R(FC) 1/91

Mr. V. G. H. Hallett **CFC/25/1989**
17.1.91

Income – earnings of self-employed earner – whether motoring expenses and telephone expenses for both business and personal use may be apportioned – whether bad debts deductible – whether capital drawings relevant

The claimant, who was self-employed in partnership with her husband and supplied accounts of the business, claimed family credit. The adjudication officer in awarding family credit did not allow amounts shown in the accounts for depreciation, bad debts, lunches, private motoring expenses and the private use of the telephone. The claimant appealed against the decision. In his submission to the tribunal the adjudication officer said that since the claimant and her husband had taken two weeks holiday during the period of the accounts, the calculation of earnings should have been based on a fifty week assessment period. The tribunal, in allowing the appeal, directed that the award of family credit be recalculated to allow as expenses bad debts, lunches, private use of the telephone and private motoring expenses. The adjudication officer appealed to the Commissioner.

Held that·

1. expenses that could be apportioned were motoring expenses including road fund licence, insurance and repairs and maintenance, and telephone expenses including rental charges. (Insofar as the Adjudication Officers' Guide was inconsistent it was not to be followed R(SB) 28/84 cited). Apportionment by tax inspectors was cogent evidence of the amount used for the business and should be accepted in the absence of contrary evidence;

2 bad debts relevant to the period were deductible; entertainment lunches were not (paras. 36 and 37);

3 capital drawings should be treated as such; where there was a dispute as to whether a sum was capital or income commercial accounting principles were to be followed, unless they conflicted with the regulations (para. 38);

4. the effect of holiday and the application of the change in the regulations on 12 September 1988 was considered at paragraphs 1(8) and 24 and the first appendix

DECISION OF THE SOCIAL SECURITY COMMISSIONER

1. My decision is:

(1) the decision of the social security appeal tribunal dated 22 August 1989 is erroneous in law and I set it aside;

(2) the family credit payable to the claimant for the period of 26 weeks from 25 April 1989 is to be re-calculated by the adjudication officer;

(3) the following expenses relevant to the assessment period (whether or not defrayed in that period) are to be apportioned between the partnership business carried on by the claimant and her husband and any private use:

(a) all motor expenses including the cost of the road fund licence, insurance and repairs and maintenance, and

(b) all telephone expenses including rental charges;

(4) any proved bad debt relevant to that period is to be deducted in ascertaining the net profit of the partnership;

(5) the expense of any lunches given by way of entertainment is not to be so deducted;

(6) the apportionment made by HM Inspector of Taxes of the expenses referred to in paragraph (3) is cogent evidence of the amount wholly and exclusively incurred for the purposes of the partnership business which the adjudication officer is entitled to and (in the absence of contrary evidence) should, accept;

(7) drawings shown in the partnership accounts as capital expenditure (failing evidence that this is not justifiable on business and accountancy principles) are to be accepted as such, and are not to be treated as revenue expenditure;

(8) for the purpose of ascertaining the claimant's normal weekly earnings, the adjudication officer shall determine in accordance with the directions set out in the first appendix to this decision whether any week or period of weeks in the assessment period is to be disregarded;

(9) the adjudication officer and the claimant are at liberty to apply in the event of any dispute in carrying out the terms of this decision.

Representation

2. I held an oral hearing of the present appeal (*Bulman)* and another family credit appeal (*Burr*, reference CFC/26/1989). An income support appeal, raising similar questions (*Gallagher*, to be reported as R(IS) 13/91) was then referred to me for decision and a further oral hearing of all three decisions was held. The claimant in *Gallagher* attended in person. In the other cases, the claimant was in each case represented by her husband. Mr. N. Butt of the Solicitor's Office, Departments of Health and Social Security, represented the adjudication officer at both hearings. Mr. Mark Rowland, counsel instructed by the Treasury Solicitor, appeared as *amicus curiae* at the second hearing.

Nature of the appeal

3. This appeal is concerned with the computation of the claimant's income and with his expenses for the purpose of working out his family credit (FC). Family credit "is a tax-free means-tested benefit for low-waged workers with children ... The idea is that FC tops-up your wages to ensure that your income in work does not drop below a certain level ... To work out your FC you first of all calculate the maximum family credit for your family circumstances ... Then you compare your income ... with a set figure (called the applicable amount) ... If your income [equals or] is less you will receive the maximum FC for your family circumstances ... If it is more ... you will get the maximum FC reduced by 70 per cent of the difference...": see the National Welfare Benefits Handbook, 20th Edition pages 110 and 116.

4. Subject to exceptions (not relevant here), the income of all members of the claimant's family is taken into account: see sections 20(1) and 22(5) of the Social Security Act 1986.

5. All three appeals raise questions as to the deduction of expenses in computing that part of a family's income comprising the net profit of a self-employed claimant (and, in the present case, of her partner and husband). It is a common feature of each appeal that the adjudication officer, consonant with the instructions in the Adjudication Officer's Guide (the relevant passages from which relating to family credit are set out in the second appendix), has refused to apportion telephone rental, motor road tax, insurance, servicing, maintenance and repairs between business and private use and has refused to allow any deduction in respect of such expenses in that computation. In all three cases, a social security appeal tribunal has allowed the claimant's appeal against the adjudication officer's decision in this respect, and directed apportionment. The adjudication officer is appealing against all three decisions.

6. As already indicated, the present family credit appeal relates to a claimant who was in partnership with her husband. But it is not suggested that this materially affects the questions at issue or that the result of the appeal would be different if the claimant were self-employed on her own account.

7. In respect of this appeal, in addition to the apportionment issue, a number of other issues have been raised by the adjudication officer concerning the calculation of a self-employed claimant's net profit for family credit purposes. Is the cost of lunches deductible? Are bad debts deductible? Are drawings shown in the accounts "other income" (distinct from earnings) which fall to be included when determining whether family credit is allowable. During the assessment period, the claimant had a two weeks "holiday". Having regard to this "holiday", what is the length of the assessment period to which the net profit is to be related?

The period in issue

8. Family credit is awarded for a fixed period, usually 26 weeks: see section 20(6) of the Social Security Act 1986.

9. The period now in issue is the 26 weeks from 25 April 1989 referred to in the adjudication officer's decision of 8 May 1989. It is accordingly 25 April 1989 to 24 October 1989.

The relevant law

10. This comprises, as regards the present appeal:

(1) the Social Security Act 1986; and

(2) the Family Credit (General) Regulations 1987 as amended and in force on 25 April 1989.

The relevant provisions of the Act and those regulations are set out in the third appendix.

The claim for Family credit

11. The claimant made a claim for family credit on 20 April 1989 (the date of its receipt). She declared that she lived with her husband at an address in Jarrow and had three children. She was in receipt of child benefit. She stated that she was in partnership with her husband (a self-employed area sales manager).

12. On 18 April 1989, a chartered accountant acting for the partnership sent to the Department a set of accounts, comprising the trading and profit and loss account of the partnership for the year ended 31 March 1989 and the balance sheet of the partnership as at that date. A copy is set out in the fourth appendix. The accounts were certified by him as being in accordance with the books of account, information and explanations given to him and in his letter he stated to the Department that they would form the basis for assessment to income tax for the tax year 1989/90 (to 5 April 1990). The assessable profit (adjusted for tax purposes) was £3,321.

The adjudication officer's decision

13. On 8 May 1989, an adjudication officer issued the following decision:

> "The claimant is entitled to family credit at the weekly rate of £24.78 for 26 weeks from 25 April 1989. Sections 20 and 21 of the Social Security Act 1986. Regulations 4, 7, 10 15, 20, 24, 46, 47 and 48 of, and Schedules 2 and 4 to, the Family Credit (General) Regulations 1987 (SI 1987 No. 1973). Regulations 6 and 27 of, and Schedule 4 to, the Social Security (Claims and Payments Regulations 1987 (SI 1987 No. 1968)."

14. The claimant, through his accountant, appealed against that decision on 12 May 1989.

15. In his written submission to the appeal tribunal, the adjudication officer stated that certain expenses of the business shown on the accounts were not allowable for family credit purposes and that he had added back to the profit £265 for depreciation, £42 for bad debts, £111 for lunches, £2,460.62 for motor expenses for private use, £181.92 for private use of the telephone. This gave a figure of £6,083.54 for the gross income of the business (£3,023 + £3,060.54 = £6,083.54). Regulation 22 defined the calculation of the profit of self-employed earners and the gross income of each partner calculated to £3,041.77. The weekly gross income of each partner calculated to £58.17 (£3,041.77 divided by 366 and multiplied by 7 equalled £58.17). In the result, £24.78 family credit should be awarded. The submission continues that the adjudication officer had now re-calculated the family credit in the light of the claimant's statement of 26 April 1989 that during the period covered by the accounts he "took two weeks holiday in caravan - couldn't afford to be sick!". On the basis that the calculation should have been based on a 50 weeks assessment period (352 days) this gave the total gross income of each partner as £60.48. The appropriate maximum credit was £61.10 and as the difference between the excess income of the claimant (£36.316, the submission sets out the calculation) and the maximum credit was £21.96 this was the amount of benefit payable. The tribunal was requested to give the decision that the adjudication officer was unable to give namely that the family credit payable from 25 April 1989 to 23 October 1989 was at the weekly rate of £21.96.

16. On 21 July 1989 the accountant wrote to the claimant's husband confirming that HM Inspector of Taxes had agreed the taxable profit (adjusted for private use of car and telephone) at £3,321 to be divided equally between him and his wife i.e. £1,660.50 each which was equal to £31.93 per week each, to which should be added the interest from the building society deposit of £82 per annum divided by 2 = £0.79p each week. He stated that cash drawn from the business for the year was £5,741 but did not think this could be described as income since it exceeded the profits earned

and the excess represented a reduction for the business assets funded mainly by increased borrowing from the bank and a reduction in debts.

17. In a further letter dated 27 July 1989 the accountant agreed that £265 (depreciation) was correctly added back. He wrote that there was no justification for added back bad debts since these all related to business debts which were found to be bad during the year under review. Lunches were paid to agents and assessable upon them for tax purposes as benefits "in kind and he saw no legal reason to add back these." As to motor costs, in fact only one eighth or 12.5% of the use of the car was for private use and the officer had made no comment nor queried this portion which had been agreed and used by the Inspector of Taxes. Total motor costs were £4,344 of which 12.5% equalled £541.74. As for the telephone, the amount charged included the line rental and as the business use of the telephone was 70% he again could not understand why the officer had made an additional addition to the agreed 30% accepted by the Inland Revenue as the rental was as much [*sic*] a properly incurred expense of the business. The total add back under this head was £547 x 30% = £164. So the correct add back total as agreed by HM Inspector was £971 which added to the profit per accounts of £3,023 was £3,994. From this there should be deducted agreed capital allowance per Income Tax Acts for the year of £403 and agreed deduction in respect of a proportion of rates, heat and light for the use of home as store and office of £270. This gave an adjusted profit for tax and Class IV NIC of £3,321. Multiplying by 366 and dividing by 7 income worked out at £63.52 per week i.e. £31.76 each.

The appeal tribunal's decision

18. The appeal tribunal heard the appeal on 22 August 1989. The chairman's note of evidence states:

> "The claimant produced further correspondence from her accountant. The tribunal noted that the accountant was a qualified chartered accountant and had confirmed in writing that Inland Revenue had agreed the taxable profit of the claimant's equal partnership with her husband as being £3,321.00 after making all necessary adjustments for private use."

19. The tribunal's decision was:

> "Appeal allowed and the adjudication officer is directed to recalculate the correct amount of family credit payable to the claimant having deducted from his calculation the add-backs for bad debts, lunches, motor expenses for private use and private use for telephone."

Their recorded findings of fact were:

> "1. The claimant applied for family credit on 20 April 1989.
>
> 2. She was self-employed in partnership with her husband.
>
> 3. For the year ended 31 March 1989 the taxable profit of the business was £3,321 to be divided equally between the claimant and her husband.
>
> 4. No sums fall to be added back to that sum for private use, lunches or bad debts."

Their recorded reasons for this decision were:

"The claimant and her husband have satisfied the Inland Revenue as to their claims for expenses in arriving at their taxable profit and save for the depreciation (specifically excluded from deduction by regulation 22 Family Credit (General) Regulations 1987) the tribunal can see no justification for the bad debts, lunches and calculations for private use being refused for deduction. The amounts added back by the adjudication officer in these respects have been incorrectly added back having regard to the adjustments already agreed by Inland Revenue on the same principle as for family credit purposes i.e. were the expenses wholly and exclusively incurred for the purposes of the business?"

20. The adjudication officer appeals against this decision, with the chairman's leave, on the following grounds:

"I wish to appeal on the following point of law: In arriving at their decision the tribunal have allowed the business elements of motor and telephone costs as an expense. It is my contention that where an expense has dual use i.e. both business and private, that expense cannot be said to be wholly and exclusively incurred for the purpose of the employment."

21. In reply, the claimant's husband puts his case as follows:

"If I understand the contention correctly, for family credit purposes they cannot accept the sum below:

£165	Road tax
£398	Insurance
£1,630	Repairs
£267.62	Fuel (private use)
£2,460.62	TOTAL

(please see p. 17, M. Bulman's breakdown re. Q2 motor expenses).

The argument is that these expenses have "dual use" and, therefore, cannot be claimed! In other words, because **part of** the use of my vehicle was for private use, I would have incurred in any event (1) car tax, (2) insurance and (3) repairs.

May I put to you the following questions.

(1) If my vehicle had been a **van** and I had used it solely for business and owned a separate vehicle for private use, then presumably all the expenses for the van would be acceptable but not for the car? I have an estate car which I try to use as a dual purpose vehicle, to carry my wife and three children safely and to carry varying amounts of stocks to my agents.

(2) Whilst I appreciate Tax Law may well be different from Family Credit Regulations - the tax authorities have accepted the principle that a proportion of my total motor expenses, (fuel, tax, insurance, repairs) was for private use and the balance for business. In other words, **they** do not contend that I cannot claim **any** of the car tax, insurance, repairs, because a small part of the vehicle use was private.

(3) If I did not require my vehicle to be on the road everyday, then I would not have gone to the expense that I did.

(4) Does not the contention made by the adjudication officer miss the point? The fact is I did incur those expenses, as testified to by an independent accountant and accepted by the Inland Revenue. My income is **NOT** £106.34 as alleged, but £63.52!

(5) Is not their submission going beyond the "spirit" or indeed the whole point of family credit which is, I understand, to help people on low income, particularly those who are trying to support their own business?"

Was the tribunal's decision erroneous in law?

22. Yes, but not on the original grounds of appeal which, for the reasons set out later in this decision, I reject. Mr. Butt submitted, on behalf of the adjudication officer, that:

(1) the appeal tribunal were wrong to equate family credit legislation as regards expenses in any way with the income tax legislation, the use of identical words in the family credit legislation being, he submitted, coincidental;

(2) the appeal tribunal wrongly took the Inland Revenue assessment as binding on them;

(3) they wrongly apportioned the fixed motor and telephone rental charges, which were dual purpose;

(4) they wrongly allowed the cost of lunches;

(5) they wrongly allowed bad debts as an expense;

(6) they failed to consider the length of the assessment period, the claimant having been on holiday for two weeks.

Mr. Butt also submitted that the "drawings" shown in the accounts should have been brought into account as "other income" when calculating entitlement to family credit. This point was not put to the appeal tribunal and I do not think Mr. Butt suggested that the failure to deal with it was an error of law.

23. It is not in dispute that the tribunal's decision was erroneous in law in holding that the cost of lunches was allowable as an expense on the ground that it had been allowed by the Inland Revenue in arriving at their taxable profit. Regulation 22(5)(f) of the Family Credit (General) Regulations specifically provides that no deduction shall be made in calculating the net profit of the partnership for "any expenses of business entertainment". The relevant income tax provision relating to business entertaining expenses, section 577 of the Income and Corporation Taxes Act 1988 (consolidating earlier legislation) contains elaborate provisions which differ, in material respects, from that regulation. It was clearly essential for the tribunal to consider regulation 22(5)(f) itself. The failure to do so was an error of law.

24. The appeal tribunal's findings were also defective in that they failed to consider the adjudication officer's submission that in his original decision he had calculated the claimant's normal weekly earnings incorrectly because the net profit of

the partnership had there been divided by 52 instead of by 50. The contention of the adjudication officer was that the claimant was on holiday for two weeks which therefore fell to be excluded from the 52 weeks assessment period: see regulation 15(1)(b) and 17(b). There are no findings on this point at all, which is crucial in calculating the claimant's entitlement to benefit. Detailed findings are required before any conclusion can be arrived at as to whether the fact that the claimant was on holiday affected the method of calculation of her entitlement to family credit: see appendix 1 below. The social security appeal tribunal was also required to consider the applicable legislation bearing in mind that the claimant's holiday was taken at about the time when regulation 17(b) was amended. The failure to consider it at all was an error of law.

25. For the above reasons, I set aside the decision of the appeal tribunal as erroneous in law.

The apportionment of motor expenses, telephone rental and gas and electricity standing charges between business and private use

26. Mr. Butt, in effect, adopted the directions set out in the Adjudication Officer's Guide, the relevant parts of which are set out in the third appendix. In his submission, the adjudicating authorities must not adopt the practice of the Inland Revenue in apportioning the motor costs of the licence, insurance, maintenance, and telephone rental and other standard charges. Any expense which had a dual purpose was not deductible. In support Mr. Butt referred to the following decisions on income tax matters: *Norman v. Golder* [1945] 1 All ER 352, *Bentley Stokes and Lawless v. Beeson* [1952] 2 Al (ER 82 at pages 84-5; *Bowden v. Russell* [1965] 2 All ER 258; *Murgatroyd v. Evans-Jackson* [1967] 1 All ER 881 at pages 882 and 887; *Edwards v. Warmsley* [1968] 1 All ER 1089; *Prince v. Mapp* [1970] 1 All ER 519; *Lucas v. Cattell* [1972] ATC 97; *Mallalieu v. Drummond* [1983] 2 AC 861 at pages 868 and 870F; and *MacKinlay v. Arthur Young & Co* [1990] AC 239. In his submission, any apportionment by the Revenue of telephone rental, gas and electricity standing charges, motor road tax, motor servicing maintenance and repair between business and private use is purely concessionary on the part of the Revenue and cannot be applied in the case of family credit.

27. Mr. Rowland, appearing as *amicus curiae,* did not support this submission. In his submission, apportionment is usually a matter of practice rather than concession. The Court had not approved of extra-statutory concessions: see *Vestey v. IRC* (No. 2) [1979] Ch 198 at pages 202-204. Lord Upjohn disapproved of them in *Bates v. IRC* [1968] AC 483 at page 516, but approved of apportionment in *IRC v. Korner* [1969] 1 WLR 554 at page 558. The strictness with which the words "wholly and exclusively" are construed depended on the statutory context: see *IRC v. Richards' Executors* [1971] 1 WLR 571. The use of familiar phrases by the draftsman of the social security legislation was intended to promote consistency in practice. Since those on low incomes might be expected to be more careful in their domestic expenditure than the general body of tax payers, the legislature was unlikely to have intended that the phrase should be applied more strictly in the context of social security than in the context of income tax.

28. In Mr. Rowland's submission it was the "expense" which must have been "wholly and exclusively" incurred or defrayed. It was common ground that one payment might cover a number of expenses. Thus the adjudication officer had

accepted apportionment of the call charges on the telephone bill as a way of estimating those "wholly, or exclusively" incurred for business purposes. The mere fact that a person derived a private advantage from expenditure does not mean that the expenditure was not exclusively for business purposes: see *Bentley, Stokes & Lawless v. Beeson supra.* It was the intention of the person incurring the expenditure which was relevant although that might not be the same as the person's conscious motive; see *Mallalieu v. Drummond supra* and *MacKinlay v. Arthur Young & Co supra.* Thus the whole of the expenditure might be deductible even though there was some private advantage. *Norman v. Golden, Murgatroyd v. Evans-Jackson* and *Prince v. Mapp* (medical expenses cases mentioned above) could all be distinguished on the ground that there was inevitably a personal object behind the expenditure; and this was also the case in *Bowden v. Russell* which might be contrasted with *Edwards v. Warmsley supra* where there was a personal advantage but the sole purpose of the expenditure was nonetheless for business.

29. The idea of apportionment to ascertain that part of a payment which might be regarded as wholly and exclusively incurred for business purposes had been approved by Templeman J in *Caillebotte v. Quinn* [1975] 1 WLR 731, where it was pointed out that some items could be apportioned on a time basis whereas a meal cannot be apportioned. Apportionment was not disapproved of by the Court of Appeal in *Newlin v. Woods* 45 ATC 29. In *Lucas v. Cattell* 5 ATC 97, Brightman J reserved the question whether apportionment of the rental charge in a telephone bill was permissible under the Income Tax Act 1952. Although the rental element of a telephone bill was charged in respect of a quarter, it accorded with common sense to apportion it between the calls made. It makes the telephone available for the whole quarter but use was made of the telephone only when a call was made. Similarly with repairs, insurance and tax on a car. It was desirable that there should be consistency between decisions of tax inspectors and R(FIS) 4/85 should be read in that light.

30. I agree with Mr. Rowland's submission and with his reasoning. In determining the net profit in a case where accounts have been produced in accordance with regulation 15(1)(b) of the Family Credit Regulations 1987, as amended with effect from December 5 1988, the net profit of the employment, both in the case of a self-employed earner (where para. (3A) of regulation 22 applies) or of a partnership (where para. 4(A) applies) subject to exceptions not relevant here, the calculation is made by taking into account the earnings of the employment relevant to the assessment period:

> "(whether or not received in that period) less ... any expenses relevant to that period (whether or not defrayed in that period) and which were wholly and exclusively incurred for the purposes of that employment."

So the calculation is made on an earnings basis. Compare section 74 of the Income and Corporation Taxes Act 1988 (consolidating earlier provisions in force when Family Credit was first introduced) which provides that subject to the provisions of the Tax Acts, in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of:

> "(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation."

The similarity of language in the regulations and in the corresponding income support regulation (regulation 38(3)(a) of the Income Support (General) Regulations 1987 which I have set out in the appendix to *Gallagher* to be reported as R(IS) 13/91) and in the wording used in the case of employed persons, which corresponds with section 198 of the above mentioned Taxes Act 1988, cannot be accidental. In determining whether expenses are wholly and exclusively incurred for the purposes of an employment of a self-employed person or partner or, in the case of an employed person wholly, exclusively and necessarily incurred in the performance of the duties of that employment, the income tax cases on that wording form a useful guide to the interpretation and practice of the regulations.

31. But the authorities cited by Mr. Butt do not assist him. It is not in doubt that expenses which are not wholly and exclusively incurred for the purposes of an employment of a self-employed person or partner cannot be deducted in ascertaining their net profit. The question in this case is whether those expenses which **are** wholly and exclusively incurred for the purposes of that employment can be ascertained by apportionment. The main, and at the first oral hearing the only, authority relied on by Mr. Butt (other than CIS/38/1989), where apportionment was not in issue at all for his contention that there could be no apportionment of the telephone, gas, electricity and motor expenses referred to in regulation 22 was *MacKinlay v. Arthur Young & Co supra*. No question of apportionment is mentioned anywhere in that case. The question did not arise. What was in issue was whether a partner's domestic removal expenditure incurred when the partner was required to move to work in another office could be said to be laid out not just partly but exclusively for the purposes of the partnership business. The House of Lords held that it makes not the slightest difference whether a partner incurs expenditure out of his own pocket and recovers it from the partnership or draws the money from the partnership in the first instance. In either case there is only one relevant expenditure and it is the purpose for which that outlay arose which had to be regarded. The payment of estate agent's fees, conveyancing costs and so on and the provisions of carpets and curtains could not but have been intended to serve the purpose of establishing a comfortable private home for the partner even though his motive was to assist him in establishing the partnership business. In *Mallalieu by Drummond supra,* where Miss Mallalieu claimed to deduct the cost of a black suit as expenses of a barrister her "restrained and sober garb inevitably served and cannot but have been intended to serve the purpose of preserving warmth and decency and her purpose in buying cannot but have been, in part at least, to serve that purpose": see page 255 letters G-H of the report in *MacKinlay's* case. The report in *Mallalieu's* case shows that no question of apportionment was ever raised.

32. Neither in *Norman v. Golder supra* (where a shorthand writer claimed medical expenses) nor in *Prince v. Mapp supra* (operation on finger of guitar player) was the question of apportionment of such expenses raised at all. In *Murgatroyd v. Evans-Jackson supra* a percentage of medical expenses was claimed on the basis that the claimant ran an office from the nursing home and 60% of his expenses were claimed. It was held that such a claim must fail on the basis that the expenses involved a dual purpose. The claimant could only receive all, or nothing. The expenses could not be for the purposes of the business alone. The whole object of going into the nursing home was to receive treatment for an injury. The claimant was entitled to nothing except an amount for telephone rent and calls, (which had been conceded by

the Inspector of Taxes). Neither *Bowden v. Russell* nor *Edwards v. Warmsley* related to apportionment. In the former case, the claimant failed in claiming to deduct the expenses of going to a conference in view of the admission that he was also taking a holiday. In *Edwards v. Warmsley* it was accepted on the facts, that the sole purpose of attending the conference was to assist the business and the claim succeeded. The case of *Bentley Stokes and Lawless* shows that, under the law as it stood in 1952, the whole cost of lunches for business purposes could be allowed even if there was an incidental private advantage. No question of apportionment arose in that case.

33. These authorities show that medical expenses, clothing expenses, conference expenses are not apportionable. It is all or nothing. It is the same with lunches. The cost of a lunch is not apportionable: see *Caillebotte v. Quinn supra* at page 734 letter H, per Templeman J (as he then was). In *Bentley Stokes and Lawless supra* the claimant obtained the whole costs for business purposes, namely the entertainment of clients. By contrast, *Caillebotte v. Quinn supra* the cost of lunches away from home of a self-employed carpenter was held not to be allowable at all. No question of entertainment was involved. It was all or nothing.

34. Contrast the well-established cases of time apportionment. For example, a bricklayer whose home was the base from where he carried on the business was apparently allowed a proportion of the cost of a study in *Horton v. Young* [1972] Ch 157, where the study was used partly for business and partly for leisure. Mr. Justice Templeman, commenting on that case, (p. 734 letter F) said:

> **"but it is possible to apportion the use and cost of a room on a time basis, and to allow the expense of the room during the hours in which it is used exclusively for business purposes, in the same way as it is possible to calculate the business expenses of a car which is sometimes used for business purposes exclusively and sometimes used for pleasure."** (my emphasis)

In my judgment, this passage is the key to the reason why apportionment is in practice regularly made by the Revenue of telephone rental (as in *Murgatroyd v. Evans-Jackson)* and why standing charges for equipment used for business and private use such as gas and electricity as well as motor expenses such as licence fees, insurance premiums, car maintenance charges can be apportioned. When a motor car is used for the delivery of goods and stock, or by a barrister travelling from one court to another, or a plumber to attend a leak, that car is being used wholly and exclusively for business purposes and **all** the expenses of using that car should be allowed. It is not suggested that the cost of the petrol cannot be apportioned; see the third appendix. But the petrol in a car tank, where the car is also used for private purposes will often be consumed during one period of time on business and at another for private use. Why then, one may ask, cannot the licence fee, insurance premiums, maintenance costs be similarly apportioned so that the cost attributable on a time basis? There is absolutely no justification for a different approach from that adopted by the Revenue on identical words. I agree with Mr. Rowland's submission that the practice of apportionment is not concessionary. It is simply a method of determining, on a time basis, what proportion of use is wholly and exclusively for business purposes.

35. It was not suggested by Mr. Butt that the claimant did not, for a considerable proportion of the time, use his motor car wholly and exclusively for the purposes of

his employment in terms of regulation 22 of the Family Credit Regulations; for he did not dispute that the cost of petrol is allowable, and the Adjudication Officer's Guide expressly states that it should be. Such cost can only be allowable for use wholly and exclusively for the purpose of his employment. The question of the proportion of such use is in my view a question of fact and can only be overturned by the Commissioner if the appeal tribunal have misdirected themselves; compare *Edwards v. Bairstow* [1956] AC 14 and *Bentley Stokes and Lowless v. Beeson* [1952] 2 All ER 82 at page 86 letter A. The question whether such expenses are apportionable at all is a question of law. If the adjudication officer had accepted that the disputed motor expenses were apportionable, I would have affirmed the actual apportionment on the basis that that was a question of fact on which the tribunal had adequate evidence on which to act and that they had not misdirected themselves. A professional chartered accountant had agreed the apportionment with the Inspector of Taxes. The tribunal could act on this as evidence, of the proportion of business and professional use cf. decision R(FIS) 4/85 at paragraph 9. Since, however, the tribunal's decision must be set aside as erroneous in law for the reasons given in paragraphs 23 and 24 above, I think that the adjudication officer should have an opportunity of considering whether there is any evidence to cast doubt on the 85% proportion of exclusive business motor use and 70% telephone use accepted by the Revenue. If that is none, those proportions should be accepted by the adjudication officer.

Lunches

36. The cost of lunches is not apportionable: see *Caillebotte v. Quinn supra.* Business entertainment is not a deductible expense: see regulation 22(5)(f) of the Family Credit (General) Regulations 1987. But they were allowed by the Inspector of Taxes and the claimant's accountant has stated that the cost of the lunches were taxable as benefits in kind against the agent or agents. Was it part of his remuneration and not entertainment at all? Further enquiries should be made by the adjudication officer. If the matter cannot be settled by agreement, it can be referred back to me.

Bad debts

37. It is the adjudication officer's contention that bad debts are not deductible at all, since there is no specific provision for them in the regulations. I disagree. The claimant gave evidence before me, that the debt of £42 in the accounts was incurred during the trading year. The claimant was, on her own undisputed account, in partnership with her husband who was a self-employed area sales manager of GWB (General Welfare of the Blind). The Board paid a commission to agents when stock was sold. If an agent absconded with stock, the claimant's husband was accountable to the Board for the stock. The agent in question absconded between April 1988 and April 1989 with stock for which he had signed and for which the claimant was accountable to the Board. The stock was for use for the purposes of the claimant's employment in the year in question. Its cost is accordingly a deductible expense.

Drawings

38. Such drawings as were not made from the current year's profits clearly came from capital. They appear as capital in the claimant's balance sheet, agreed with the Revenue and it is indeed obvious that they represent profits from previous years. Where there is a dispute as to whether a sum is capital or income, the established principles of commercial accounting should be followed unless they conflict with the

regulations, applying similar principles to those relating to income tax: see, for example *Odeon Associated Theatres v. Jones* [1973] Ch 288; *Beauchamp v. FW Woolworth Plc* [1990] AC 478 and Halsbury's Laws of England, 4th Edition volume 23 paragraph 294. (The Crown have accepted this as a basic principle of income tax law: see *MacKinlay's* case *supra* at page 241 letter F.) If the claimant had had capital exceeding £6,000 (now £8,000) at the time of claim, he would have been excluded from benefit altogether: see regulation 28 of the Family Credit (General) Regulations. If it exceeded £3,000 it would be tariff income: see regulation 36. If they were less than £3,000, his capital drawings are entirely irrelevant to the claimant's entitlement to, and the calculation of the amount of, his family credit.

Concluding remarks

39. The claimant's entitlement to family credit should now be recalculated by the adjudication officer in accordance with the principles set out in paragraph 1 above. All motor and telephone expenses should be apportioned (see paras. 26-35). The instructions to the contrary in the extract from the Adjudication Officer's Guide set out in the second appendix state the law differently. But the guide is inadmissible as an aid to construction: see decision R(SB) 28/84 and the authorities there cited. In so far as those instructions are inconsistent with this decision, they should not be followed by the adjudication officer. Failing further evidence, the drawings shown in the accounts do not enter into the computation as "other income" (see para. 38). The bad debt of £42 is to be allowed in computing net profit, failing further evidence (see para. 37). The expense of lunches is to be disallowed unless the claimant shows they were not given by way of business entertainment (paras. 33 and 36). In the absence of further evidence, the adjudication officer can rely on the apportionment accepted by HM Inspector of Taxes (para. 35). *Prima facie*, the drawings shown on capital account are irrelevant to the computation. The length of the assessment period is to be determined in accordance with the directions in paragraph 24 and the first appendix.

40. Mr. Butt and Mr. Rowland made submissions as to the effect of my decision on subsequent claims or requests for review. Paragraph 7 of Schedule 6 of the Social Security Act 1990 apparently applies, since I have decided that the decision of the appeal tribunal was erroneous in law. I have come to the conclusion that that Act ought not to alter, or affect, the form of my decision in any way. Accordingly, it is not necessary to express any opinion as to its effect and I do not do so.

Date: 17 January 1991

(signed) Mr. V. G. H. Hallett
Commissioner

APPENDIX 1 (see paras. 1(8), 24 and 39)

Effect of a holiday where regulation 17(b) applies

1. Regulation 17(b) of the Family Credit (General) Regulations 1987 applies where accounts are produced pursuant to regulation 15(b). The regulation was amended and the relevant amendment came into force on 12 September 1988. For its wording see the third appendix to this decision. The law to be applied is that from time to time in force during the holiday.

2. Under the old law, any "period" covered by the regulation was directed to be left out of the assessment period. Its practical effect was to reduce the figure by which the claimant's earnings for the assessment period were to be divided for the purpose of ascertaining his normal weekly earnings. If, for example, a claimant's earnings over the relevant 52 weeks were £5,200 and he took a two weeks holiday during that period, the divisor would be 50, not 52. But the sum for earnings over the 50 week period would be same as that for earnings over the 52 week period, since the claimant would not have been earning when he was carrying on no activities in his business. In this form if a holiday were taken for a period of more, or less, than an exact number of weeks, the divisor would not be a whole number. For example, the divisor in the case of a holiday (during which no activities were undertaken) of one week and four days would be 50 and 3/7ths.

3. Under the new law, any "week or periods of weeks" covered by the regulation is directed to be left out of the assessment period. "Week" is defined in regulation 2(1) as "a period of seven days beginning with midnight between Saturday and Sunday". The effect of this amendment is that the divisor to be applied when ascertaining a claimant's normal weekly earnings will always be a whole number. Days not included in a complete week, as above defined, are not taken into account. (There is no ground for contending that the definition does not apply, because the "context otherwise requires".)

4. The regulation covers holidays, but only where no activities are carried on for the purposes of "the business". In the case of a partnership, "business" refers to the employment carried on in partnership by the claimant and her husband.

5. Accordingly, the adjudication officer should in the present case:

(1) ascertain the dates when the two weeks holiday began and ended;

(2) if it ended before 12 September 1988, apply the old law. If it began on or after 12 September 1988, apply the new law. If it straddled the period, apply the old law to the period before 12 September 1988 and the new law on and after that date;

(3) if the holiday was taken before 12 September 1988, divide by the appropriate fraction of the assessment period after excluding the period during which the holiday was taken and there were no business activities carried on by either partner;

(4) if the holiday (during which there were no business activities) was taken after 12 September 1988 the divisor for calculating weekly earnings will be 50 *if, and only if,* the holiday covered two full seven day periods calculated

from midnight between Saturday and Sunday. If there is only one such period, the divisor will be 51.

APPENDIX 2 (see para. 5)

Extracts from the Adjudication Officer's Guide

Meaning of "wholly and exclusively"

41101 With the exception of self-employed child minders (to whom special rules apply - AOG 41084), only those expenses wholly and exclusively defrayed for the purpose of the employment [FC (Gen) regs. 22(3)(a) & (4)] may be allowed as a deduction against the gross receipts (AOG 41093) of the business. This means that the expense has been incurred only because of the demands of the business. [R(FIS) 4/85]

41102 In many small businesses it is not unusual for an item of expense to cover both business and private uses, particularly when the business is run from the claimant's home or there is only one vehicle which is used for both business and private purposes.

41103 In such a case it is only the portion of the expense attributable wholly and exclusively to the business which may be allowed as a deduction. The claimant's statement to that effect should normally be accepted unless there is evidence to suggest otherwise, such as the size and nature of the business or information held on a previous claim. Deductions should only be made for charges **capable** of apportionment. This will apply in particular to -

1. telephone calls, but **not** the rental unless there is separate equipment used only by the business

2. units of electricity or gas consumed, but **not** the standing charge

3. the cost of petrol or diesel fuel for vehicles, but **not** road tax, insurance, servicing, maintenance or repairs.

.....

Examples

1. Lighting and heating consumption costs were apportioned 80/20 between business and domestic use. If the business was run from one room of the home and information in the papers showed that there were five main rooms in that property (three bedrooms, lounge and dining room), the AO would be justified in questioning how the apportionment was made. The AO may wish to consider the number of hours worked, the nature of the work, the appliances used, and previous fuel bills. The standing charge cannot be apportioned and should not be allowed as a deduction even though the account might be in the name of the business.

2. The cost of petrol for a car was apportioned 90/10 in favour of the business, because of the claimant's statement to this effect. No deduction was allowed for insurance, road tax or other running costs not capable of being apportioned between business and domestic use.

APPENDIX 3 (see para. 10)

Relevant Legislation

Social Security Act 1986

Subsections (1) and (6) of section 20 provide:

> **Income-related benefits**
>
> 20. - (1) Prescribed schemes shall provide for the following benefits (in this Act referred to as income-related benefits) -
>
> (a) income support;
>
> (b) family credit; and
>
> (c) housing benefit
>
> .....
>
> (6) Family credit shall be payable for a period of 26 weeks or such other period as may be prescribed [...] and, subject to regulations, an award of family credit and the rate at which it is payable shall not be affected by any change of circumstances during that period

Subsection (5) of section 22 provides:

> (5) Where a person claiming an income-related benefit is a member of a family, the income and capital of any member of that family shall, except in prescribed circumstances, be treated as the income and capital of that person.

The Family Credit (General) Regulations 1987 as amended and in force at the date of claim (20 April 1989)

Regulation 2(1) provides:

> **Interpretation**
>
> 2.- (1) In these Regulations, unless the context otherwise requires -
>
> "week" means a period of seven days beginning with midnight between Saturday and Sunday;
>
> "week of claim" means the week which includes the date of claim;

Paragraph (1) of regulation 15 provides:

> **Normal weekly earnings of self-employed earners**
>
> 15.- (1) Subject to regulation 17 (periods to be disregarded), where a claimant's income consists of earnings from employment as a self-employed earner, his normal weekly earnings shall be determined, subject to paragraph (2), by reference to his weekly earnings from that employment -
>
> (a) except where sub-paragraph (b) applies, over a period of 25 weeks immediately preceding the week in which the date of claim falls; or

(b) where the claimant provides in respect of the employment a profit and loss account and, where appropriate, a trading account or a balance sheet or both, and the profit and loss account is in respect of a period of at least six months but not exceeding 15 months and that period terminates within the 12 months preceding the date of claim, over that period; or

(c) over such other period of weeks preceding the week in which the date of claim falls as may, in any particular case, enable his normal weekly earnings to be determined more accurately.

(1A) In paragraph (1)(b) -

(a) "balance sheet" means a statement of the financial position of the employment disclosing its assets, liabilities and capital at the end of the period in question;

(b) "profit and loss account" means a financial statement showing the net profit or loss of the employment for the period in question; and

(c) "trading account" means a financial statement showing the revenue from sales, the cost of those sales and the gross profit arising during the period in question.

Regulation 17, so far as relevant, provides:

Periods to be disregarded

17. For the purposes of ascertaining a claimant's normal weekly earnings there shall be disregarded -

(a) ....

(b) in the case of a self-employed earner, any week or period of weeks in the assessment period during which no activities have been carried out for the purposes of the business,

and his normal weekly earnings shall be determined by reference to his weekly earnings in the remainder of that period and in such a case and reference in these Regulations to a claimant's assessment period shall be construed as a reference to the latter period.

Note: In regulation 17(b), the words "any week or period of weeks" were substituted for "any period" by SI 1988 No. 1438, reg. 3, which came into force on 12 September 1988.

Regulation 21(1) provides:

Earnings of self-employed earners

21.- (1) Subject to paragraph (2), "earnings", in the case of employment as a self-employed earner, means the gross receipt of the employment and shall include any allowance paid under section 2 of the Employment and Training Act 1973 to the claimant for the purpose of assisting him in carrying on his business unless at the date of claim the allowance has been terminated.

Note: regulation 21(2) is not relevant to this appeal

Regulations 22, 24 and 36 respectively provide:

Calculation of net profit of self-employed earners

22.- (1) For the purposes of regulation 15 (normal weekly earnings of self-employed earners), the earnings of a claimant to be taken into account shall be -

(a) in the case of a self-employed earner who is engaged in employment on his own account the net profit derived from that employment;

(b) in the case of a self-employed earner whose employment is carried on in partnership or is that of a share fisherman within the meaning of the Social Security (Mariners' Benefits) Regulations 1975, his share of the net profit derived from that employment less -

(i) an amount in respect of income tax and social security contributions payable under the Social Security Act calculated in accordance with regulation 23 (deduction of tax and contributions for self-employed earners); and

(ii) one-half of any qualifying premium payable.

(2) There shall be disregarded from a claimant's net profit any sum, where applicable, specified in Schedule 1.

(3) For the purposes of paragraph (1)(a) the net profit of the employment shall, except where paragraph (3A), (9) or (10) applies, be calculated by taking into account the earnings of the employment received in the assessment period, less -

(a) subject to paragraphs (5) to (7), any expenses wholly and exclusively defrayed in that period for the purposes of that employment;

(b) an amount in respect of -

(i) income tax; and

(ii) social security contributions payable under the Social Security Act, calculated in accordance with regulation 23 (deduction of tax and contributions for self-employed earners); and

(c) one-half of any qualifying premium payable.

(3A) For the purposes of paragraph (1)(a), in a case where the assessment period is determined under regulation 15(1)(b), the net profit of the employment shall, except where paragraph (9) applies, be calculated by taking into account the earnings of the employment relevant to that period (whether or not received in that period), less -

(a) subject to paragraphs (5) to (7), any expenses relevant to that period (whether or not defrayed in that period) and which were wholly and exclusively incurred for the purposes of that employment;

(b) any amount in respect of -

(i) income tax; and

(ii) social security contributions payable under the Social Security Act, calculated in accordance with regulation 23; and

(c) one-half of any qualifying premium payable.

(4) For the purposes of paragraph (1)(b) the net profit of the employment shall, except where (4A), (9) or (10) applies, be calculated by taking into account the earnings of the employment received in the assessment period less, subject to paragraphs (5) to (7), any expenses wholly and exclusively defrayed in that period for the purposes of that employment.

(4A) For the purposes of paragraph (1)(b), in a case where the assessment period is determined under regulation 15(1)(b), the net profit of the employment shall, except where paragraph (9) applies, be calculated by taking into account the earnings of the employment relevant to that period (whether or not received in that period) less, subject to paragraph (5) to (7), any expenses relevant to that period (whether or not defrayed in that period) and which were wholly and exclusively incurred for the purposes of that employment.

(5) Subject to paragraph (6), no deduction shall be made under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, in respect of -

(a) any capital expenditure;

(b) the depreciation of any capital asset;

(c) any sum employed, or intended to be employed, in the setting up or expansion of the employment;

(d) any loss incurred before the beginning of the assessment period;

(e) the repayment of capital on any loan taken out for the purposes of the employment;

(f) any expenses incurred in providing business entertainment.

(6) A deduction shall be made under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, in respect of the repayment of capital on any loan used for -

(a) the replacement in the course of business of equipment or machinery; and

(b) the repair of an existing business asset except to the extent that any sum is payable under an insurance policy for its repair.

(7) An adjudication officer shall refuse to make a deduction in respect of any expenses under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, where he is not satisfied that the expense has been defrayed or given the nature and the amount of the expense that it has been reasonably incurred.

(8) For the avoidance of doubt -

(a) a deduction shall not be made under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, in respect of any sum unless it has been expended for the purposes of the business;

(b) a deduction shall be made thereunder in respect of -

(i) the excess of any VAT paid over VAT received in the assessment period;

(ii) any income expenses in the repair of an existing business asset except to the extent that any sum is payable under an insurance policy for its repair;

(iii) any payment of interest on a loan taken out for the purposes of the employment.

(9) Where a claimant is engaged in employment as a child minder the net profit of the employment to be taken into account shall be one-third of the earnings of that employment, less -

(a) (i) income tax; and

(ii) social security contributions payable under the Social Security Act,

calculated in accordance with regulation 23 (deduction of tax and contributions for self-employed earners); and

(b) one-half of any qualifying premium payable.

(10) Where regulation 15(2) (normal weekly earnings of self-employed earners) applies -

(a) for the purposes of paragraph (1)(a), the net profit derived from the employment shall be calculated by taking into account the claimant's estimated and, where appropriate, actual earnings from the employment less the amount of the deductions likely to be made and, where appropriate, made under subparagraphs (a) to (c) of paragraph (3); or

(b) for the purposes of paragraph (1)(b), his share of the net profit of the employment shall be calculated by taking into account the claimant's estimated and, where appropriate, his share of the actual earnings from the employment less the amount of his share of the expenses likely to be deducted and, where appropriate, deducted under paragraph (4); or

(c) in the case of employment as a child-minder, the net profit of the employment shall be calculated by taking into account one third of the claimant's estimated earnings and, where

appropriate, actual earnings from the employment less the amount of the deductions likely to be made and, where appropriate, made under sub-paragraphs (a) and (b) of paragraph (9).

(11) For the avoidance of doubt where a claimant is engaged in employment as a self-employed earner and he is also engaged in one or more other employments as a self-employed or employed earner any loss incurred in any one of his employments shall not be offset again: his earnings in any other of his employments.

(12) In this regulation "qualfiying premium" means any premium or other consideration payable under an annuity contract for the time being approved by the Board of Inland Revenue as having for its **main** object the provision for the claimant of a life annuity in old age or the provision of an annuity for his partner or for any one or more of his dependants and in respect of which relief from income tax may be given .

.....

OTHER INCOME

Calculation of income other than earnings

24.- (1) For the purposes of regulation 16 (normal weekly income other than earnings), the income of a claimant which does not consist of earnings to be taken into account shall, subject to paragraphs (2) to (4) be his gross income and any capital treated as income under regulation 25 (capital treated as income).

(2) There shall be disregarded from the calculation of a claimant's gross income under paragraph (1), any sum, where applicable, specified in Schedule 2.

(3) [...]

(4) Where the payment of any benefit under the Benefit Act is subject to any deduction by way of recovery the amount to be taken into account under paragraph (1) shall be the gross amount payable.

(5) For the avoidance of doubt there shall be included as income to be taken into account under paragraph (1) any payment to which regulation 19(2) applies (payments not earnings).

.....

Calculation of tariff income from capital

36.- (1) Where the claimant's capital calculated in accordance with this Chapter exceeds £3,000, it shall be treated as equivalent to a weekly income of £1 for each complete £250 in excess of £3,000 but not exceeding [£8,000].

(2) Notwithstanding paragraph (1), where any part of the excess is not a complete £250 that part shall be treated as equivalent to a weekly income of £1.

(3) For the purposes of paragraph (1), capital includes any income treated as capital under regulation 31 (income treated as capital).

APPENDIX 4 (see para. 12)

Mr. & Mrs. M. Bulman, _____

TRADING & PROFIT & LOSS ACCOUNT for year end 31 March 1988

Commission receivable (Net of VAT)		£49,647
LESS EXPENSES:		
Agents commission	38,833	
Agents lunches	111	
Motor expenses	4,334	
Parking & tolls	50	
Telephone	547	
Stationery & adverts	642	
Carriage	792	
Stall rent & exhibition exp's.	139	
Bookkeeping & accounts	201	
Bad debts written off	42	
Bank loan interest & charges	668	
Depreciation less gain on sale	265	46,624
		£ 3,023

BALANCE SHEET as at 31 MARCH 1989

Vehicles, fixtures and fittings (per schedule)			1,850
CURRENT ASSETS:			
Debtors (less provision for bad debt)		4,857	
Cash float		50	
Deposit at Building Soc'y.		1,317	
		£6,224	
LESS LIABILITIES:			
Bank loan account	2,135		
Bank Current account	1,418		
Sundry creditors	2,187	£5,740	
EXCESS OF CURRENT ASSETS OVER LIABILITIES			484
Net CAPITAL EMPLOYED			£ 2,334
(represented by) CAPITAL ACCOUNT			
Balance b/f.			4,970
Building Soc'y. Int.			82
Profit on trading			3,023
			£ 8,075
LESS: Drawings			5,741
			£2,334

ACCOUNTS CERTIFICATE: I have prepared the above accounts from the books of account, Information & explanations given to me and certify that they are in accordance there with.

J.N. . . . . F.C.A.
(chartered accountant)