TOOLS OF NECESSITY, KNOWLEDGE BY SCHOLARLY COMPULSION SMITH v ABBOTT[1]

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The Background

Smith v Abbott is a very important case for all those who are concerned with the framing of contracts of employment.

These appeals concerned the expenses incurred by four employees of the *Daily Mail* and one of the *Mail on Sunday*. The five held the following positions: news layout journalist, staff photographer, sports reporter, news sub-editor and pictures editor. I shall concentrate on the cases of the first two in that list (the news layout journalist and the staff photographer) because the former was the only appellant to fail and the findings of fact and law in relation to the remaining quartet were virtually identical.

The question before the High Court is best put in the judgment of Warner J:

> "In each of those years each of the taxpayers received from Associated Newspapers Ltd an allowance in reimbursement of the cost of newspapers and periodicals which he bought. In each year the amounts of the allowance received by the taxpayers were identical, except that Mr Woodhouse received no allowance for 1980-81 and only part of the allowance for 1981-82.
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> 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 emoluments as an expense under s.189(1) of the Income and Corporation Taxes Act 1970. It was agreed between the parties before the Commissioners: (1) that the amount of the allowance was correctly included in that taxpayer's assessment under Sch E as an assessable emolument; and (2) that he had spent on newspapers and periodicals an amount at least equal to the amount of the allowance."

Section 189(1) provides that:

> "If the holder of an office or employment is necessarily obliged to

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1 [1991] STC 661.

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> incur and defray out of the emoluments thereof the expenses of travelling in the performance of the duties of the office or employment, or of keeping and maintaining a horse to enable him to perform the same, or otherwise to expend money wholly, exclusively and necessarily in the performance of the said duties, there may be deducted from the emoluments to be assessed the expenses so necessarily incurred or defrayed."

As Warner J was moved to comment[3]: "It is notorious that the provision is rigid, narrow and to some extent unfair in its operation."

There are four limbs to the test. The taxpayer has to show that:

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

2. s/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[4]; and that

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

The Facts

The staff photographer, Mr Holt, worked in the North of England. His role was to compose picture features for the *Daily Mail* as well as simply taking photographs. The Commissioners found that he was "on call effectively for 24 hours a day". There were a number of reasons why Mr Holt needed to buy the enormous numbers of newspapers that he did buy. First, to "obtain ideas for stories and photographs and to check that any idea he had not already been dealt with by another newspaper, whether local or national". Secondly, he needed to be appraised of the latest news so that "he was always ready for discussion of matters raised by the picture editor". The newspapers were delivered to his house at about 7.00 am, at which time he scanned them and then homed in on anything which interested him. He would also buy the local newspapers in any town he happened to be working in to see whether or not there were any ideas to be gleaned from them. In the facts found by the Commissioners in relation to the successful appellants there was a paragraph which read:

> "We accept the evidence of Mr Burden [Deputy Managing Editor of the *Daily Mail*] and the taxpayer that the reading of this material was a necessary part of the duties of a staff photographer as described above and was not merely required to qualify, or maintain the

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3 at p.674h.

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

qualifications of the taxpayer to do the work."

In the case of the news layout journalist, Mr Abbott, there was no similar finding that reading the newspapers was a necessary part of the duties of the employment and not merely required to maintain his qualifications to do the work.

Mr Abbott's duties were to "create a page or series of pages with news stories and pictures relative to one another and to the advertisements in such a way as to be attractive and to make people want to read [them]". It was found that Mr Abbott had to read other newspapers to be both informed about current news and to see how other periodicals were reacting to a particular story. It was accepted that he had to have this information before reaching the office so that he did not have to be primed once there.

In the cases of all five of the employees, the Commissioners found that their appeals succeeded. However, Warner J was unable to accept that the Commissioners had found enough in their case stated to enable them to say that Mr Abbott had satisfied the four-limbed test as outlined above.

The Crown's Contentions

Counsel for the Crown had three basic objections to the Commissioners' findings in relation to all five appellants.

The first was that none of the expenses had been incurred "in the performance of the duties of the employment". Rather, pedantically enough, they were incurred before the duties of the employment began. In the cases of all five employees, they read their newspapers before arriving at the office or setting out on a job having spoken to their respective editors by phone. Therefore they cannot have been "on the job" at the time when the expense was incurred and therefore it is not deductible. The distinction which the Crown alleged that the Commissioners had failed to take into account was that between making yourself ready to perform the duties of the employment and that of actually performing those duties.

The taxpayers' response was to rely on the words of Lord Salmon in *Taylor v Provan*[5] to the effect that the terms of an employee's employment were determinative of the duties of that employment:

> "When you are considering where the duties of a man's employment require him to work, you look first at the terms of his employment. These normally are conclusive. A term which may appear to be rather more for the man's benefit rather than for the benefit of his employers is still a term of the employment."

He goes on to cite the example of the employee who is dispatched to work from a hotel in the South of France with the likely intention on both his part and that of his employers that he receive two weeks' holiday with his expenses met free of tax.

Warner J seeks to distinguish such broad dicta from the case before him and prevent them from having general application[6]:

> "Lord Salmon was here dealing with the relevance of a man's terms of employment in considering where his duties required him to work. I do not think that Lord Salmon can have meant to say that the terms of his employment were normally conclusive of the scope of the duties of his employment within the meaning of the statutory phrase."

Therefore, it will not be enough to avoid the charge to tax that a contract of employment is 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.

The second objection made is 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". Warner J was not prepared to disturb the Commissioners' finding that in Mr Holt's case the expenditure was "a necessary part of the duties of a staff photographer".

The same result was reached with reference to the Crown's third argument that the expenditure was not incurred "wholly and exclusively" in the performance of the

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5 [1974] STC 168 at 191.

6 at page 681h-j.

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 Mr Holt 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."

This statement should be cross-referred with the remarks I shall make below in connection with the performance of research activities prior to advising clients, where the information thrown up is discovered either by an employee acting in the course of her duties or one acting in her spare time.

It is worthwhile examining the three examples which Warner J posits when discussing the question of what type of preparation for the performance of the duties is allowable as a deduction.

He says at p.682a-b:

> "There is in my judgment no doubt that expenditure incurred by the holder of an office or employment in qualifying himself, or keeping himself qualified, to perform the duties of it - such as expenditure by a professional man in keeping himself informed of the developments in his professional field, or expenditure by a teacher in acquiring the knowledge of a subject that he needs in order to teach it - is not incurred by him in the performance of the duties of the office or employment in the statutory sense."

Warner J refers to the fact that the rules operating in favour of self-employed professionals with reference to deductions are somewhat more liberal in this respect. The question is raised below as to what difference there is between preparing in advance of a situation arising in the course of the performance of a employee's duties and scurrying about to perform the same operation after the situation has arisen.

Warner J proceeds at p.682b-c:

> "On the other hand, it is not in my judgment the law that no reading that is preparatory to the performance of duties of an office or employment can ever itself be part of the performance of the duties of that office or employment."

Where is the line between an employee who, in the case of an employed solicitor, reads the papers sent by the client in advance of the conference; an employee who researches the background law surrounding those papers once they have arrived on her desk in advance of the conference; and an employee who performs general research in the evenings after work so that she will be able to research papers in advance of a conference more efficiently than her peers?

Warner J concludes these ruminations at p.682c-d with this very example:

> "There are manifestly cases where preparatory reading is part of the duties of an office or employment. An example that springs to my

> mind is that of an employed solicitor reading in preparation for giving advice to a client the papers in that client's case and the statutory provisions or other authorities relevant to it. That reading is just as much in the performance of the duties of his employment as is the giving of the advice itself. What is true is that, where preparatory reading is part of the performance of the duties of an office or employment, it will probably be rare for the undertaking of it to put the holder of the office or employment to expense, but that itself is not in point."

Levels of Foresight

What is difficult to see in the case of a person who does preparatory reading, is why there should be a difference between, in the case of an employed solicitor, reading the papers to ascertain the facts and doing any technical reading that is then required. Were it the case that the solicitor took instructions and then had to perform background research in an unfamiliar area of law to advise the client properly, this research would be in the course of the performance of the duties of the employment. It may therefore be the case that the employee is required to purchase legal materials to enable her to carry out that research. In this instance it may well be the case that the employee is required to incur expense personally[7] in the course of preparing papers, which she may well feel entitled to have re-imbursed to her or, at the least, deducted from her taxable emoluments.

The further difficulty is then with the timing of the expense. Where the employee buys the books in expectation that the client will require advice in the area but before it can necessarily be said to be a part of the duties of the employment (that is, before the client instructs the solicitor that he wants advice on that area but after the instructions have been sent), will that same expense still be deductible? It would be arguable here that the expense is incurred to enable the solicitor to provide the best possible advice for the client. Here the solicitor would undoubtedly be negligent if she failed to provide the fullest possible advice for the client. If she were not a tax expert but had an inkling that the client might have made a taxable supply for VAT purposes, she would have to advise the client as to the risk. Therefore she might buy a book on VAT before the client comes for consultation. It would, in my opinion, be reasonably arguable that at this stage she is acting in the course of her duties in incurring the expense of the book.

The natural extension would therefore be with reference to the employee who perceives that there will be a need amongst her clientele to receive advice about the effect of, for example, a new Act of Parliament (the Children Act 1989 or the offshore provisions in the Finance Act 1991). Perceiving this need, she goes out and spends money, initially on her own credit cards, to ensure that she and her office are primed on this new area.

It may be that the employee is preparing a lecture on this new area so that she can win clients for her practice. This is not simply maintaining her own level of expertise, although it is undoubtedly doing that, it is enabling her to appear learned before

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[7] It might be that she buys a book in her lunch hour on the basis that she can reclaim the purchase price later.

potential clients. On the basis of the decision in *Smith v Abbott*, she would have to demonstrate that it was a part of her duties to attract such clients in this way. Or it may be, simply, that she wishes to appear learned before the clients she already has. If she could show that it was a necessary part of her duties and that the expense was incurred wholly in the performance of those duties, then the deduction should be allowed. This does bring us into new areas of job demarcation which may prove to be generative of inconsistencies in the taxation of different employees.

The Implied *De Minimis* Exception

The speech of Warner J clearly provides that any duality of purpose in the expense incurred will disallow the taxpayer's ability to set the sum off against income. However, this broad premise must be subject to some form of *de minimis* rule. 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 their cost 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. Is the sports writer to be able to deduct the proportionate value of the foreign news pages of other newspapers? The journalists must have known that only a few pages could possibly be relevant, so how can their aim be said to have been to incur this expense wholly, exclusively and necessarily in the employment. The effect, on the other hand, will only ever be a partial use in the employment. Naturally there is no suggestion that the Revenue could, or would, enter into such a nit-picking exercise.

In the case of an employee in that same solicitor's practice who is required as part of the duties of her employment to expend money in the purchase of relevant material, what happens when the employee realises that she derives thorough enjoyment from the study of, for example, foreign trusts provisions? She casts "Anna Karenina" aside and shuns the lure of fashionable society, in favour of academic treatises on the Finance Act 1991. Is she to be penalised for enjoying her work in that she takes the furtherance of her knowledge beyond what is strictly necessary for her present situation but which will help her to be better in the future? In a business culture which values the work ethic, should we tax those who are both discharging their duties and deriving enjoyment? There is duality of purpose here but has it kept within our *de minimis* guidelines? Seemingly, it must have done on the basis of Warner J's test.

The Complete Employee

Let us instead posit the following example. An employee takes up a series of expensive purchases of books which she feels will enable her to become a more competent employee. Let us suppose that she is an assistant solicitor in the tax department of a City firm. There is no requirement in her contract of employment that she undertake such work. Yet she does more than subscribe to learned periodicals, she buys further afield; books more suitable for a business studies degree than those of a tax lawyer. She feels that this will increase her effectiveness to give advice to corporate clients. Seemingly, this will not qualify her for a deduction. However, were it her clearly defined role within the department, specifically provided for by her contract of employment, to scour such periodicals to uncover means of better meeting the demands of corporate clients, it must be presumed that she would be able to deduct the cost of purchasing such reading matter, given that she is *de facto*

discharging the duties of a real employment.

What is the difference between two similarly optimistic practices? The former is born of a laudable conscientiousness while the latter is the very stuff of the daily drudge. It might be that, in the former instance, the assistant is an employed partner in a small solicitor's practice and unable to afford the wages of the researching solicitor in the latter instance. It appears that the smaller practice is being discriminated against on the basis that it cannot afford or justify the expense on a professional level but still relies on the zeal of its individual solicitors to conduct this research and thus keep its corporate clients. The latter firm has the resources to afford a library which contains a good many periodicals which are neither used nor referred to. Yet the existence of a member of staff whose job it is to survey such reading matter in the hope that something of use will materialise, will enable the individual employee to deduct the amount where she is required to incur the expense herself. The large firm benefits from the economy of scale. Its ability to make the initial outlay, in employing a solicitor to perform that role, rubs off on the employee.

In the vicious world of taxation advice, when is it "necessary" to make the expenditure? At one level, the more that is expended the better. A thousand minds are better than one. Where is the line between keeping up with the field and discharging the obligation of the employment?

Conclusion

The upshot of this gap in logic is a need for a new test which is based on results rather than pure necessity. The fact which the employee and the employer would be required to prove to the satisfaction of the Commissioners would be that the expenditure would indeed make the employee more knowledgeable and better able to discharge the obligations of her employment. The former would include the latter. If expenditure had the result of helping to discharge the duties of the employment, by making the employee more efficient, knowledgeable, and so on, then it must be necessary for the proper (that is optimum) performance of the duties of the employment. To insist that expenditure be narrowly "required" for the job is to deter a positive work culture. At a time when training and positive attitudes in the business place are at a premium in the minds of all political parties and employers, this is perhaps the time for a change.

In conclusion it is clear that contracts of service will need to be carefully drafted in the future to take account of this decision. Of particular interest is the notion that if it is an express part of the employee's duties of employment that particular acts be performed and further that it is expected that the individual employee meet any expenditure necessarily connected with the discharge of these duties where appropriate that such expenditure will be deductible expenditure. The multiplicity of contracts of employment which would now benefit from the sturdy and steady gaze of members of the junior bar beggars belief.