EMPLOYMENT - deductions - employee incurred legal fees in order to resolve an investigation commenced by his previous employer - until that investigation was resolved the new employer could not effect a professional registration which was a requirement of the new employment - pending the results of the investigation the employee was offered a revised contract of employment by the new employer - whether employee was necessarily obliged to expend the money on legal fees wholly, exclusively and necessarily in the performance of the duties of the revised employment - appeal dismissed - ICTA 1988 s 198(1)

THE SPECIAL COMMISSIONERS

BEN NEVIS

Appellant

- and -

THE COMMISSIONERS OF INLAND REVENUE

Respondents

SPECIAL COMMISSIONER : DR NUALA BRICE

Sitting in London on 4 April 2001

Mr J Grewal of Messrs Redford & Co Solicitors for the Appellant

Mr P W Anderson, HM Inspector of Taxes, for the Respondents

DECISION

The appeal

1. Mr Ben Nevis (the Appellant) appeals against a refusal to grant a claim for error or mistake relief in respect of an income tax assessment for the year 1990-91. The alleged error or mistake was the failure to deduct the sum of £5,730.84 (which had been paid as legal fees) from the emoluments of the Appellant's employment.

The legislation

2. The claim was made under the provisions of section 33 of the Taxes Management Act 1970 (the 1970 Act). At the relevant time section 33 provided that, if any person who had paid tax alleged that it was excessive by reason of some error or mistake in a return, he might by notice in writing make a claim to the Board for relief.

3. At the relevant time section 198(1) of the Income and Corporation Taxes Act 1988 provided:

"(1) If the holder of an office or employment is necessarily obliged to incur and defray out of the emoluments of that office or employment the expenses of travelling in the performance of the duties of the office or employment, ... or otherwise to expend money wholly, exclusively and necessarily in the performance of those duties, there may be deducted from the emoluments to be assessed the expenses so necessarily incurred and defrayed."

The issue

4. In the year in question the Appellant expended the sum of £5,730.84 on legal fees. The issue for determination in the appeal was whether the Appellant was necessarily obliged to spend the money wholly, exclusively and necessarily in the performance of the duties of his employment.

The evidence

5. A bundle of documents was produced by the parties. This contained a statement of agreed facts. The Appellant gave oral evidence on his own behalf.

The facts.

6. Form the evidence before me I find the following facts.

7. The Appellant commenced employment with his first employer in 1980 as a dealer on the Stock Exchange. As he could only conduct business if registered by the Securities Association (the TSA) it was a condition of his employment that he should be so registered. His first employer registered him as one of their employees.

8. On 1 May 1990 the Appellant moved from his first employer to his second employer. His registration with the TSA as an employee of his first employer was terminated and his second employer made an application that he be registered as one of their employees.

9. At about the same time the first employer instituted an internal investigation into the department in which the Appellant had worked because certain allegations had been made about the Appellant. Because of that investigation the TSA declined to register him as an employee of the second employer. That meant that, for all practical purposes, the Appellant was debarred from doing the work which he had been engaged by his second employer to do.

10. However, the second employer wrote to the Appellant on 16 May 1990. The letter said that the firm were prepared to allow him to remain in their employment pending the results of the investigation but subject to a number of conditions. One of the conditions was that all the rules of the TSA would be strictly observed; another was that the Appellant would keep his second employer

fully informed of all material developments in the TSA investigation; another condition was that, until the outcome of the investigation was known, the Appellant would be paid one-half of his agreed salary. A fourth condition was that the arrangements in the letter would remain in effect "for whichever is the shorter of six months or the completion by the TSA of its investigation". The terms of the letter made it clear that, although the Appellant was expected to keep his second employer informed of the investigation, it was for the Appellant to decide how to participate in the investigation. It was not made a condition of the Appellant's revised employment with his second employer that the Appellant should take legal advice about the investigation. However, it was clear that the Appellant could not take up employment with his second employer as originally arranged until registration with the TSA was complete.

11. The Appellant accepted the terms of the letter of 16 May 1990 and remained employed by his second employer, performing duties which did not require his registration with the TSA. Meanwhile, the registration with the TSA was delayed pending the outcome of the inquiry instituted by the first employer.

12. The Appellant wanted to clear his name and to get back his livelihood. He also wished to have the position resolved within the six-month period mentioned in the letter of 16 May 1990. Accordingly, during the period May to August 1990 he incurred expenditure of £5,730.84 in obtaining legal advice and representation to defend himself against the allegations made and also to speed up the process of the investigation.

13. In September 1990 it was accepted that the allegations made about the Appellant were unfounded. The Appellant was completely exonerated; his registration with the TSA as an employee of his second employer was completed; and he resumed his duties as a dealer for his second employer.

14. In October 1996 the Appellant made a claim under section 33 of the 1970 Act in respect of the expenditure on legal fees which had been made in 1990 and which had not been included in his return for that year. The claim was formally refused on 14 July 2000 and on 4 August 2000 the Appellant appealed against that refusal.

The arguments for the Appellant

15. For the Appellant Mr Grewal argued that the expenditure had been wholly, exclusively and necessarily incurred in the performance of the Appellant's duties as an employee of his second employer. At the time of the expenditure the Appellant was undertaking duties under the revised contract of employment of 16 May 1990. He cited Brown v Bullock (1961) 40 TC 1 and relied upon the words of Lord Donovan as authority for the view that the test was whether the duties could be performed without incurring the outlay. Here the duties dictated the expenditure as the Appellant could not have continued with his duties without incurring the expense. He also cited Elwood v Utitz (1965) 42 TC 482 and Mitchell v Child (1942) 24 TC 511. He also relied upon McKnight v Sheppard [1999] STC 669; he accepted that that case was concerned with an assessment under Schedule D rather than Schedule E but argued that the principles established applied generally.

The arguments for the Respondents

16. For the Respondents Mr Anderson argued that that the Appellant had not been "necessarily obliged" to incur the expenditure; that the expenditure was not

"necessarily" incurred; and that it was not incurred "in the performance of the duties" of the Appellant's employment. He cited Ricketts v Colquhoun (1926) 10 TC 118 at 135 and Eagles v Levy (1934) 19 TC 23 at 30, as authority for the view that an expense was only deductible if it was necessarily incurred by each and every occupant of the office; the expenses in the present appeal were personal to the Appellant. He cited Simpson v Tate (1925) 9 TC 314 and Humbles v Brooks (1962) 40 TC 500 at 502 as authority for the view that a taxpayer was only "necessarily obliged" to incur expenses "in the performance of his duties" if the expenses were incurred in the course of the performance of the duties and not in obtaining or keeping qualifications to enable the taxpayer to perform the duties. He argued that, at the time that the expenses were incurred, the Appellant was undertaking duties under the revised contract of employment contained in the letter of 16 May 1990 and the expenses were not incurred in the performance of those duties but to obtain registration in order to undertake other duties. Finally, he cited Lomax v Newton (1953) 34 TC 558 at 561 as authority for the view that expenditure could be necessary without being "necessarily in the performance of the duties". He distinguished McKnight v Sheppard which concerned Schedule D where different legislative provisions governed the right to deduct.

The arguments of the Appellant in reply

17. In reply Mr Grewal for the Appellant argued that the Appellant was "necessarily obliged" to incur the expenditure as his second employer required him to be registered with the TSA; the expenditure was not incurred for personal reasons. He distinguished Humbles v Brooks where the course undertaken had been optional and done in private. He also distinguished Simpson v Tate which concerned subscriptions to medical societies which were not relevant in the present appeal. He distinguished Ricketts v Colquhoun where the travelling expenses were incurred to enable the Recorder to get to his duties; here the Appellant incurred the expenses while he was employed and undertaking his duties. Finally, he distinguished Lomax v Newton and argued that the Appellant had to be registered with the TSA and that any other person doing the duties for which he had been originally engaged would have to be so registered; the requirement was not personal to the Appellant.

Reasons for decision

18. Before considering the arguments of the parties it is recalled that the expenditure sought to be deducted by the Appellant was the amount of legal fees incurred to resolve the outstanding matters with his first employer. The Appellant was not claiming to deduct the expenses of the actual registration (which was to be undertaken by his second employer).

19. The very restrictive nature of section 198(1) was considered in Lomax v Newton (1953) where Vaisey J (at page 561) described the words of section 198(1) as "notoriously rigid, narrow and restricted in their operation" and continued at page 562:

"The words are indeed stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the Rule is to be claimed successfully. They are, to my mind, deceptive words in the sense that when examined they are found to come to nearly nothing at all."

20. The arguments of the Respondents sought to identify three conditions which had to be fulfilled for the section to apply. These were: that the taxpayer had to be "necessarily obliged" to incur the expenditure; that the expenditure had to be

incurred "wholly, exclusively and necessarily for the purposes of the employment"; and that the expenditure had to be incurred "in the performance of the duties of the employment". I have approached this trisection of the statutory provisions with some caution. Under the words of section 198(1) what I have to decide is whether the Appellant was necessarily obliged to expend the money wholly, exclusively and necessarily in the performance of his duties. However, as the arguments were put under the three heads I consider them separately.

"In the performance of the duties"

21. In my view the decisive issue in this appeal is whether the expenditure was incurred "in the performance of the duties of" the Appellant's employment at the time the expenditure was incurred, that is the revised employment under the letter of 16 May 1990. All the authorities distinguish expenditure incurred in the performance of duties (which is deductible) from expenditure incurred to put the taxpayer in a position to perform the duties (which is not).

22. In Simpson v Tate (1925) it was held that subscriptions to medical and scientific societies made by a county medical officer of health, in order to keep up to date on medical questions affecting public health, were not deductible as they were expended for the purposes of enabling the taxpayer to continue to be qualified for his duties and not in the performance of them. Ricketts v Colquhoun (1926) concerned a barrister practising in London who was also appointed Recorder of Portsmouth. He claimed to deduct from the emoluments as a Recorder the cost of travelling from London to Portsmouth. The House of Lord rejected a claim to deduct those expenses on the ground that they were not incurred "in the course" of the duties of the office but partly before the taxpayer could begin to perform the duties and partly after he had fulfilled them. In Humbles v Brooks (1962) a headmaster of a school, who was required to teach history, attended week-end lectures in history to improve his background knowledge. He claimed the expenditure as an expense of preparing his history lectures at the school. The claim was rejected and a distinction was drawn between preparing for lecturing in general and the preparation of a particular lecture; the former was not deductible but the latter might be. At page 502 Ungoed-Thomas J reviewed the authorities in the following way:

"In the performance of the duties" means in the course of their performance: see Viscount Cave's speech in Ricketts v Colquhoun. It means "in doing the work of the office, in doing the things which it is his duty to do while doing the work of the office": see Rowlatt J's judgment in Nolder v Waters, 15 T.C. 380 at page 387. It does not include qualifying initially to perform the duties of the office, or even keeping qualified to perform them: see Simpson v Tate 9 T.C. 314 at page 318 per Rowlatt J. As Danckwerts J said in Brown v Bullock 40 T.C. at page 6, it does not mean adding to the taxpayer's usefulness in performing his duties. The requirement of the employer that the expenditure shall be incurred does not, of itself, bring the expense within the Rule, nor does the absence of such a requirement exclude it from the application of the Rule: see the passage which I have already referred to from the judgment of Donovan LJ., and Blackwell v Mills 26 T.C. 468, Griffiths v Mockler 35 T.C. 135 and Brown v Bullock."

23. Applying those principles to the facts of the present appeal, the duties of the Appellant at the time the expenditure was incurred were contained in the revised contract of employment contained in the letter of 16 May 1990 from his second employer. It was not in the course of the performance of the duties of that employment that the Appellant took the legal advice at issue in the appeal. He did not take the legal advice in doing the work for his second employer or in

doing anything which it was his duty to do while doing that work. The advice was taken in order to resolve matters left over from his previous employment with his first employer. In taking such advice he speeded up the progress of the investigation and, when that was complete, his second employer was able to proceed with his registration with the TSA. Thus, in incurring the expenditure, he was putting himself in a position to perform, or qualifying himself to perform, the duties for which he had originally been employed by his second employer.

24. I therefore conclude that the expenditure at issue in the appeal was not incurred "in the performance of the duties" of the employment from the emoluments of which the Appellant seeks to make the deduction. That means that the appeal must be dismissed. However, as arguments were put on the meaning of "necessarily obliged" and "wholly, exclusively and necessarily" I consider them briefly.

"Necessarily obliged"

25. In Ricketts v Colquhoun (1926) at page 135 Lord Blanesburgh stated that allowable expenses were limited to those which each and every occupant of the office was "necessarily obliged" to incur; the terms were not personal but objective. Deductible expenses did not extend to those incurred because of circumstances personal to the taxpayer or the result of his own volition. The principle was applied in Eagles v Levy (1934) where a taxpayer took proceedings to recover his pay and where the costs of the proceedings were disallowed on the grounds that the amount paid was not a sum which the taxpayer was "necessarily obliged" to incur. The principle was also followed in Brown v Bullock (1961) where it was virtually a condition of the employment of a bank manager that he become a member of a club. The Court of Appeal held that the annual subscription paid to the club was not deductible because the duties of a bank manager could be performed without being a member of the club. The fact that the employer imposed a condition was not conclusive.

26. In the present appeal the expenditure incurred by the Appellant was personal to him and was not an objective requirement of the holder of any post as a dealer. I have also found as a fact that the incurrence of the expenditure on legal fees was not a condition of the revised contract of employment of 16 May 1990. (The registration with the TSA was a condition of the employment under the original contract of employment with the second employer. However, the money was not expended on that registration but in resolving a dispute prior to such registration.)

27. The Appellant relied upon Elwood v Utitz (1965) where a taxpayer who lived in Ireland was required by his employer to visit London in the performance of his duties. Rather than stay at hotels he became a member of two clubs. The Court of Appeal in Northern Ireland allowed the deduction of the club subscriptions on the ground that they were paid "not to gain membership as an end in itself, but to obtain accommodation and facilities which the appellant had to get if he was to perform the duties of his office" (see page 498). As it is clear that any taxpayer who lived in Ireland and had to travel to London to perform his duties could deduct the expenses of accommodation and facilities in London it does not seem to me that this decision departs in any way from the principle established in Ricketts v Colquhoun.

27. I therefore conclude that the Appellant was not "necessarily obliged" to incur the expenditure at issue in the appeal.

"Wholly, exclusively and necessarily"

28. The Appellant relied upon Mitchell v Child (1942) where the Rector of Cranford was under a legal obligation, as a term of his office, to reside in the rectory and to leave it to his successor on his retirement. A Bill was introduced into Parliament, one consequence of which might have been the loss of the rectory without compensation. The Rector incurred expenditure in connection with a petition to Parliament to oppose the Bill. It was held that the expenditure was incurred "wholly, exclusively and necessarily in the performance of the duties" imposed on the taxpayer by his tenure of the office of Rector of the parish of Cranford. This decision is consistent with the view that the Rector was "necessarily obliged" to incur the expenditure to ensure that he could continue to fulfil his obligations. The obligation was that of the holder of the post and not a personal obligation of that Rector. The decision can be distinguished from the facts in the present appeal where the expenditure was not incurred in the performance of the duties of the taxpayer.

29. The Appellant also relied upon McKnight v Sheppard. However, that appeal concerned the deduction of legal fees by the sole proprietor of a stock broking firm who was assessed under Case I of Schedule D. The statutory provisions about the deduction of expenditure incurred for the purpose of a trade or profession are contained in section 74(1)(a) of the 1988 Act and are much less strict than those in section 198(1) which apply to Schedule E. The word "necessarily" does not occur in section 74(1)(a) and the words "for the purposes of the trade, profession or vocation" replace the words "in the performance of the duties of the employment". The decision in McKnight v Sheppard was based on a finding that the expenditure was incurred for the purposes of preserving the trade from destruction; that concept is not relevant in the present appeal.

30. I therefore conclude that in this appeal the expenditure was not incurred "wholly, exclusively and necessarily" in the performance of the duties of the employment.

Decision

31. My decision on the issue for determination in the appeal is that the Appellant was not necessarily obliged to spend the money at issue wholly, exclusively and necessarily in the performance of the duties of his employment.

32. The appeal is, therefore, dismissed.

DR NUALA BRICE

SPECIAL COMMISSIONER

Released 30th May 2001

SC 3113/00