



**TC03834**

**Appeal number: TC/2013/05002**

*INCOME TAX – Appellant sub-postmaster receiving termination payment on closure of sub-post office – business carried on together with that of a stationery shop – payment made at time of acquisition described as goodwill – whether payment deductible from termination payment – ITEPA 2003 s 336(1) – held, not deductible – whether any alternative basis for deduction – no – appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**SABARATNAM DEVARAJ**

**Appellant**

**- and -**

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

**TRIBUNAL: JUDGE JOHN CLARK  
MR MICHAEL BELL ACA CTA**

**Sitting in public at 45 Bedford Square London WC1B 3DN on 5 June 2014**

**Victor Arulananthan, Victor & Co, Chartered Certified Accountants, for the  
Appellant**

**Michael Boyle, HM Revenue and Customs Specialist Investigations Appeals &  
Reviews Team, for the Respondents**

## DECISION

1. Mr Devaraj appeals against a decision by the Respondents (“HMRC”) by means  
5 of a closure notice, subsequently confirmed on review, to disallow the deduction of a  
sum paid for goodwill on acquisition of a post office from a payment made by Post  
Office Limited in respect of the closure of that post office.

### *The facts*

2. The evidence consisted of a bundle of documents; there were no witnesses.  
10 From the evidence we find the following facts.

3. On 17 November 1997, Mr Devaraj purchased a post office and stationery store  
for £110,000. The solicitors acting for the vendor wrote to Mr Devaraj’s solicitors on  
6 June 1997 suggesting that this be apportioned as to £60,000 for the property,  
£45,000 for the goodwill and £5,000 for fixtures and fittings.

4. Post Office Limited wrote to Mr Devaraj on 15 May 2003 in connection with  
15 the “Network Reinvention” programme. The letter referred to the preference which he  
had expressed the previous year for leaving the network. If he was still thinking of  
doing so, ie by closing his branch, the letter specified the compensation arrangements.  
Sub-postmasters who had been appointed on or before 31 March 1999 and who were  
20 able to leave the network under the Network Reinvention programme would receive a  
payment equivalent to 28 months of their remuneration. The letter also stated that  
compensation payments for sub-postmasters appointed after 31 March 1999 were to  
be calculated using the method described at Appendix 2 of the letter.

5. It continued:

25 “Sub-postmasters who leave the network under the Network  
Reinvention programme must agree, under the terms of compensation  
offered, to assist in the migration of customers to another Post Office  
branch. Failure to do so, could lead to a withdrawal of an offer of  
compensation.”

6. The post office was compulsorily closed down by Post Office Limited on 23  
30 June 2008. The compensation payment which Mr Devaraj received was £73,851.35.  
This sum, minus £30,000 exempt under s 403(1) Income Tax (Earnings and Pensions)  
Act 2003 (“ITEPA 2003”), was chargeable to tax under the Income Tax (Pay as You  
Earn) Regulations 2003, SI 2003/2682 (“the PAYE Regulations”) and reflected in the  
35 P45 form issued to Mr Devaraj for 2008-09.

7. In his self assessment tax return for 2008-09 submitted on 30 January 2010, Mr  
Devaraj claimed the original acquisition cost of the goodwill plus apportioned costs  
(the total figure being £53,022) as cessation capital allowances, which resulted in a  
trading loss. This loss was offset against his other income for the year under s 64 of  
40 the Income Tax Act 2007 (“ITA 2007”), resulting in an overpayment of tax. A  
repayment of £9,048.30 was issued by HMRC on 25 February 2010.

8. On 24 December 2010 Neil Welsh, an Officer of HMRC, opened an enquiry into Mr Devaraj's personal 2008-09 tax return under s 9A of the Taxes Management Act 1970 ("TMA 1970").

5 9. Subsequently correspondence was exchanged between Mr Devaraj (and later his accountants Victor & Co) and HMRC. It was established that of the £53,022 claimed, an amount of £45,000 related to the original acquisition of the goodwill, with a further £2,037 relating to apportioned costs. The balance of £5,985 was accepted by HMRC as an appropriate deduction. Mr Welsh contended that any loss on the goodwill was a capital loss and could not be set against Mr Devaraj's other income; the authority for this was s 33 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005").

10 10. Victor & Co contended that the money paid for the acquisition of the goodwill was paid to purchase a source of employment income and should be treated as a revenue expense. They argued that in the particular circumstances surrounding the Post Office business it was to be treated as a revenue earning asset of which the cost was to be treated as a revenue expense, with the compensation being a resultant revenue receipt.

15 11. As no agreement could be reached as to the treatment of the £47,037 (ie the £45,000 "goodwill" element of the £110,000 and allocated expenses paid for the post office), on 10 April 2013 Mr Welsh issued a closure notice to Mr Devaraj under s 28A TMA 1970. This increased the tax due by £9,991.90.

20 12. On the same date a notice of a proposed penalty was issued, at a percentage rate of 18 per cent of the additional tax, the amount of the penalty therefore being £1,798.54. No appeal was made against this penalty.

25 13. Following an appeal letter sent to Mr Welsh by Victor & Co on 25 April 2013, Mr Welsh wrote to Mr Devaraj offering a review. On 12 June 2013 Victor & Co wrote to confirm that the offer was accepted. On 9 July 2013, the Review Officer, Mrs Crossley, wrote to Mr Devaraj with the result of the review; she upheld HMRC's decision to disallow the claim for £47,037 because there was no legislation that provided for relief for income tax for a sole trader. Goodwill was a capital asset and as such the cost could not be allowed against Mr Devaraj's profits. Nor could the cost of the goodwill be claimed against his income as an employee of Post Office Limited, because the cost was not incurred wholly and exclusively and necessarily in the performance of his duties of that employment. Section 336 ITEPA 2003 specifically precluded a claim. She confirmed that as goodwill was a capital asset, a loss on that asset could give relief for capital gains tax purposes.

30 35 14. On 26 July 2013, Victor and Co wrote to HM Courts & Tribunals Service ("HMC&TS") seeking permission to deal with the matter through the First-tier Tribunal. They did not complete and submit a Notice of Appeal form. On 12 August 40 2013 HMC&TS wrote two letters to Mr Devaraj. The first acknowledged receipt of his Notice of Appeal dated 29 July 2013 (ie the letter from Victor & Co received on that date) and confirmed that the appeal was to proceed under the 'standard' category.

The other letter requested him to complete, sign and return a form to give notice of Victor & Co as his representative. That form was received by HMC&TS on 20 August 2013.

*Arguments for Mr Devaraj*

5 15. In the absence of a Notice of Appeal form, there was no specific statement of Mr Devaraj's grounds of appeal. In their letter to HMC&TS dated 26 July 2013, Victor & Co stated:

10 "We apply to tribunal against the decision by the case review officer in treating the initial sum paid to acquire the earning right as Post Master as capital payment.

15 The Post Office was closed by the Post Office Counters Ltd as per their internal policy decision and as a result our client lost the earning right of the unexpired period. The compensation paid by the Post Office for the loss earning is the net present value (NPV) of the future earnings.

As Post Office calculates the payment due to Post Master is based [*sic*] on the respective percentage of commission receivable on turnover. It should be a base for treating the initial sum paid purchase [*sic*] the earning right to be treated as a Revenue payment."

20 16. Mr Devaraj provided a Statement of Case; Mr Arulananthan used this as the basis for presenting the arguments to the Tribunal. The sum of £48,022 paid to the retiring postmaster on 6 June 1997 was paid to acquire the net present value of future earning rights of remuneration from Post Office Limited [ie, at the time, Post Office Counters Limited] as a Postmaster.

25 17. He relied on HMRC Manuals CG68060 and BIM35600. These two HMRC practice notes explained the concept of whether compensation paid was of a capital nature or a revenue nature.

30 18. His contention was that the payment made was not a payment for goodwill and was not of a capital nature. It was of a revenue nature and should be available to set off against the total income earned during the year 2008-09.

35 19. He referred to various elements of the factual background in support of his arguments. The revenue lost was the Postmaster's future earnings discounted to net present value of the unexpired contract period. It was clearly a compensation payment for the future earning sacrifice. The fact that the Postmaster's earnings were paid under a PAYE scheme did not prejudice in any way the contention that the compensation payment was made for loss of earning right. He made reference to sections of the letter dated 15 May 2003 from Post Office Limited, and in particular the matrix used to calculate the compensation payment. The Post Office Limited calculation was based on the net value of the earnings.

*Arguments for HMRC*

20. In referring to the facts, Mr Boyle mentioned that Mr Devaraj was registered as a self-employed accountant from 1 May 1990. As an accountant, he could be expected to have a reasonable understanding of the distinction between capital and revenue.

5 21. In his letter dated 1 February 2011 to HMRC, Mr Devaraj had referred to the original apportionment of the purchase price, with £45,000 being allocated to goodwill; as a result of the closure of the post office, the value of the goodwill had now been reduced to nil.

10 22. Mr Boyle submitted that the goodwill was inseparable from the business as a going concern; he referred to the statement in HMRC Manual CG68030. The loan agreement which Mr Devaraj had entered into with Barclays was expressed to be for the purpose of “assisting with the purchase of the freehold interest and goodwill” of the post office. Based on this evidence, there was very little doubt that £45,000 had been paid for the acquisition of goodwill, ie the customer base.

15 23. Victor & Co had referred to the payment being for the acquisition of future earning rights. They had stated in their letter to HMRC dated 29 May 2012 that:

20 “The Goodwill value of the Post Office has not diminished through its usage (economic value) but it was virtually ‘killed off’ or ‘wiped out’ by the ad-hoc closure of the Post Office as a result of the policy of Post Office Counters Ltd.”

24. HMRC submitted that Victor & Co accepted that the payment related to goodwill. However, they were maintaining that relief should be given against the compensation payment received from Post Office Ltd. Mr Boyle submitted that HMRC, and in particular Mr Welsh, had shown authorities as to why the loss on the goodwill could not be set against the income payment received from Post Office Ltd. Mr Boyle referred to s 336 ITEPA 2003, s 64 ITA 2007 and s 33 ITTOIA 2005.

25 25. Reference had been made in the case of *Lakbir Singh Uppal v Revenue and Customs Commissioners* [2010] UKFTT 215 (TS), TC00516 at [30] b. to the HMRC concession under which Post Office remuneration received by a sub-postmaster could be treated as part of the trading income of the shop; the strict position was that all such income was taxable as employment income.

26. In their May 2012 letter Victor & Co had expressed the opinion that the cost of the goodwill paid at the point of purchasing the business should be given relief against the compensation paid by Post Office Limited in respect of the closure of the post office run by Mr Devaraj. Mr Welsh had asked on numerous occasions for the authority on which they relied to support this opinion, but Victor & Co had not been able to produce legislation or authority in support of the proposition. HMRC submitted that there was just no legal authority or grounding for their view.

27. Victor & Co had expressed the view in their letter dated 3 April 2012 that the description of the payment of £45,000 as “Goodwill” in the accounts had no relevance to the question, and that this amount had been paid to purchase a source of

employment income from the retiring sub-postmaster; they considered it to be similar to purchase of a franchise or copyright.

28. HMRC did not accept this at all, and wished to point out that rights, copyrights and franchises were all capital assets within s 21 of the Taxation of Chargeable Gains Act 1992 (“TCGA 1992”), as mentioned in HMRC Capital Gains Manual CG68270 and CG68250. Mr Boyle referred to CG12080, which stated that a right to future income payments could be an asset for capital gains purposes, so that even if the payment had not been for goodwill and instead had been made for the earning rights of a sub-postmaster, then that right itself would be classed as an asset under s 22(3) TCGA 1992.

29. In their letter to HMRC dated 20 December 2012, Victor & Co had stated that the sum of £45,000 had been paid “for the revenue earning right” from Post Office Ltd. Had this been the case, then Mr Devaraj would have made the payment to Post Office Ltd and not to the vendor of the business.

30. Victor & Co had referred to amortisation of goodwill through the accounts. This again suggested acceptance that the payment was for goodwill. Amortisation of goodwill was allowed under s 29 of the Finance Act 2002; however, this was specifically for companies in relation to corporation tax. There was absolutely no similar authority for this to apply to a sole trader. The opposite was the case; s 33 ITTOIA 2005 stated that in calculating the profits of a trade, no deduction was allowed for items of a capital nature.

31. Based on the evidence and facts before the tribunal, HMRC respectfully asked for the appeal to be dismissed.

#### *Discussion and conclusions*

32. Two issues need to be considered. The first is the nature of the payment received by Mr Devaraj from Post Office Limited. It is clear from *Uppal* and from *Basil Bimson v Revenue and Customs Commissioners* [2012] UKFTT 216 (TC) (TC0191) that such payments constitute employment income payable to an office holder, and qualify for the exemption in respect of the £30,000 threshold. In their letter to HMRC dated 21 September 2011, Victor & Co provided a reconciliation of the gross amount stated in the form P45 for 2008-09, which referred to the deduction from the “total compensation” figure of £30,000 for “golden handshake”. They clearly accepted that the compensation paid by Post Office Ltd to Mr Devaraj was employment income.

33. The second issue is whether anything can be set against the taxable balance of that compensation. On the basis that this receipt was income, the only way in which any relief may be set against the excess over the £30,000 threshold would be if that relief was a deduction of an income nature.

34. Mr Boyle referred to the comments in *Uppal* at [30] b. We should point out that paragraphs [28]-[30] of the decision record the submissions made by HMRC, and are

not the comments of the Tribunal. However, we accept that the argument recorded at [30] b. is an appropriate description of the operation of the concession and of the strict position under the terms of the applicable legislation. The result is that the compensation constitutes employment income, as found by the Tribunal in *Uppal* at [32]-[22].

35. On the basis of that strict position, the only deductions allowable from employment income are those set out in s 336(1) ITEPA 2003:

**“336 Deductions for expenses: the general rule**

(1) The general rule is that a deduction from earnings is allowed for an amount if—

(a) the employee is obliged to incur and pay it as holder of the employment, and

(b) the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.”

36. As Mr Welsh stated in his letter to Victor & Co dated 17 October 2012, the question was whether the payment made by Mr Devaraj to acquire the sub-post office business qualified under s 336 ITEPA 2003 as a deduction. His conclusion was that it did not; all the payment did was to put Mr Devaraj into a position to perform the duties of the office of sub-postmaster, not actually to perform them. Under the employment income rules, the deduction would not therefore be allowable. We entirely agree with his conclusion on this question. Another point not referred to by Mr Welsh is that the payment was made in respect of the business as a whole, ie the stationery store as well as the sub-post office, and therefore the exclusivity requirement in s 336(1)(b) ITEPA 2003 was not met. As a deduction is only available where all the conditions in s 336(1) are fulfilled, the payment of £45,000 (and associated costs) cannot be deducted from the termination payment.

37. In our view (and as indicated by Mrs Crossley in the review letter) this is a complete answer to the question whether the payment is deductible as Mr Devaraj claims. The terms of the concession prevent the termination payment from being regarded as ‘business income’. However, as considerable argument has been devoted in the correspondence and at the hearing to the case for regarding the £45,000 plus costs as in some way deductible from the income receipt, we examine the merits of that case.

38. In the letter dated 17 October 2012, Mr Welsh also acknowledged that two cases recognised that goodwill attached to the office of sub-postmaster; these were *Anthony Cude v Revenue and Customs Commissioners* [2010] UKFTT 424 (TC), TC00693, and *Uppal*.

39. The first question in the context of the £45,000 and further costs incurred on acquisition of the business is whether (and if so, how) a deduction can be made against the compensation payment for the loss in value of the goodwill.

40. Putting to one side for the present the difficulty for Mr Devaraj that the concessionary treatment of Post Office remuneration does not extend to termination payments and so would not permit any such deduction, we can see no basis for such a deduction. The payment made to the vendor of the business was for the acquisition of an asset. That asset was the trading connections of the business. We respectfully agree with the various authorities cited in HMRC Manual CG68030. We are satisfied that the acquisition of that asset by Mr Devaraj was a capital transaction rather than on revenue account.

41. Section 24(1) TCGA 1992 provides that the occasion of the entire loss, destruction, dissipation or extinction of an asset shall constitute a disposal for capital gains tax purposes. As indicated at HMRC Manual CG68070, if a person ceases to carry on a business without disposing of it as a going concern, any goodwill in that business may be presumed to have ceased to exist provided that the cessation is permanent. The closure of the sub-post office was a permanent cessation, and therefore gave rise to a disposal for capital gains tax purposes pursuant to s 24(1) TCGA 1992, producing a capital loss. That loss is not eligible for deduction from the compensation payment, although it is available to be carried forward to be set against any capital gains which Mr Devaraj may make in the future.

42. In our view the status of the £45,000 as a capital payment for acquisition of an asset precludes any argument that such payment should in some way be deductible from the termination payment. However, Mr Arulanathan argued strongly, both in correspondence and at the hearing, that the £45,000 was of a revenue nature and should be available to be set off against Mr Devaraj's total income earned during the tax year 2008-09.

43. The argument was based on the letter from Post Office Limited to Mr Devaraj dated 15 May 2003. Mr Arulanathan referred to the matrix used to calculate the compensation payment; Post Office Limited did not refer in their letter to a loss of goodwill. He contended that the payment to Mr Devaraj was a payment for loss of earning rights and not for goodwill. The £45,000 had not been amortised in the accounts for the business; the money was not paid for a period, but was perpetual. The compensation paid by Post Office Limited represented the net present value of the loss of future earnings for terminating the involvement of Mr Devaraj in the Post Office Network. Mr Arulanathan submitted that this again confirmed the receipt to be of a revenue nature.

44. The latter submission addresses the wrong question. The relevant question is whether the £45,000 was revenue expenditure or capital expenditure; the termination payment was clearly income.

45. Leaving aside for the present the issue of capital or revenue expenditure, we are unable to see on what basis the £45,000 could be related to the right to receive remuneration from Post Office Counters Ltd (now Post Office Limited). Mr Arulanathan relied on the "matrix" set out in the May 2003 letter. In our view, this was inapplicable to Mr Devaraj. The letter states:

5 “Subpostmasters who were appointed on or before 31 March 1999 and who are able to leave the network under the Network Reinvention Programme, will receive a payment equal to 28 months of their remuneration. Compensation payments for subpostmasters appointed after 31 March 1999 are calculated using the method described at appendix 2.”

46. Mr Devaraj was appointed before 31 March 1999, having purchased the post office and stationery store in 1997. He therefore qualified for the maximum payment of 28 months’ remuneration.

10 47. What Mr Arulanathan referred to as the “matrix” appears in Appendix 2 to the Post Office Limited letter. This Appendix is headed: “Calculation of compensation for subpostmasters appointed after 31 March 1999”. The sliding scale for the ‘fixed sum’ compensation calculation sets out the number of months’ remuneration payable by reference to the date of appointment. It shows that those appointed before 31 March  
15 1999 are to receive 28 months’ remuneration.

48. The information relating to those appointed before 31 March 1999 is presumably included for completeness, as this is stated in the main body of the letter. In our view, the “matrix” is irrelevant to such individuals, of whom Mr Devaraj was one. Equally, the “Business value” method of calculating the compensation set out in  
20 Appendix 2 was inapplicable to those appointed before 31 March 1999, so (unlike Mr Bimson in the *Bimson* case) Mr Devaraj could only rely on the 28 months’ remuneration basis for calculation of the compensation payment.

49. In his case, the appointment commenced in 1997. There was no adjustment to take account of the additional two years. Even if his appointment had commenced 20  
25 years beforehand, the compensation payment would still have been calculated as 28 months’ remuneration. There is thus no proportionate relationship between the time for which the post office business continued and the level of compensation; it was a “flat” 28 months’ remuneration.

50. In the letter from Victor & Co dated 6 January 2012, they stated:

30 “Solicitors had named the premium paid to acquire the membership to join the ‘Post Office Network’ as Goodwill. How they name this payment is not relevant here. It is a payment for joining the ‘Network’ and should have been amortised and written-off in the Profit and Loss Account over the useful life of the asset, treating the ‘write-off’ as  
35 revenue expenditure for the year.

The compensation payment made by the Post Office is for the loss in revenue by compulsory purchase. As a result, the compensation received should qualify as a revenue receipt.

40 Further, we clarify that Goodwill is normally a capital asset. However in this [*sic*] particular circumstances surrounding the Post Office business it is to be treated as revenue earning asset and resultant revenue receipt.

The compensation received should qualify as revenue profit on leaving the 'Post Office Network'. Any compensation received to be allowable as a revenue income and not as capital proceeds.

5 The compensation received is the net present value of the lost future earnings for leaving the Post Office Network. This fact again confirms the type of receipt is of 'revenue' nature."

51. For the reasons which we have set out above, we are satisfied that the compensation received was a revenue receipt. However, we do not consider it possible to treat the payment made of £45,000 made in 1997 as a revenue deduction. 10 Although Victor & Co stated that the payment should have been amortised and written off in the accounts of the business, this is not what happened in practice. We do not consider that it would have been open to Mr Devaraj to claim a deduction for the amortisation of the goodwill which in itself is a capital item. The payment had been referred to in the correspondence between the advisers as "goodwill". As HMRC 15 pointed out, the payment was made by Mr Devaraj to the vendor of the business, and not to Post Office Counters Ltd; the vendor could not confer on Mr Devaraj the necessary entitlement to act as a sub-postmaster, because the only entity which had the power to do so was Post Office Counters Ltd. The vendor could not have known how long the tenure of Mr Devaraj's office as sub-postmaster might be.

20 52. It appears to us that the argument as to the £45,000 payment being of a revenue nature was something of an afterthought; the form of the claim in the return was cessation capital allowances, in Box 55 headed "Allowances on sale or cessation of business". In his letter to HMRC dated 1 February 2009, Mr Devaraj referred to that amount having been paid for goodwill; on closure of the post office, the value of the 25 goodwill and the fixtures and fittings had become nil. Those assets "were not depreciated until the post office and the shop were closed down".

53. As pointed out both by Mr Welsh in correspondence and by Mr Boyle at the hearing, there is nothing in relation to a sole trader which permits goodwill to be amortised in the accounts for tax purposes in a manner corresponding to the position 30 for a company under Schedule 29 of the Finance Act 2002 as it applied at the relevant time.

54. In relation to these alternative arguments, which fail to address the point that the 'trading income' concession does not extend to termination payments made to sub- 35 postmasters on closure of post offices, we are unable to find any basis on which the payment of £45,000 plus costs made in 1997 could be treated as deductible in computing Mr Devaraj's income for the year 2008-09.

55. As Mrs Crossley indicated in the review letter, goodwill is a capital asset for the purposes of TCGA 1992. The £47,037 capital loss on disposal of the goodwill therefore remains available to be set off against any capital gains which Mr Devaraj 40 may make, after taking account of available exemptions.

*Result of the appeal*

56. As we find that the payment is not deductible from his income for that year, we dismiss his appeal.

*Right to apply for permission to appeal*

5 57. 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 e (First-tier Tribunal) (Tax Chamber)  
Rules 2009. The application must be received by this Tribunal not later than 56 days  
10 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.

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**JOHN CLARK  
TRIBUNAL JUDGE**

**RELEASE DATE: 22 July 2014**

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