

MPs' expenses and tax issues: note from HMRC

Taxation of employment income

1. Employees and “office holders” are taxed on the income from their office or employment under the rules now set out in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). ITEPA is one of the products of the Tax Law Rewrite programme to put tax rules into more accessible language but did not change the substance of the rules in earlier pieces of legislation. MPs are office holders and therefore fall within the ITEPA rules. This note uses the terms employment and employee to cover offices and office holders as well.

2. The terms of the agreement between an employer and the office holder or employee are a matter for the parties to the agreement. Individuals are taxed on the earnings from the employment or office and on the benefits they receive by reason of it. Expense payments from their employer are taxable, but there may be a matching deduction from taxable income under the rules covered below.

3. The general rule on the deductions from employment income allowed for tax purposes is set out in S. 336 of ITEPA. This says that a deduction is allowed for expenses:

- that the employee has to pay because they hold the employment and
- that are incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

These rules have been the subject of extensive case law. This establishes that they are to be applied very strictly.

4. The requirement that expenditure has to be incurred “wholly and exclusively” for the purposes of the employment rules out expenditure with a personal element – for example, there is always a personal element in the cost of ordinary clothing. The requirement for expenditure to be “necessarily” incurred means that each and every holder of an employment would have to

incur it – it is not enough for a particular employee to find it necessary. Finally, a deduction is only allowed for expenditure incurred whilst actually performing the duties of the employment – expenditure that puts the employee in a position to perform those duties is not allowed. For example, expenditure on newspapers incurred by journalists, even if the employee is obliged to buy them, is not allowable because, whilst reading the newspapers, the employee is not carrying out the duties.

5. The general rule on deductions does not apply to travel expenses. The general rules on travel are in S. 337 and 338 of ITEPA. The costs of travel met by the employee can be deducted if

- the employee is obliged to incur the expense and
- the expense was necessarily incurred on travel whilst performing the duties.

A deduction can also be allowed for the costs of travel to a place the employee has to attend in the course of carrying out their duties but there is no deduction for the costs of “ordinary commuting”. Broadly, this means that travel to a permanent workplace is not allowed. But the cost of travelling to a temporary workplace can be allowed. So for example, someone who lives in Bedford but travels to work in their London office every day cannot claim tax relief on their travel costs. But if they were required to attend a meeting in Manchester in the course of their work, a deduction for the travel costs could be claimed. There are rules on the definition of “temporary workplace” but this note does not attempt to cover them.

MPs expenses

6. There are some specific provisions in ITEPA on the tax treatment of MPs’ allowances. Apart from those specific provisions, the ordinary rules apply. But a general point is that no tax deduction is available for the costs of party political activities.

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7. The Personal Additional Accommodation Expenditure (formerly known as the Additional Costs Allowance) is covered by a complete exemption from tax set out in S. 292 of ITEPA. The scope of the allowance is determined by a resolution of the House and the exemption is for an allowance expressed to be “in respect of additional expenses necessarily incurredfor the purpose of performing Parliamentary duties”. The scope of the allowance is determined by the Parliamentary authorities and the amounts paid to MPs do not have to be reported on tax returns.

8. There is also a specific provision in S. 294 of ITEPA exempting from tax the costs of European travel by MPs and other elected representatives. This covers travel to EU institutions or to the national Parliaments of other Member States or members of the European Free Trade Association.

9. Apart from these specific provisions, other amounts paid to MPs – including London Supplement - are taxable and deductions can be claimed in the normal way.

10. For the purposes of the rules on travel expenditure, MPs are regarded as having two permanent places of work. HMRC accept that travel between Westminster and the constituency is tax-free because travel is in the performance of the duties. Travel by MPs’ spouses or civil partners is treated in the same way as travel by the MP themselves but the cost of travel by children is taxed.

11. As for any other employer, where an expense payment is taxable but HMRC are satisfied that a matching deduction from taxable income would be due, an agreement can be reached that the expense can be paid tax-free and the amounts not reported to HMRC (these agreements are known as “dispensations” and aim to relieve the employer (and HMRC) from administrative costs in circumstances where it is clear that no tax is at stake).

12. There is nothing in the tax rules to prevent an MP employing members of their family. Provided tax and National Insurance are properly applied to

the remuneration paid, and the expenditure meets the general requirements for a deduction from employment income, there are no problems from a tax perspective. PAYE in respect of MPs' employees is administered by the Department of Resources.

Capital Gains Tax

13. There are no special rules for MPs.

14. The general capital gains tax rule is that the gain arising on disposal of a person's only or main residence is normally exempt from capital gains tax if it has been their only or main residence throughout their period of ownership. If it has been their only or main residence for only part of that period, the gain is apportioned on a time basis and tax is charged on the gain arising in the period when it was not the only or main residence. Provided a property has at some time been a taxpayer's only or main residence during their period of ownership, the gain arising on the last 36 months of their ownership qualifies for exemption in any event.

15. If a person has more than one residence, they can choose which one is to qualify for the exemption from capital gains tax. It must be a property which they actually occupy as their home for at least part of the time. The choice must be made within two years of the person first having more than one residence. In the absence of an election determining which property is to qualify for relief, the property which is in fact the main residence attracts the relief.

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further Evidence

Dave Hartnett CB
Permanent Secretary for Tax

4C 19
100 Parliament Street
London
SW1A 2BQ

Sir Christopher Kelly KCB
Chair
Committee on Standards in Public Life
35 Great Smith Street
LONDON
SW1P 3BQ

Tel .

Fax

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Our Ref
Your Ref

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Dear Sir Christopher

Thank you for the opportunity to comment on the draft transcript of my appearance at the Committee on 7 July. There is only one point on which I wish to comment. As recorded, paragraph 656 is potentially misleading although the exchanges that follow are fine. I think it would help if I clarified the tax treatment that would apply for various journeys by an MP to ensure that there is no misunderstanding. You may wish to amend the transcript or add a note at the end of the record.

The following examples should make the point clear. If an MP lives 60 miles from his constituency and receives travel expenses for a journey from the constituency to Westminster via his home in a single continuous journey, we would not regard that as taxable to the extent that the overall cost of the journey does not exceed the cost of a direct journey from the constituency to Westminster. If he travelled from his home to Westminster via his constituency in a single continuous journey we would regard the constituency to Westminster part of the journey as non-taxable. If, however, he started his journey from his home and travelled straight to Westminster without going via his constituency, we would regard the whole journey as taxable.

I also agreed to provide the Committee with further information on four issues. I hope you find helpful the paragraphs which follow:

1. How many random enquiries have we undertaken on MPs?

MPs' returns are included in the population from which HMRC randomly selects a small proportion for enquiry, in addition to those returns selected for enquiry under the normal risk criteria. In fact, there have not been any returns from an MP in the cases so selected in recent years. This is not unusual given the number of MPs as a proportion of the general self assessment taxpayer population.

2. If we do random or other enquiries, do we look at the staffing allowance and office costs allowance?

An enquiry may focus on one or more aspects of information contained within a return, or in other information received by HMRC, and may depend on the aspects identified as risks by HMRC. The Administrative and Office Expenditure Allowance (office costs allowance) is taxable and should be included in the returns of MPs. Accordingly the amount of AOE included in a return and any associated claim for relief for expenditure incurred wholly, exclusively and necessarily in the performance of parliamentary duties may be subject to an enquiry. The Staffing Expenditure Allowance, although taxable, is not required to be entered on the returns of MPs. This is on the basis of a long-standing agreement with HMRC that the allowance is only paid in circumstances where it is covered by matching tax relief. However, where an MP overspends their staffing allowance they are required to enter details of the overspend on their return and may claim a deduction for any expenses incurred wholly, exclusively and necessarily in performing their parliamentary duties. This may be subject to an enquiry by HMRC.

3. The resettlement grant: if an MP stands down voluntarily, how can we say that's compensation for loss of office that ought to attract the £30,000 tax-free?

The Resettlement Grant, payable to MPs who fail to be re-elected or who do not stand at a general election, was introduced with effect from 1 January 1972 under a House of Commons Resolution passed on 20 December 1971. The resolution gave effect to a recommendation made by The Review Body on Top Salaries (Boyle Committee) of Ministers of The Crown and Members of Parliament that in the event of losing their seats following a general election, MPs should be entitled to a terminal grant equivalent to three months salary as an MP.

In their report the Review Body commented on absence of financial assistance made to alleviate the effects of MPs losing their seats or retiring at a general election and noted that general elections occur at little notice, and when they do, Members have little time or opportunity to make arrangements for alternative employment and MPs not retiring on a pension may suddenly find themselves without a regular source of income. They recommended that "in view of the uncertainties attached to the tenure of a Parliamentary seat, which may arise from boundary changes as well as shifts in electoral behaviour, and the widely different circumstances of Members in regard to opportunities to obtain alternative earnings, a severance payment should be available to all members who lose their seat at a general election".

The legislation at section 291 of the Income Tax (Earnings and Pensions) Act 2003 which provides an income tax exemption (subject to the £30,000 tax-free limit for

termination payments generally) in respect of the payment of the Resettlement Grant was originally introduced by the 1972 Finance Act. Under the terms of the resolution under which the Resettlement Grant is paid Members have a predetermined right to the grant if they satisfy the conditions specified. Under the law as it stood at the time, any terminal payments to which an office holder held a predetermined right were taxable as emoluments under the old Schedule E rules. However, the reality of the grants payable to Members under the House resolution is that they have to be determined in advance, simply because it is impracticable to make provision for payments to MPs out of public funds in any other way. The grants are, nevertheless, not emoluments but rather they are compensation for loss of office on the basis that they are paid to help bridge the gap between an MP losing their office and taking up a new employment. The exemption was introduced to put MPs in the same position as other taxpayers receiving tax-free termination payments to which there was no predetermined right.

- 4. London MPs are allowed the costs of travel to Westminster (I think this is provided the residence is within 20 miles of Westminster and the constituency) - how come this is not regarded as ordinary commuting?**

MPs are allowed the costs of travel from their constituency to Westminster. Under a long standing practice agreed by the former Inland Revenue the "constituency" for this purpose includes any point (including the MP's home) within 20 miles of the constituency boundary. It was recognised that, particularly in urban constituencies, members might live outside the constituency boundaries but within the same general area and the Board did not wish to treat their journeys differently from those of members who happened to live just within the constituency boundary. But, since the expense of travel from home to work is not allowable for tax purposes it was not considered right to exempt journeys from homes in the London area to Westminster, unless the home is also within 20 miles of the constituency boundary so that the journey can be regarded as one from the constituency to the House of Commons. HMRC is currently reviewing all of its administrative concessions, with a view to retaining them, putting them on a legislative footing or withdrawing them. Where a concession or practice is withdrawn as part of this review HMRC would provide a reasonable notice period.

Yours sincerely

DAVE HARTNETT