The Crown and the Cushion affair

Management of taxes



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Keith Gordon considers another case which concerns the well-known test of ‘wholly and exclusively’

Key Points

What is the issue?

A hotel owner near Silverstone decided to sponsor his granddaughter Alice’s career as a racing driver. The expenditure was described as to ‘fund Alice’s needs’ but was

also to promote the company's business through Alice.

What does it mean to me?

The key to deciding the case was to identify the company's motive in incurring the expenditure (in this case that of the active minds behind the company). In this regard, the Tribunal considered that the sole object was to promote the company's business, with any benefit to Alice being an inevitable consequence.

What can I take away?

The case should therefore provide taxpayers with the encouragement that the wholly and exclusively test does not put an insurmountable hurdle between a business and a tax deduction – even when there is some (albeit incidental) personal benefit.

Imagine a client coming in with this great tax-saving idea. Your client runs a hotel near the Silverstone racing circuit and decides to sponsor a local up-and-coming racing driver in order to promote the motorsport 'credentials' of the hotel. You begin to wonder where the inevitable catch is when your client explains that the up-and-coming driver happens to be your client's granddaughter. At this point, I suspect your heart is likely to sink.

Although the 'wholly and exclusively' test for claiming deductions against business income is easier to pass than its three-part (or technically four-part) equivalent in the context of employment income, it is by no means a push-over. There have been many cases where a taxpayer has fallen foul of the duality of purpose pitfall that is inherent in the test: one leading example is the case of the barrister, Miss Ann Mallalieu (now the *Baroness Mallalieu QC) (Mallalieu v Drummond (HM Inspector of Taxes)*[1983] STC 124), whose court dress served both her primary purpose (being to conform to the sartorial rules of the Bar Council when appearing in Court) but also her subconscious purpose of needing to wear something.

Closer to the facts of your client's case, deductions for sponsorship expenditure have failed in many cases. Recently, there was the *Interfish* case (*Interfish Ltd v CR*C [2014] EWCA Civ 876) where the commercial benefits of the sponsorship of a local rugby club were not the only reason for the payments made – there was also the payer's desire to 'improve the financial position of the Club, in particular by enabling

it to enhance its squad of players without incurring a deficit'. Twenty years ago, there was the case of *Executive Network (Consultants) Ltd v O'Connor* [1995] SpC 56 where the company's sponsorship payments were held to be at least partly designed to benefit the director's wife's business and therefore not exclusively for the purposes of the business of the taxpayer itself.

Your client however is not as naïve as you might initially have thought. He reminds you of the case of *McQueen v HMRC* [2007] SpC 601 where the taxpayer's business incurred money on the taxpayer's own motor rallying hobby as a means to promote the business. In that case, the Special Commissioner noted that sponsorship of an unrelated individual would have been too expensive to be justified and that Mr McQueen was merely 'using his skill and enthusiasm for motor rallying as the best means available to him for promoting the … business'. The fact that he enjoyed the activity was no more than an incidental effect of the expenditure (and therefore would not taint the business purpose for the payments made).

Whether such a conversation took place in relation to the expenditure incurred by the taxpayer company in the present case might never be known. However, The Crown and Cushion Hotel (Chipping Norton) Ltd did indeed incur expenditure on sponsorship in broadly these circumstances and claimed a deduction for tax purposes. That deduction was challenged by HMRC and the company's appeal was duly heard by the First-tier Tribunal ([2016] UKFTT 765 (TC)).

Facts of the case

The company's business was founded by a Mr Jim Fraser. At the relevant times, however, the company's shares were owned by Mr Fraser's two daughters, one of whom (Mrs Powell) was the company's sole director. Mrs Powell's own daughter, Alice, was an aspiring racing driver with ambitions to drive at Formula 1 level. The Tribunal's decision recorded a number of Alice's impressive achievements suggesting that her goal had realistic prospects of being achieved.

The expenditure at the heart of the present case was incurred under an agreement reached when Alice was 15 years old and signed on her behalf by Alice's father. Although the agreement described the expenditure as designed to 'fund Alice's needs' as a racing-driver, her grandfather considered it to amount to sponsorship expenditure. In particular, Alice (even if not a household name) was well-known in

racing circles and her implicit endorsement of a local hotel (which, by then, had been rebranded as a Silverstone Hotel) was designed to promote the company's business.

The Tribunal's decision

The case was heard by Judge Harriet Morgan (sitting with Mr Tym Marsh).

The closing section of the Tribunal's decision began with a discussion of the leading cases in relation to the 'wholly and exclusively' test. As the decision correctly notes, the key to deciding the case was to identify the company's motive in incurring the expenditure (in this case that of the active minds behind the company). In this regard, the Tribunal considered that the sole object was to promote the company's business, with any benefit to Alice being an inevitable consequence.

Although this conclusion was formed mainly on the basis of Mr Fraser's evidence as to his motivations, the Tribunal noted that this conclusion was corroborated by additional evidence for example, concerning the hotel's financial performance prior to the expenditure being incurred. Furthermore, the Tribunal accepted Mr Fraser's evidence that his granddaughter would have been easier to 'control' in a business sense than an unrelated driver who might have been sponsored as an alternative. Furthermore, the fact that Alice's reputation in the motor-racing industry was relatively unusual by reason of her age and sex meant that sponsorship of her would have the potential of attracting additional publicity for the company's business.

The company's appeal was therefore allowed.

Commentary

The law in this area is firmly established with well-known decisions at the highest judicial levels. Ultimately, therefore, the case was decided on its facts. What was undoubtedly key the company's success was the clear evidence provided to the Tribunal as to the business reasons for the expenditure, assisted by the fact that the Tribunal accepted the company's witnesses' evidence. On reading the decision, I found particularly striking the fact that Mrs Powell was not particularly keen on her daughter's hobby (perhaps not surprisingly) but felt (notwithstanding her legal right to do so) unwilling to overrule her father (who remained active in the business) in

relation to a business decision.

The case should therefore provide taxpayers with the encouragement that the wholly and exclusively test does not put an insurmountable hurdle between a business and a tax deduction – even when there is some (albeit incidental) personal benefit. On the other hand, it should always be remembered that each case is different and a less favourable result could also have been obtained (especially if the evidence were not as convincing in the present case). As should be appreciated by readers, taxpayers have had a chequered history when it comes to claiming deductions in this area but that should be a further reason to lap up the company's success in this case.

Update on earlier case analysis

In my article, 'Whose claim is it anyway?', in the January 2015 issue of *Tax Adviser*, I wrote about the First-tier's decision in *Leadley v HMRC*. HMRC appealed against the decision to the Upper Tribunal which has allowed HMRC's appeal (*HMRC v Drown & Leadley (Executors of Leadley deceased)* [2017] UKUT 111 (TCC)). Given that the taxpayer was not represented at the Upper Tribunal hearing, it may be safely assumed that the case will not proceed any further. The effect of the Tribunal's decision is that personal representatives may not make negligible value claims that could have been (but were not actually) made by the deceased.