CHILD CARE EXPENSES of a self-employed person – whether deductible – no – whether Human Rights Act 1998 applies to a tax year before coming into force where the act of disallowance took place afterwards – no – whether the point is covered by primary legislation – yes – whether article 1 protocol 1 and article 14 of the Human Rights Convention apply – no – whether articles 8 and 14 apply – no

THE SPECIAL COMMISSIONERS

NENA MARIA CARNEY - Appellant
- and -
DEVI NATHAN (HM INSPECTOR OF TAXES) - Respondent

Special Commissioner: DR JOHN F AVERY JONES CBE

Sitting in London on 1 November 2002

William Curry, Victor Stewart & Co, Chartered Accountants, for the Appellant

Ian Mitchell Inland Revenue London Region Advocacy Unit for the Respondent

DECISION

1. This is an appeal by Miss Nena Maria Carney against an amendment to a self-assessment for 1998/99. The Appellant was represented by Mr William Currey and the Inspector by Mr Ian Mitchell.
2. The only items in dispute are the deductibility of nursery costs of £1,534 and playgroup costs of £104 in computing the profits of the Appellant as a self-employed graphic designer.
3. Both parties provided skeleton arguments. I had a witness statement from the Appellant but she did not give oral evidence. After Mr Mitchell's opening speech Mr Currey asked if he could have further time to reply to the human rights points in writing to which I agreed and Mr Mitchell made written comments on his reply.
4. The Appellant's witness statement says that he works from her home and her work involves clients and suppliers visiting. She has two children, born 26 September 1994 and 15 July 1997. She found it unprofessional and embarrassing to have children running around and playing in her working environment while third parties are visiting. She did not want the sound of children in the background when she was telephoning. She also has to visit clients regularly. She says that her object in making the payments for a nursery facility was to stop losing clients and to be able to have clients and suppliers visit her with the appearance of a business-like office/studio at her home. But for her business it was unlikely that the children would be sent to nursery care.

Whether the expenditure is disallowed

5. Mr Currey contends that the expenditure was wholly and exclusively incurred for the purposes of her trade within section 74(1)(a) of the Taxes Act 1988. Mr Mitchell does not argue the expenditure being included in the accounts but contends that they are disallowed under that provision and also paragraph (b) as:

   "any disbursements or expenses of maintenance of the parties, their families or establishments, or any sums expended for any other domestic or private purposes distinct from the purposes of the trade, profession or vocation."

6. Both parties referred to a number of familiar authorities on section 74(1)(a). I can start with the following summary from *Vodafone Cellular Ltd v Shaw* [1997] STC 734, 742e:

> The leading modern cases on the application of the "exclusively" test are *Mallalieu v Drummond* [1983] AC 861 and *Mackinlay v Arthur Young McClelland Moores & Co.* [1990] 2 AC 239. From these cases the following propositions may be derived:
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> 1. The words "for the purposes of the trade" mean "to serve the purposes of the trade". They do not mean "for the purposes of the taxpayer" but for "the purposes of the trade", which is a different concept. *A fortiori* they do not mean "for the benefit of the taxpayer."
> 2. To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment.
> 3. The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment.
> 4. Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made.
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> To these propositions I would add one more. The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the Commissioners, not for the

> taxpayer. Thus in Mallalieu v Drummond the primary question was not whether Miss Mallalieu intended her expenditure on clothes to serve exclusively a professional purpose or partly a professional and partly a private purpose; but whether it was intended not only to enable her to comply with the requirements of the Bar Council when appearing as a barrister in Court but also to preserve warmth and decency."

I should also refer to the following passage from *Mallalieu v Drummond* [1983] STC 665, 668j and 669e:

> The words in the paragraph "expended for the purposes of the trade, profession or vocation" mean in my opinion "expended *to serve the purposes* of the trade, profession or vocation"; or as elaborated by Lord Davey in *Strong & Co of Romsey Ltd v Woodifield* [1906] A.C. 448, 453 "for the purpose of enabling a person to carry on and earn profits in the trade etc." The particular words emphasised do not refer to "the purposes" of the taxpayer as some of the cases appear to suggest: as an example see the report of this case [1983] 1 W.L.R. 252, 256. They refer to "the purposes" of the business which is a different concept although the "purposes" (i.e. the intentions or objects) of the taxpayer are fundamental to the application of the paragraph…..
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> The object of the taxpayer in making the expenditure must be distinguished from the effect of the expenditure. An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes. For example, a medical consultant has a friend in the South of France who is also his patient. He flies to the South of France for a week, staying in the home of his friend and attending professionally upon him. He seeks to recover the cost of his air fare. The question of fact will be whether the journey was undertaken solely to serve the purposes of the medical practice. This will be judged in the light of the taxpayer's object in making the journey. The question will be answered by considering whether the stay in the South of France was a reason, however subordinate, for undertaking the journey, or was not a reason but only the effect. If a week's stay on the Riviera was not an object of the consultant, if the consultant's only object was to attend upon his patient, his stay on the Riviera was an unavoidable effect of the expenditure on the journey and the expenditure lies outside the prohibition in section 130.

7. The two possible answers to the question of what was the Appellant's purpose in incurring the childcare expenditure are (1) to prevent the clients being put off by interruptions from children and to enable her to work without distraction, in which case having her children looked after is not a purpose but merely an effect of the expenditure, and (2) to have the children properly looked after while she worked. I accept that (1) was *one* of the purposes and that it served the purposes of the trade. The Appellant says that (1) was her *only* purpose but she has not been cross-examined on this. I am unable to accept that (1) was her only purpose. It seems to me inconceivable that (2) was not also a purpose of the expenditure, in which case the expenditure has a dual purpose, and is not wholly and exclusively incurred for the purpose of the trade. I accept that, but for her trade, she would not have incurred the expenditure, but when incurring

the expenditure she must have had the purpose of having the children properly looked after as well as serving the purposes of the trade. Even if I had accepted that this was her only conscious purpose, I find that (2) was an unconscious purpose. It is inconceivable that it is not an unconscious purpose just as the purpose of clothes in *Mallalieu* was to provide warmth and decency. Accordingly the expenditure is disallowed.

8. I also agree with Mr Mitchell that paragraph (b) disallows the expenditure as maintenance of the parties or their families, for which there is no purpose test; or as sums expended for any other domestic or private purposes distinct from the purposes of the trade, profession or vocation, which does contain a purpose test that I have decided is a domestic or private purposes distinct from the purposes of the trade.

The Human Rights Act 1998

Retrospectivity

9. The Appellant raises human rights arguments in addition. Mr Mitchell contends that since the Human Rights Act 1998 came into force on 2 October 2000 it cannot affect the Appellant's tax for 1998/99 under a self-assessment return submitted on 2 June 1999. Mr Curry contends that the relevant act was that of the Inspector amending the self-assessment disallowing the expenditure on 17 October 2000. The Appellant's case is really that the tax legislation is wrong in not allowing the deduction (whether this is correct I will consider below), not that the Inspector acted on the basis of the legislation. By section 3 of the Human rights Act 1998 "So far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the Convention rights." The act of disallowing the deduction follows from the legislation. A similar point arose in *Britax International GmbH v IRC* [2002] EWCA Civ 806 in which the taxpayer argued in the Court of Appeal that the High Court's interpretation of tax legislation was in breach of section 3 of the Human Rights Act. The Court after referring to the authorities that section 3 was not retrospective said:

"the events in question were the trading activities of Autolease during the accounting period ending 31 December 1999; the issue in the proceedings is as to the tax consequences of those trading activities. Plainly, [counsel for the taxpayer's] reliance on the 1998 Act requires that it should operate retrospectively in relation to those trading activities, and to that issue, so as to produce a result (in terms of the true construction of section 35(2) [of the Capital Allowances Act 1990]) which was not available under the law as it then stood. Accordingly, in my judgment, [counsel for the taxpayer's] third submission fails on the reprospectivity issue."

The same principle applies here. The issue is the deductibility of expenditure incurred in a period before the Human Rights Act came into force. This is an appeal against a 1998/99 self-assessment, not against an act taken by the Inspector on 17 October 2000 disallowing the expenditure. While there was an act of a public authority which took place after the Human Rights Act came into force, just as there was an act of a public authority after the Act came into force in *Britax*, the effect of the Appellant's submission is to achieve an interpretation of the tax legislation which is to be applied retrospectively to a time before the Human Rights Act was in force. I therefore agree with Mr Mitchell that the Act does not

apply. I will, however, consider the substantive points on the Act in case I am wrong on this point.

Point covered by primary legislation

10. By section 6(1) it is unlawful for a public authority to act in a way which is incompatible with a Convention right. Section 6(2) provides a defence so that the prohibition "does not apply to an act if (a) as the result of one or more provisions of primary legislation, the authority could not have acted differently…." Mr Mitchell contends that this is applicable here. I agree with him. The point is covered by primary legislation, section 74(1)(a) and (b) of the Taxes Act 1988 which I have held disallows the expenditure.

Article 1 of the First Protocol and article 14

11. Article 1 of the First Protocol of the European Convention on Human Rights provides:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

The Appellant contends that the disallowance of the expenditure constitutes discrimination within article 14 in relation to article 1:

"The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."

12. Mr Curry contends that there is discrimination between an employer and the self-employed in relation to child care in that an employer obtains a deduction for childcare costs for employees on general principles and, subject to certain conditions, an employee is not taxed on employer-funded childcare expenses (section 155A Taxes Act 1988). Mr Mitchell contends first that this is not discrimination on the ground of "other status," and secondly that, in general employers and the self-employed are not similar, and in particular the Appellant's situation is different from that of an employer paying for childcare for other persons, its employees. An employee is in the same position as a self-employed person; neither can deduct childcare expenses. If the Appellant operated through a limited company so that the company obtained a deduction and the Appellant was not taxed (assuming that the conditions in section 155A were satisfied) he contended that the situation of the Appellant as a sole trader was different from that of a director and shareholder of a company, and it was proper for the tax system to take this into account.
13. On the question whether there is discrimination on the ground of "other status," the European Court of Human Rights in *Kjeldsen Madsen and*

Pedersen v Denmark Application Nos. 00005095/71; 00005920/72; 00005926/72 (1976) 1 EHRR 711 stated:

"The Court first points out that Article 14 prohibits, within the ambit of the rights and freedoms guaranteed, discriminatory treatment having as its basis or reason a personal characteristic ("status") by which persons or groups of persons are distinguishable from each other."

Here any discrimination is financial and does not depend on status in the sense used by the court..

14. I was not referred to any authority where different treatment between an employer and a self-employed person was held to be within article 14. Mr Mitchell pointed out that the Commission on Human Rights declared a claim inadmissible and accepted a distinction in taxing rules between employed and self-employed persons in *X v Austria*, Application No 6163/73. In that case employed persons paid tax at fixed rates and self-employed at progressive rates and employees receiving special payments obtained preferential tax treatment. The Commission found that different tax treatment was justified and not discriminatory. I am aware of other cases to the same effect in relation to national insurance contributions: *National Federation of the Self-Employed v UK,* Application No.7995/77 and *Juby v UK* No.11592/85. The same must apply to childcare expenses. An employer obtains a deduction for childcare expenses for employees as the provision of a benefit to its employees; the employee is not taxed on that benefit, perhaps because it is difficult to value the benefit to a single employee, but the employee cannot deduct the expense if he or she incurs it. The Appellant as a self-employed person paying childcare expenses for herself is not in a similar situation to an employer paying for an employee. There is no discrimination within article 14 to which article 1 of Protocol 1 can apply.

Articles 8 and 14

15. Mr Curry also relied on article 8 in conjunction with article 14. Article 8 headed *Right to respect for private and family life* provides:

"1. Everyone has the right to respect for his private and family life, his home and his correspondence.

2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others."

16. The issue here is whether paying more tax is an interference with the right to respect for the Appellant's private and family life, her home or her correspondence. I was not shown any authority where article 8 was held to include substantive tax rules, as opposed to procedural matters, such as the exercise of powers to obtain information. It is not a natural reading of those words that substantive tax liability is covered. I do not think that article 8 is potentially breached. For the reasons already given I do not consider that article 14 is applicable to the distinction between an employer and a self-employed person in relation to article 8.

17. Mr Mitchell pointed out that the government does now provide help for some childcare expenses equally for the employed and the self-employed through the childcare tax credit as part of the working families tax credit. The childcare tax credit covers up to 70 per cent of eligible childcare costs of up to £135 per week for the first child and £200 per week for two or more children.
18. Accordingly I dismiss the appeal in principle.

DR JOHN F. AVERY JONES

SPECIAL COMMISSIONER

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