there wasn't, there were no barriers to insurance, lease, or licences.

59. On the other hand, personal reputation is less concerned with legal technicalities. A person disposed to think well of Mr Rogers may have considered that the first conviction was unfair as the goods were not stolen. A person disposed to think badly of him may have considered that the conviction was only overturned by the fact that the goods were not stolen, and said nothing about what Mr Rogers would have done if they were.

60. We consider that therefore personal reputation was not relevant when deciding whether to incur the legal fees. It was the professional reputation that could be restored by the defence to the first conviction and then the overturning of that conviction in due course.

61. We distinguish here the case of *Duckmanton*. Here the taxpayer was charged with gross negligence manslaughter. Not only was that therefore a much more significant matter, it clearly did carry the possibility of a custodial sentence. The FTT refused to believe that the taxpayer was indifferent to a prison sentence and therefore held that the expenditure was not incurred wholly and exclusively for the purposes of trade.

62. We find the case of *McKight* much more analogous, where the House of Lords held that the special commissioners were entitled to conclude that the taxpayer's purpose was to protect his business, although the effect also extended to preserving his personal reputation.

63. We find the purpose of incurring the legal expenses was wholly and exclusively for the purposes of the trade. Within 24 hours of the police operation, multiple important trading stakeholders were making it very clear to the partnership that this was being taken extremely seriously and that conviction would lead to the withdrawal of the lease, the insurance, the banking services and various licences, not to speak of customers/suppliers no longer dealing with them. We find that any defence of personal reputation was not a consideration when incurring the fees, although the consequence of the Court of Appeal judgement was that the personal reputation of Mr S Rogers may have improved slightly.

64. This Appeal is therefore ALLOWED.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

65. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SARAH ALLATT
TRIBUNAL JUDGE

Release date: 29 NOVEMBER 2021