The Personal Tax Planning Review

SCHEDULE E - BENEFITS IN KIND

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Schedule E tax is chargeable on the full amount of the emoluments, which expression shall include all salaries, fees, wages, perquisites and profits whatsoever; under TA 1988 s.131(1).

The general rule applicable to benefits is that the value of the benefit is the amount of money into which it can be converted. In *Wilkins v Rogerson* (1960) 39 TC 344 employees were provided with clothing up to a value of £15 by being given a letter to take to a local tailor who duly provided the clothing and invoiced the employer. It was held that the quantum of the benefit was the resale value of the clothing, not its cost. Nowadays the benefit would be taxed differently if the letter to the tailor could count as a non-cash voucher taxable under TA 1988, s.141 on the cost to the employer.

In *Tennant v Smith* (1892) 3 TC 158 a bank agent was required to live in a bank house which included residential accommodation but the value of that accommodation could not be taxed as it was neither money nor money's worth convertible into money.

In *Heaton v Bell* (1969) 46 TC 211 an employee was provided with a car by his employer if he wished to use it. His salary was reduced if he did take the option to have the use of the car and it was held that the taxable benefit was the amount by which his salary was reduced on taking up the car. Clearly in this case the benefit of the car was convertible into money because the additional salary was again available if the car was given back to the employer.

The basic Schedule E concept of money or money's worth is Lord Macnaghten's judgment in *Tennant v Smith* which examined the nature of the bank agent's occupation. "It appears that the appellant is bound as part of his duty to occupy the bank house as custodian of the whole premises belonging to the bank, and also for the transaction of any special bank business after bank hours. He is not

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entitled to sub-let the bank house or to use it for other than bank business; and in the event of his ceasing to hold his office he is under obligation to quit the premises forthwith. Property therefore in the house he has none, of any sort or kind. He has the privilege of residing there. But his occupation is that of a servant and not the less so because the bank thinks proper to provide for gentlemen in his position in their service accommodation on a liberal scale ..... I do not doubt that the occupation of the bank house rent free, though not unattended with some inconveniences, is on the whole a considerable advantage to the appellant. It is a gain to him in the popular sense of the word ... No doubt if the appellant had to find lodgings for himself he might have to pay for them. His income goes further because he is relieved from that expense. But a person is chargeable for income tax under Schedule D, as well as under Schedule E, not on what saves his pocket, but on what goes into his pocket. And the benefit which the appellant derives from having a rent-free house provided for him by the bank brings in nothing which can be reckoned up as a receipt, or properly described as income."

Lord Halsbury commented:

> "Now, I agree with Lord Adam in his very lucid judgment, that what Mr Tennant is to be assessed upon must be assessed under Schedule E, and I agree with the criticisms which he applies to the words within which, if at all, this advantage of occupying a house rent free must be brought, and none of the words, either "perquisites," "profits" or "emoluments" are properly applicable, inasmuch as by the rule in which those words are used or explained, the word "payable" as applied to them renders it to my mind quite impossible to suppose that the mere occupation of a house is reconcilable with the first application of that word.
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> I come to the conclusion that the Act refers to money payments made to the person who receives them, though, of course, I do not deny that if substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable."

In *Wilkins v Rogerson* Lord Evershed stated:

> "On behalf of Mr Rogerson it was said that any perquisite or profit was limited, in this case, to the value expressed in money of the thing which he got, namely, the clothing. For the purpose of this case, the value of the clothing treated, of course, as second-hand the moment it has been delivered, has been agreed at £5. Let me say it once that this involves no reflection upon Montague Burton Ltd who are not before the Court; and it should not, of course, be assumed for a moment that goods which they supply are worth only one-third of the price which they charge. But it is, of course, notorious that apart from purchase tax, the value of clothing is very much reduced the moment it can be called second-hand. If any case,

> the value is one which has been mutually accepted and agreed, and nothing turns upon it. It may have been agreed at a low figure to discourage any cross-appeal by Mr Rogerson. If so, it has achieved its purpose, for it is now accepted on his behalf that he is rightly taxed, as the learned Judge in the Court below held, upon the money value for what he got."

Lord Evershed brought out an important distinction that:

> "This was not a case in which [Mr Rogerson] was entitled to call upon the company to pay some sum of money on his behalf as that phrase is ordinarily understood ... What Mr Rogerson got, what the company intended to give him, what the letter to him and Montague Burton Ltd said would be done, and was done, was a present of a suit. Until he got it he got nothing and when he got it the thing which came in, which was his income expressed in money's worth, was the value of the suit."

Harman LJ stated:

> "It appears to me that this perquisite is a taxable subject matter because it is money's worth. It is money's worth because it can be turned into money and, when turned into money, the taxable subject matter is the value received. I cannot, myself, see how it is connected with the cost to the employer ... The taxpayer has to pay on what he gets. Here he has got a suit. He can realise it only for £5. The advantage to him is, therefore, £5. The detriment to his employer has been considerably more, but that seems to me to be irrelevant, and I do not see that it makes any difference that no property in this suit ever passed to the employer. I think, in Lord Watson's words in *Tennant v Smith* that it is a benefit consisting in "something acquired which the acquirer becomes possessed of and can dispose of to his advantage - in other words, money or that which can be turned to pecuniary account." This can be realised in cash, and it is that realisable quality which is the measure of the taxpayer's liability."

In *Heaton v Bell* Lord Reid begins by identifying the actual agreement.

> "[Mr Bell] says that he agreed to accept a reduced wage and that, as a counterpart, his employers agreed to give him the use of a car. If that is right then he became entitled to two things: first, the reduced wage, and, secondly, the use of the car. Then the question arises whether the use of the car was a perquisite within the meaning of the Income Tax Acts so that he had to pay tax in respect of it. All the learned Judges in the Courts below have held that this was what was agreed."

He further stated:

> "Income tax is a tax on income and income means money income."

He continued:

> "The Crown argues that "perquisites" has a meaning wider than money perquisites, and that tax is assessable on the value of the perquisite and not merely on the money which the recipient could get by dealing with it. "Value" is an elusive word: it may mean market value, it may mean value in money to the owners, or it may have other meanings like the value of the work necessary to produce it, or even sentimental value. No one suggests that here it means sentimental value, and I do not think that the Crown argued that it means cost of production - for that may have no relation to the present value of the thing or right to anybody. And the Crown rightly declined to argue that it means value to the owner, for that was expressly disapproved in Tennant's case and would often be almost impossible to assess. I think that in the end counsel argued for market value. If the recipient of the perquisite could immediately sell or assign it, that is the same thing as the money equivalent approved in Tennant's case. But what if he could not? A good example is to be found in *Wilkins v Rogerson*. There the perquisite was the right to get a suit of clothes without payment from a particular tailor - or it may have been the suit of clothes itself. The recipient could not sell or assign the right to get the suit: if he had been entitled to do that, the money equivalent would have been almost as much as the tailor's price. But he could sell the suit once he got it: but then it would only have a second-hand value, in that case about a third of the tailor's price. The Court of Appeal held that he could not be assessed to tax on the tailor's price, or on the value of the suit to him, but only on the second-hand value. The Crown argued that that case was wrongly decided. In my opinion the decision was right.
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> As I understand it the argument with regard to the present case was that we should value the right to use the car on the untrue assumption that the respondent could assign his right to use the car to the highest bidder, and that if he did so the employers would not exercise their right to terminate this right on 14 days' notice; but, as there was no evidence as to what anyone else would pay for the right, we should take the weekly sum which the respondent was willing to forgo in wages as the best evidence of market value. I have no hesitation in rejecting that argument. Not only is it inconsistent with what I hold to be the true meaning of the Act and with the whole course of authority, but it could lead to most unfair results. Any right or property has different values for different people: if put up to auction, many people bid at first but one by one they drop out when the bids of others go beyond its value to them, and the highest bid, the market value, is the value of one alone of all the bidders. Why should a man who finds it only just worth while to accept an unassignable perquisite on favourable terms be taxed on something far above its value to him or what he would have been willing to pay for it? Parliament may see fit to make such an enactment in special cases, as it did in Part VI of the Income Tax Act 1952,

> but I am satisfied that that is not the meaning of the general provisions with regard to perquisites."

He supported the judge at first instance and held, in a minority judgment,

> "That the proper basis of assessment was the increase in wages to which the respondent would have been entitled during the year of assessment if he had chosen to surrender his right to have the car on the first day of that year."

Lord Morris of Borth-y-Gest disagreed with Lord Reid holding that it was the gross wage that was taxable, although this effectively produced the same result as valuing the benefit as the reduction in gross income as a result of taking the option for the car. Lord Morris quoted Lord Radcliffe in *Abbott v Philbin* [1961] AC 352.

> "If they (the perquisites) are by their nature incapable of being turned into money by the recipient they are not taxable, even though they are in any ordinary sense of the word of value to him."

He stated:

> "The principles laid down and recognised in the two cases in this House were, I think, correctly applied in *Wilkins v Rogerson*. The opportunity to acquire the suit of clothes (or overcoat or raincoat) could not be assigned or sold, but the suit when received could be sold. In that way the perquisite cold be turned to pecuniary account, i.e., it could be turned into money.
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> How, then, should the well established principles be applied if it is to be assumed that since 1961 the respondent was employed on the terms that his wage was a reduced one but that he was to have the free use of a car? In my view, the free use of a car was a perquisite which represented money's worth and was taxable. It is true that his right to use the car could not be assigned (just as the option in *Abbott v Philbin* could not be transferred) but the right could be converted into money. The option in *Abbott v Philbin* could be exercised, and the shares acquired by its exercise could then be sold. It was recognised that by such process the option was by its nature capable of being turned into money. In the present case the respondent's rights to use the car could be converted into money or was capable of being turned into money by a much simpler process. The respondent could at any time (subject only to giving two weeks' notice), and without making any new contract, say to his employers that he relinquished in their favour his right to use the car and in exchange could require that an ascertained sum of money should be paid to him. His employers would be bound to accept the use of the car - which was all that the respondent has a right to. They would then be bound to pay him a sum which (on the basis now being considered) was equal to the amount by which he had agreed that his wage

> was to be reduced. His employers, for their part, could at any time (subject only to giving two weeks' notice) require him to give up his right to use the car and require him to accept a sum of money in exchange. At all times and at any time since 1954 the respondent was in a position to decide whether he should choose to have from his employers a particular and ascertained sum of money and no car, or whether he would choose not to have that particular and ascertained sum of money but to have a car. The fact that the two weeks' notice of change of will was needed does not, in my view, alter the fact that the perquisite represented money's worth. At any time since 1961 the respondent, after giving notice, could have had money rather than the use of a car. Accordingly, throughout the year of assessment the respondent could, had he so wished, have had the money equivalent into which his perquisite was convertible. The right to use the car, on the one hand, was alternative to and interchangeable with the right to the receipt of a definite sum of money on the other."

Heaton v Bell is therefore authority for two propositions. First of all that a deduction from salary to contribute to a benefit is not a deduction for tax purposes, the gross salary remaining taxable, and secondly, if a benefit can be given up in exchange for additional remuneration the taxable quantum of the benefit is the additional remuneration available on giving it up.

These three cases form the background to the provisions relating to benefits and are amended in particular cases by statute in the case of voluntary pensions (TA 1988 s.133), employee share options (TA 1988 ss.135 to 137), share incentive arrangements (FA 1988 s.88 and Schedule 14), non cash vouchers (TA 1988 s.141), credit tokens (TA 1988 s.142), cash vouchers (TA 1988 ss.143 to 144), living accommodation (TA 1988 ss.145 to 147), retirement payments and compensation payments (TA 1988 ss.148 and 188), sick pay (TA 1988 s.149), job release scheme allowances, maternity pay and statutory sick pay (TA 1988 s.150), income support (TA 1988 ss.151 and 152) and the special provisions relating to benefits for employees earning £8,500 or more and directors (TA 1988 ss.153 to 169).

It is these provisions that substitute the cost to the employer for the money or money's worth available to the employee by reason of TA 1988 s.154 which provides that:

> "(1) Where in any year a person is employed in employment to which this chapter applies and (a) by reason of his employment there is provided for him, or for others being members of his family or household, any benefit to which this section applies and (b) the cost of providing the benefit is not (apart from this section) chargeable to tax as his income, there is to be treated as emoluments of the employment, and accordingly chargeable to income tax under Schedule E, an amount equal to whatever is the cash equivalent of the benefit.

> (2) The benefits to which this section applies are accommodation (other than living accommodation), entertainment, domestic or other services, and other benefits and facilities of whatsoever nature (whether or not similar to any of those mentioned above in this subsection) excluding however (a) any benefit consisting of the right to receive, or the prospect of receiving, any sums which would be chargeable to tax under s.149 [sick pay] and, (b) any benefit chargeable under section 157, 158, 159A, 160 or 162; and subject to the exceptions provided for by ss.155 and 155A.
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> (3) For the purposes of this section and ss.155 and 156 the persons providing a benefit are those at whose cost the provision is made."

TA 1988 s.156(1) provides that the cash equivalent of any benefit chargeable to tax under s.154 is an amount equal to the cost of the benefit less so much (if any) of it as is made good by the employee to those providing the benefit.

> "(2) ... the cost of a benefit is amount of any expense incurred in or in connection with its provision and (here and in [the following] subsections) includes a proper proportion of any expense relating partly to the benefit and partly to other matters."

Section 156 then goes on to deal with a benefit which consists of the transfer of an asset to a person or an asset being made available for the use of an employee. The special provisions cover living accommodation provided by reason of the employment, pensions, canteen meals, medical treatment outside the UK, third party entertainment benefits (TA 1988 s.155), care for children (TA 1988 s.155A), cars available for private use (TA 1988 s.157 and Schedule 6), car fuel (TA 1988 s.158), pooled cars (TA 1988 s.159), mobile telephones (TA 1988 s.159A), beneficial loan arrangements (TA 1988 ss.160 and 161), employee share benefits (TA 1988 s.162), expenses connected with living accommodation (TA 1988 s.163), directors tax paid by the employer (TA 1988 s.164) and scholarships (TA 1988 s.165).

The provisions of TA 1988 s.156 provide that the cash equivalent of the benefit is the cost to the employer, but do not explain what is meant by the cost to the employer, and in particular whether the reference is to the average cost to the employer or the marginal cost by which the employer's total costs are increased as a result of the benefit provided to the employee. This fundamental question is considered in the case of *Pepper v Hart*.

Pepper v Hart came before Mr Justice Vinelott on 20th, 21st and 24th November 1989. It concerned Mr Hart and other assistant masters employed by Malvern College together with the Bursar of the College. The taxpayers were employees of the college and had one or more sons in attendance at the college pursuant to a concessionary fee scheme. The concession available to the staff require payment of 20% of the normal fee. Certain of the masters' sons were in receipt of an

academic scholarship which reduced the minimum fee to 12%. The school had a total capacity of 585 boarders and 40 day boys (625) and the total numbers of boys in the college varied from 613 in 1983/84 to 595 in 1985/86.

The fees are set on the basis of a day boy fee at 70% of the boarding fee and the budget assumes an intake of 545 boarders and 40 day boys equivalent to 573 boarding units. The fees are set by dividing the anticipated running costs plus a 2% contingency margin by 573. Extras such as art, music, handicrafts and sport which are charged in addition to the basic fees and the cost of textbooks were paid for in full by the masters.

The additional direct costs attributable to each boy under the concessionary fee scheme varied between £385 in 1984/85 and £430 in 1985/86 and the full fees for boarders varied from £4,675 in 1983/84 to £5,300 in 1985/86.

The Special Commissioner's conclusion was as follows:

> "The Crown's approach is straightforward. They say that Bruce is educated fed and watered at the college with all that that entails and accordingly the cost to the college of providing those facilities is broadly speaking the cost of running the college during each of the years in question, divided by the total number of pupils in attendance there.
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> That approach however seems to me to ignore the commercial realities of the situation. On the facts the taxpayer's sons occupied only surplus places at the college and their right to do so was entirely discretionary. Had those boys not attended the college no other boys would have filled their places, no fee paying boy was denied a place at the college solely on account of the presence there of the taxpayer's sons or any of them. No further staff were employed by reason of those boys presence in the school and conversely no fewer staff would have been employed had those boys not been educated at the college. Apart from the direct consumption of food, stationery, etc., no additional costs were incurred by the college in providing education and accommodation for the taxpayer's sons."

The Special Commissioner found that the amounts paid under the concessionary fee scheme for masters' children was in excess of the marginal cost of their presence in the college and found for the taxpayer.

Mr Justice Vinelott however thought:

> "In reaching that conclusion the Special Commissioner it seems to me must have overlooked the terms of [TA 1988 s.156(2)]. The measure of a benefit conferred on an employee is not to be confused on the one hand with the market value of the goods or services or other facilities provided, nor on the other hand with the marginal cost of providing those goods, services or

> other facilities to the employee taken in isolation from the overall cost of providing them for all who share in them (a calculation which might in some instances result in the benefit of the employee being assessed at a figure greater than its market value and greater than an apportioned part of the overall cost. The benefit to a member of the staff whose son is allowed to attend the school and who is charged concessionary fees is that his son is allowed to participate in all the facilities afforded by the school to the boys who are educated there and [under s.156(2)] the cost of providing that benefit is to be taken to the expense incurred in, or in connection with the facilities afforded, and so far as shared with the other boys at the school a rateable proportion of the cost of the facilities afforded to them all."

Vinelott J also commented:

> "There is one other matter which I should mention. I was referred by Counsel for the taxpayer, in the course of his able argument, to a textbook on the income tax Rowland's Tax Guide 1978/79 (2nd edition) page 277 in which it is said by way of commentary on [s.156] "the benefit of staff discounts and services such as cheap travel available to airline employees is not taxable as a benefit so long as the employee pays at least the marginal cost to the employer. See Inland Revenue Press Release 1 June 1977."
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> Counsel for the Crown was alarmed to hear that there had been a Press Release of which he and those instructing him were unaware. On investigation it transpired that the Inland Revenue Press Release was directed to other aspects of the legislation charging tax on benefits provided for directors and higher paid employees. Counsel for the taxpayer's enquiries also revealed that the editors of the passage may have had in mind observations made by the Chief Secretary to the Treasury in the course of the debate on the Finance Bill in Committee. That of course cannot be resorted to as a guide to the construction of the Finance Act. However, the passage in Rowland's Tax Guide which I have cited must now be read subject to the specific provisions first introduced in 1982 and reproduced in s.141 of the Income and Corporation Taxes Act 1988 which relate to travel vouchers."

As author of the passage in question in Rowland's Tax Guide I can confirm that I did have in mind the assurances of the Chief Secretary to the Treasury and also the then prevalent Revenue practice, both of which matters were considered again when the case got to the House of Lords.

Clause 54 of the Finance Bill 1976 eventually became s.63 of the 1976 Act (TA 1988 s.156). As introduced, clause 54(1) provided that the cash equivalent of any benefit was to be an amount equal to the cost of the benefit. Clause 54(2) provided that except as provided in later subsections the cost of a benefit is the amount of any expense incurred in or in connection with its provision. Crucially

clause 54(4) of the Bill sought to tax in-house benefits on a different basis from that applicable to external benefits. It provided that the cost of a benefit consisting of the provision of any service or facility which was also provided to the public (i.e., in-house benefits) should be the price which the public paid for such a facility or service. Employees of schools were not excluded from the new charge. On 17th June 1976 the Financial Secretary to the Treasury, Mr Robert Sheldon, made an announcement in the following terms.

> "The next point I wish to make concerns services and deals with the position of employees of organisations, bodies or firms which provide services where the employee is in receipt of the services free or at a reduced rate. Under clause 54(4) the taxable benefit is to be based on the arm's length price of the benefit received. At present the benefit is valued on the cost to the employer. Representations have been made concerning airline travel and railway employees ... It was never intended that the benefit received by the airline employee would be the fare paid by the ordinary passenger. The benefit to him would never be as high as that because of certain disadvantages that the employee has. Similar considerations, although of a different kind, apply to railway employees. I have had many interviews, discussions and meetings on this matter and I have decided to withdraw clause 54(4). I thought I would mention this at the outset because so many details which would normally be left until we reached that particular stage will be discussed with earlier parts of the legislation. I shall give reasons which weigh heavily in favour of the withdrawal of this provision. The first is the large difference between the cost of providing some services and the amount of benefit which under the bill would be held to be received. There are a number of cases of this kind and I would point out that the air and rail journeys are only two of a number of service benefits which have a number of problems attached to them. But there is a large difference between the cost of the benefit to the employer and the value of that benefit as assessed. It could lead to unjustifiable situations resulting in a great number of injustices and I do not think we should continue with it ... The second reason for withdrawing clause 54(4) is that these services would be much less used."

The very question which is the subject matter of these present appeals was also raised. A member at cols 1091 to 1092 said "I should be grateful for the Financial Secretary's guidance on these two points ... The second matter applies particularly to private sector fee paying schools where, as the Financial Secretary knows, there is often an agreement for the children of staff of these schools to be taught at less than the commercial fee in other schools. I take it that because of the deletion of clause 54(4) that is not now caught. Perhaps these examples will help to clarify the extent to which the Government amendment goes."

The Financial Secretary responded (at Col 1098) to this question as follows:

> "He mentioned the children of teachers. The removal of clause 54(4) will affect the position of a child of one of the teachers at the child's school, because now the benefit will be assessed on the cost to the employer, which would be very small indeed in this case."

In the House of Lords, Lord Browne-Wilkinson said:

> "In my view these repeated assurances [by the Financial Secretary] are quite inconsistent with the minister having had or communicated any intention other than that the words "the expense incurred in or in connection with the provision of the benefit would produce a charge to tax on the additional or marginal cost only, not a charge on the average cost of the benefit."

The Inland Revenue on 21st January 1993 published a Press Release on the Taxation of In-House Benefits in Kind and the circumstances in which they will make repayment of tax.