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## The Personal Tax Planning Review

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# SECTION 198 TAXES ACT 1988 SCHEDULE E DEDUCTIONS

Peter Vaines<sup>1</sup>

The purpose of this article is to examine one aspect of the Schedule E expense rule under section 198 Taxes Act 1988 which was highlighted in the 1994 newspaper cases *Fitzpatrick v IRC* and *Smith v Abbott* [1994] STC 237 and to suggest that an important part of the analysis has been ignored. Both cases related to the question whether the sums expended by employed journalists on the purchase of newspapers and periodicals were deductible from their income by reason of section 198 Taxes Act 1988. The familiar terms of section 198 are as follows:

"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 facts of *Fitzpatrick v IRC* and *Smith v Abbott* are well known. In each case the taxpayer was a journalist who worked for a newspaper; he purchased and studied other newspapers as an essential part of his job. Briefly stated, the decision of the House of Lords applicable to both these cases was that because the taxpayer did not read the newspapers in the performance of the duties of his employment, the expenditure on those newspapers was not deductible under section 198.

Lord Templeman, who gave the leading judgment, put the test thus:

"The question in each case is whether when a journalist reads newspapers he is performing his duties of his employment."

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Peter Vaines FCA, ATII, Barrister, Brebner, Allen & Trapp, 180 Wardour Street, London W1V 3AA. Tel: (0171) 734 2244 Fax: (0171) 287 5315.

His Lordship said that he was not, the grounds being that the journalist did not read the newspapers in the performance of his duties, but to enable his duties to be performed. This conclusion is a familiar one, being the reasoning for the failure of a large number of earlier attempts in other cases to claim a deduction under section 198.

Lord Browne-Wilkinson expressed a similar test in the form of the following question:

"...whether such reading was done in the actual performance of his duties or was merely preparatory and done in order to qualify him, by obtaining background information, to do his job more effectively."

However, Lord Browne-Wilkinson considered that in these particular cases the reading was not merely preparatory but was done in the performance of his duties. Although his was the lone dissenting voice, the test he enunciated was consistent with his brethren; he merely answered the question differently.

As a matter of plain common sense it is obviously absurd that where an employee is obliged to incur expenditure to do his job properly, he should be denied tax relief for the expenditure. However, section 198 is not the only statutory provision which gives rise to absurdity and we (or our clients) have learned to take these things on the chin - even in a case like this where it was accepted that an essential part of the taxpayer's job was to read the newspapers. One might think that the position would have been improved if the taxpayer's contract of employment had required him to read the newspapers. Unfortunately, although there was some discussion about whether the taxpayer was required as a condition of his employment to read the newspapers, this issue was not pursued; Lord Templeman explained that the point was irrelevant. The journalist's duties were in connection with the production of his employer's newspaper and he was not carrying out these duties when he was reading other newspapers.

In considering the meaning of the phrase "in the performance of the said duties", Lord Templeman cited with approval the following passage from Rowlatt J in *Nolder v Walters* [1930] 15 TC 380:

"In the performance of the duties 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. A man who holds an office or employment has, equally necessarily, to do other things incidentally, and spend money incidentally, because he has the office. He has to get to the place of employment for one thing...incidentally he is obliged

to do that, but it is not doing the work of the office, which begins when he arrives, and sets to work to perform his duties."

Without necessarily wanting to challenge any of the above, I cannot help wondering whether the right test has been examined here. One of the key parts of section 198 reads as follows:

"...to expend' money wholly, exclusive and necessarily in the performance of those duties..."

If we look at the facts of these newspaper cases, the simplest analysis is that the taxpayer purchases a newspaper and then reads the newspaper. The Courts have concentrated on the reading of the newspaper and whether this is an activity which is done in the performance of the duties of the employment or merely preparatory thereto. The conclusion has been that the reading of the newspapers was an activity preparatory to the performance of the duties. However, there is a problem here. The act of reading newspapers (at least in these circumstances) does not give rise to any expenditure, so it might well be asked why the reading of the newspaper is an activity relevant to the issue at all. If we apply the statutory test to the facts we need to identify what is involved in expending money because an essential element of section 198 is that the taxpayer expends money in the performance of his duties.

Even if it were to be said (as it was by Lord Browne-Wilkinson) that the reading of the newspapers was done in the actual performance of the duties of the employment, that surely cannot be enough to fulfil the requirements of section 198. What is needed to satisfy the test in section 198 is that "when the employee expends the money he does so wholly, exclusively and necessarily in the performance of his duties. But he does not expend money by reading the newspapers; he expends money when he buys the newspapers. If a journalist calls to the newsagents on his way to work and buys a newspaper, the money is expended at or around the time he picks up the newspaper and the 30p proffered is accepted by the shopkeeper in payment. Before he has started to read the newspaper, he has expended the money. What he does with the newspaper thereafter cannot be relevant to the test under section 198. When he expended the money, was he performing the duties of his employment? Certainly not - unless part of this job was, for example, to observe the behaviour of shopkeepers at the point of sale of their product."

I would therefore submit that the wrong target has been in judicial sights. Whether or not reading of the newspapers is done in the performance of the duties has little to do with the entitlement to the deduction. It is the act of expending the money which must be done in the performance of the duties of the employment, and that seems not to have been considered at all.

If this is an accurate (albeit rather unhelpful) analysis of the position, it is very difficult indeed to imagine the circumstances where a deduction of any expenditure would be allowed under section 198. Although a detailed examination of a contract of employment to identify precisely what duties are to be performed in the office or employment would seem to be ruled out as a relevant exercise by Lord Templeman, it may well be possible to frame a contract of employment so that the very act of incurring expenditure is a specific duty of the employment which would be required by each and every office or employment. However, perhaps a better idea would be for the Steering Committee of the Tax Law Rewrite Project to start at section 198.