

## Training costs for sole traders (Lecture B1437 – 14.33 minutes)

### *Background*

The tax legislation on deductions from trading income relating to sole traders includes the general rule (in ITTOIA 2005, s.34) that in calculating the profits of a trade, no deduction is allowed for expenses not incurred 'wholly and exclusively' for the purposes of the trade, or for losses not connected with or arising out of the trade. Furthermore, ITTOIA 2005, s.33 states that in calculating the profits of a trade, no deduction is allowed for items of a capital nature.

The lack of statutory guidance on the 'wholly and exclusively' rule and the capital expenditure restriction has resulted in a number of tax cases over the years. A key principle established from case law is that expenditure is capital in nature if it has an 'enduring benefit' for the trade (*British Insulated and Helsby Cables Ltd v Atherton* [1926] 188, 192, HL).

Where profits are calculated on the cash basis, the capital expenditure provision does not apply (ITTOIA 2005, s.32A(1)). However, the cash basis rules include their own restriction, which states that no deduction is allowed for capital expenditure incurred on, or in connection with, training (ITTOIA 2005, s.3(3)).

HMRC's view on the tax treatment of training courses for business proprietors changed on 13 March 2024.

### *Tax Bulletin 1*

Prior to this change, HMRC (then the Inland Revenue) set out its view on the allowability of training costs in Tax Bulletin 1 in 1991, and in its Business Income Manual. Tax Bulletin 1 is reproduced below:

#### **'Expenditure on training courses for the proprietor of a business**

There is some uncertainty whether the cost of proprietors of a business attending a training course, directly related to the business activity, is deductible in arriving at the profits chargeable to tax under Schedule D Cases I or II.

Where attendance at a course is intended to give business proprietors new expertise, knowledge or skills which they lack, it brings into existence an intangible asset which is of enduring benefit to the business. We take the view that the expenditure is therefore of a capital nature, and deduction is prohibited by ICTA 1988, s 74(f).

On the other hand, where attendance is merely to update expertise which proprietors already possess, the expenditure is normally regarded as revenue expenditure and will be deductible if it satisfies the "wholly and exclusively ... for the purposes of the trade".

[ICTA 1988, s 74(a), (f)]'

### *Business income manual*

As mentioned, HMRC's guidance on the topic has recently been updated. Prior to this change, HMRC's Business Income Manual expanded on Tax Bulletin 1 by instructing its officers (at BIM42526) that they should not take an unduly narrow view of whether the content of any course only updates an individual's existing skills.

However, it went onto say that if a completely new specialisation or qualification was acquired as a result of the expenditure, it was unlikely that the expenditure would be wholly and exclusively for the purposes of the existing trade.

HMRC also pointed out that expenditure on new skills may also be capital if what was acquired could be viewed as an identifiable asset of sufficient substance and endurance. HMRC referred to a tax case relating to this capital test, *Dass v Special Commissioner and others* [2006] EWHC 2491 (Ch).

#### *Dass v Special Commissioner*

In *Dass*, the taxpayer traded as an English tutor and as an adviser on bringing appeals before various tribunals. In or around 1997, he started a two-year part-time college course, which would have resulted in a law diploma on passing the exams. Unfortunately, although Mr Dass twice enrolled for the examinations, he was unwell on both occasions and so was unable to sit them. However, he still incurred the cost of the examination fees of £200 in both 1998 and 1999.

Mr Dass claimed that the college course improved his communication and analytical skills and widened his knowledge. He said that the course would ultimately broaden his work options. However, HMRC disallowed tax relief for an exam fee. Mr Dass appealed. The Special Commissioner dismissed the taxpayer's appeal, concluding that the course wasn't a "refresher" course to brush up or "hone" the taxpayer's existing expertise, but was aimed at equipping Mr Dass with a new qualification enabling him to enter into a new area of practice. In dismissing the taxpayer's subsequent appeal, the High Court stated that the line between the two may often be difficult to draw, but that in this case the Special Commissioner was fully entitled to draw the line where he did and was clearly correct.

HMRC's Business Income Manual guidance (at BIM35660) referred fairly extensively to the *Dass* case, as well as its 1991 Tax Bulletin article. It stated that HMRC's officers should disallow expenditure that provides new expertise or knowledge, particularly where it brought into existence a recognised qualification like a Master of Business administration.

#### *HMRC's revised view*

HMRC updated its Business Income Manual guidance on 13 March 2024. HMRC's revised guidance in BIM42526 reaffirms that expenditure on training is normally revenue expenditure if it updates or provides expertise or knowledge in the individual's existing business area.

In addition, HMRC's revised guidance states that costs incurred on training to acquire new skills or knowledge to keep pace with advancements in technology and changes in industry practices, which are related to the owner's existing business area, will usually be allowable.

Furthermore, expenditure on training courses which are ancillary to the main trade, such as introductory bookkeeping or digital skills courses may also be accepted as constituting revenue expenditure, depending on the specific circumstances of each case.

On the other hand, HMRC's guidance at BIM35660 states that expenditure incurred on training that is unrelated to the business owner's existing business area (such as expenditure that allows them to start a new business or expand into a new, unrelated area of business) is unlikely to be an allowable deduction. Once again, HMRC cites the *Dass* case in support of its approach.

HMRC's expanded guidance features 11 examples, seven of which illustrate the types of scenarios where the cost of training is likely to be an allowable business expense for a self-employed individual, and four scenarios where the cost is likely to be disallowed.

Whilst these examples are intended to be helpful and instructive, HMRC caveats them by adding that whether an expense is allowable will depend on the individual facts and circumstances of each case, including the purpose of the owner in incurring the costs.

### *Conclusion*

HMRC's guidance and their examples seemingly attempt to draw a line between on the one hand, not only updating current skills or providing new skills or knowledge in an individual's existing trade but also the costs of keeping up with technical changes and training ancillary to their trade; and on the other hand, the costs of training that would allow the individual to begin a separate business in a new and unrelated area. The latter would, in HMRC's view, seemingly be capital expenditure.

Of course, HMRC's guidance does not carry the force of law, and as the guidance indicates, every case is different and needs to be considered on its own facts.

*Contributed by Mark McLaughlin*