IF THE CAP FITZ
Fitzpatrick v IRC (No 2)

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The purpose of this article is to consider the effect of the case of *Fitzpatrick v IRC* on the law relating to the deductibility of employees' expenditure for Schedule E income tax purposes. I have written in the *Personal Tax Planning Review* on this subject before, with reference to *Smith v Abbott* (PTPR Vol 1, 1991/92, Issue 2, 93). I proffer my apologies for any similarity in subject matter, and indeed in opinions expressed, but to some extent that is unavoidable. Indeed, I think that it is most instructive to revisit some of the points made in *Smith v Abbott* and assess the impact of the decision in *Fitzpatrick* in the light of them.

The case of *Smith v Abbott* [1991] STC 661 before Warner J, was a case which threw into relief the tortuous path that must be followed to ensure that an employee's expenses will fall within the statutory test for deductibility. It concerned the expenses incurred by four employees of the *Daily Mail* and one of the *Mail on Sunday*. Each of the taxpayers received from Associated Newspapers Ltd an allowance in reimbursement of the cost of newspapers and periodicals which he or she bought. The question for determination by the General Commissioners was whether, in the case of each taxpayer, the amount of the allowance was deductible from his or her emoluments as an expense under s.189(1) of the Income and Corporation Taxes Act 1970.

There were four limbs to the test. The taxpayer had to show that:

1. she or he incurred the expenditure "in the performance of the duties of the office or employment";

2. she or he has been necessarily obliged to incur the expenses in the performance of those duties;

3. those expenses have been "wholly" incurred in the performance of those duties[2]; and that

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[2] Warner J feels that the "better view seems to be that that goes only to quantum", at p.674j.

4. those expenses have been "exclusively" incurred in the performance of the duties of the office or employment.

What was clear from the judgment of Warner J in *Smith v Abbott* was that it will not be enough to avoid the charge to tax simply to have a contract of employment drafted to show that an employee is to be able to incur and deduct a large amount of expense as being in the performance of the duties of his employment. This would, it must be said, make life a little too easy. However, the fact remains that the scope of the employee's duties are clearly to be ascertained by a combination of the terms of the contract of employment and the factual circumstances within which the employee is required to work.

The question then is, what indicia does one use to decide what are the relevant factual circumstances? The objection raised by the Revenue was that the expense was not incurred "necessarily" in the performance of the duties. This argument was based on the contention that for expenditure to be necessarily incurred, it must expenditure of a type which "any and every holder of the office or employment would be obliged to incur". This does not remove the fact that it is within the scope of the employer to ascertain exactly what office or employment it is that the employee holds.

The same result was reached with reference to one of the Crown's other arguments that the expenditure was not incurred "wholly and exclusively" in the performance of the duties on the basis that the expenditure was incurred partly to keep the employees adequately informed so that they could perform their duties more effectively. Warner J found, interestingly, that the fact that one of the successful taxpayers took newspaper cuttings for **future** use would not affect the singularity of purpose. At p.684e-f:

> "It seems to me, however, that once it is found that preparatory reading of the kind here in question is undertaken in the performance of the duties of the employment the fact that it may yield benefits of a lasting usefulness to the employee concerned in performing the duties of that or any like employment is neither here nor there."

The upshot of this dicta is that any expenditure incurred while performing the duties of the employment, which may reap benefits now or in the future, will be deductible. Much of what I have to say revolves around the basic assertion that if something is placed within the scope of the employee's duties by the contract of employment, and the employee is actually required to perform those duties, then any expense incurred by the employee must fall within the test. The decision of the Court of Session in Scotland in *Fitzpatrick v IRC (No2)*[3] is of some help here.

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[3] [1992] STC 406.

This case concerned journalists once again. However, on this occasion, despite the remarkable similarity in facts with the *Smith v Abbott* case, the court refused the taxpayers' appeals.[4]

Aside from making some hairline distinctions on the facts, the Lord President Hope was determined that the starting point in examining this issue was to see whether or not the expenditure was incurred in the performance of the duties of the employment before looking to see whether or not the wholly, exclusively and necessarily test has been satisfied.[5] Simply identifying a need for work outside the confines of the employment is not enough. Rather, the expenditure must make up part of the performance of the duties of the employment. That is, the employee must be performing the duties of the employment at the time when the expenditure is incurred.[6]

This is a very strict reading of the test. It was acknowledged on the facts that one of the journalists used her preliminary reading as a direct foundation for many of her articles. Despite that, it was found that she was performing work preliminary to her job as a journalist rather than being at her work. It is difficult to see how there can be a division, in logic, between the time when an employee stumbles across an idea and formulates it in her mind and the time when she sits behind her word processor and turns vision into hard copy. There can be little doubt that the more important function is the intellectual effort carried out in advance of the mechanical task of writing. There is little doubt that when Archimedes leapt from his bath in his naked glory screaming "Eureka" that he was then at work on one of the fundamental tenets of applied physics, even though he was clearly away from his formal place of work. Why then is the journalist to be discriminated against?

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4 It should be noted that Lord McCluskey delivered a strong dissenting judgment. However, that judgment rested on his dissatisfaction with the facts as found by the Special Commissioners and did not address the points of principle with which this article is primarily concerned.

5 See Lord President Hope at page 431g-h.

6 While Lord Cullen concurred with the President's dismissal of the appeals, he concerned himself with the lack of any substantive legal issue to which the taxpayers were alluding in their appeal. Rather, he conceived of their appeal as being based on the facts rather than the law and therefore not within the competence of a court of appeal within the doctrine in *Edwards v Bairstow*.

What the Court of Session was looking for first of all was that the expenditure was incurred in the performance of the duties of the employment rather than in preparation for those duties. This is a marginal distinguishing feature relied on by the Court of Session when compared with the *Smith v Abbott* case. There, the expenditure was really incurred by all the employees before they began their work. It was a slightly different question, and not one phrased by Warner J in these terms, as to whether or not the employees were at their work at the time when they were reading their newspapers.

On the contrary, it is, at first blush, difficult to see what difference there is in principle between a journalist who reads other newspapers before starting her daily grind and an employee who attends evening classes to expand her knowledge of her job such that she picks up ideas she would not necessarily have in normal circumstances. The only feasible point of difference is that the journalist is "at work" from the moment she begins reading the rival newspapers in the same way that a doctor on call who gives advice on the telephone before setting off from home to the surgery is said to be "at work" during the journey from home to the surgery.

In the opinion of the majority of the Court of Session, it was a question of fact whether or not the expenditure was so incurred. The role of the person drafting a contract of employment so as to ensure that an employee will benefit from the deductibility of such amounts expended is therefore to ensure that there is no doubt that the expenditure is expected to be incurred at the appropriate time as part of the duties of the employment. The need is to have the employee "at work" at any time when he or she incurs such expenditure. In a culture of working hours and practices that are becoming ever more American for many employees, it is not unreasonable for the employee to be expected to bear intrusions on her free time to improve her performance as an equally necessary corollary to the time spent hunched over a desk.

A word of warning though. It is clear from the decisions both of the High Court and of the Court of Session that a mere moral obligation on the employee to incur the expenditure will not be enough. It is essential to note that, when drafting contracts of employment with these considerations in mind, it must be an express part of the employee's duties that this expenditure is incurred at appropriate times.

From the point of view of the employer, the existence of this positive work culture means that if it is used in the right way, and encouraged by optimum manipulation of all the tax breaks for the employee, a more productive and well-prepared workforce will result.

The Implied *De Minimis* Exception

In my last article I discussed the possibility that the speech of Warner J permitted some form of *de minimis* exception to the basic contention that any duality of purpose in the expense incurred will disallow the taxpayer's ability to set the sum off against income. The newspapers read by the most assiduous of the employees must have afforded some pleasure along the way. There must have been days when the newspapers afforded no story material, only some level of enjoyment or information, and yet they will have been deductible from the amounts assessable to income tax. There must have been some pages which afforded no stories and yet which counted as part as of the deductible expense.

Seemingly, there is nothing said in the Court of Session to dispute the validity of that assertion, provided the first limb of the test has been satisfied.

Conclusion

There is little to add to these ruminations on the decision of the Court of Session by way of conclusion except to reiterate the emphasis that was placed on satisfying the issue of incurring expenditure in the performance of the employment. Of itself, this does not change much. It reminds us that all stages of the test are to be satisfied. However, by asserting that it is the element which must be considered first, it marks a far more blinkered approach to the problem than was evident in the decision of Warner J in *Smith v Abbott*.