[2019] AACR 1

(SH v Secretary of State for Work and Pensions, CH and the Commissioners for Her Majesty's Revenue and Customs [2018] UKUT 157(AAC))

Judge Jacobs **CCS/1384/2017**
3 May 2018

Child Support Maintenance Calculation Regulations 2012 – Regulation 36 – Calculation of non-resident parent gross income

The case concerned the reimbursement by the non-resident parent's employer of expenses in respect of fuel. The appellant reported these payments to Her Majesty's Revenue and Customs (HMRC) and was not taxed on them. The Secretary of State, however, disregarded them, relying on regulation 36(2)(b). The appellant appealed to the First-tier Tribunal (F-tT). The F-tT judge felt obliged to apply regulation 36(2)(b). The appellant appealed to the Upper Tribunal (UT). The issue for the UT was: which has priority, the revenue approach or regulation 36(2)(b)?

Held, allowing the appeal, that:

1. it is not rational to base a calculation of liability on an amount that (i) by definition the non-resident parent does not have available as it has been expended for the benefit of the employer and (ii) will not be uniform in its effect as between parents, in contrast to say the rate of income tax or national insurance. Gross income will vary from parent to parent and that is reflected in the calculation, but beyond that the calculation does not descent into detail about the make-up of the income. It proceeds, no doubt, on policy assumptions about the amount that should be available to the parent after legal liabilities for tax and national insurance have been met. I can see no rational reason for taking account of this type of income that by its nature is not available to the parent (paragraph 28);

2. it is apparent from the terms and structure of regulation 36 that it is designed to make the administration less complex than it would be if the Secretary of State's decision-makers had to make their own calculations of income, and to do so by relying on the information gathered by HMRC. That suggests a degree of coherence between the income used by both Departments (paragraph 29);

3. regulation 36 is internally contradictory as between paragraphs (1) and (2)(b). I can find no way to reconcile the contradiction. The only way to remove it is to decide which has priority. In the overall structure, it is appropriate that paragraph (1) has priority. That leaves paragraph (2)(b) as redundant. The Secretary of State will now have to decide whether any amendment to the regulation and any change to the arrangements with HMRC are required (paragraph 31).

The judge set aside the decision of the F-tT and referred the case to the Secretary of State for the non-resident parent's gross income to be recalculated.

DECISION OF THE UPPER TRIBUNAL
(ADMINISTRATIVE APPEALS CHAMBER)

As the decision of the First-tier Tribunal (made at Southampton on 9 February 2017 under reference SC303/16/00226) involved the making of an error in point of law, it is SET ASIDE under section 12(2)(a) and (b)(ii) of the Tribunals, Courts and Enforcement Act 2007 and the decision is RE-MADE.

The decision is: the non-resident parent's gross income from and including the effective date of 8 November 2015 is to be calculated without regard to regulation 36(2)(b) of the Child Support Maintenance Calculation Regulations 2012.

REASONS FOR DECISION

1. My approach to the interpretation of legislation is to try to make it rational, coherent and workable. All three factors arise in this case, which concerns regulation 36 of the Child Support Maintenance Calculation Regulations 2012 (SI No 2677).

A. The issue and how it arises

2. The problem that arises is this. Regulation 36(1) and (2)(b) provide that the non-resident parent's income for child support purposes is the amount on which he was 'charged to tax' under the income tax legislation but that the amount is taken before any deductions are made for expenses. However, under the income tax legislation, deductions for expenses are made before the amount charged to tax is fixed.

3. The particular problem in this appeal concerns the reimbursement by the non-resident parent's employer of expenses in respect of fuel. He reported these payments to Her Majesty's Revenue and Customs and was not taxed on them. The decision-maker, however, disregarded them, relying on regulation 36(2)(b). The judge felt obliged to apply that provision, but gave permission to appeal to the Upper Tribunal. Which has priority: the revenue approach or regulation 36(2)(b)?

4. Unusually, the Commissioners for Her Majesty's Revenue and Customs were joined as parties to the appeal, so the Upper Tribunal has had the benefit of submissions from them (through Galena Ward of counsel) as well as from the Secretary of State. I am also grateful to Evelyn Weightman of Her Majesty's Revenue and Customs who has provided a detailed witness statement with extensive exhibits that show how regulation 36 is operated from the Revenue side and how it was applied in this case. The parent with care has not taken any part.

B. The child support legislation

5. The calculation of a non-resident parent's child support liability is based on gross income. Regulation 34 provides:

> **34 The general rule for determining gross weekly income**
>
> (1) The gross weekly income of a non-resident parent for the purposes of a calculation decision is a weekly amount determined at the effective date of the decision on the basis of either historic income or current income in accordance with this Chapter.

This case concerns historic income; the judge said in his grant of permission to appeal that 'This was not a case in which the use of current as opposed to historic income would have assisted the appellant.'

6. Regulation 35 provides for historic income to be calculated by reference to the figure supplied by Her Majesty's Revenue and Customs. Regulation 36 deals with that figure:

> **36 Historic income – the HMRC figure**
>
> (1) The HMRC figure is the amount identified by HMRC from information provided in a self-assessment return or under the PAYE regulations, as the sum of the income on which the non-resident parent was charged to tax for the latest available tax year—
>
> (a) under Part 2 of ITEPA (employment income);
>
> (b) under Part 9 of ITEPA (pension income);
>
> (c) under Part 10 of ITEPA (social security income) but only in so far as that income comprises the following taxable UK benefits listed in Table A in Chapter 3 of that Part—
>
> (i) incapacity benefit;
>
> (ii) contributory employment and support allowance;
>
> (iii) jobseeker's allowance; and
>
> (iv) income support; and
>
> (d) under Part 2 of ITTOIA (trading income).
>
> (2) The amount identified as income for the purposes of paragraph (1)(a) is to be taken—
>
> (a) after any deduction for relievable pension contributions made by the non-resident parent's employer in accordance with net pay arrangements; and
>
> (b) before any deductions under Part 5 of ITEPA (deductions allowed from earnings).
>
> (3) The amount identified as income for the purposes of paragraph (1)(b) is not to include a UK social security pension.
>
> (4) The amount identified as income for the purposes of paragraph (1)(d) is to be taken after deduction of any relief under section 83 of the Income Tax Act 2007 (carry forward trade loss relief against trade profits).
>
> (5) Where, for the latest available tax year, HMRC has both information provided in a self-assessment return and information provided under the PAYE Regulations, the amount identified for the purposes of paragraph (1) is to be taken from the former.

ITEPA means the Income Tax (Earnings and Pensions) Act 2003: see regulation 2.

C. The relevant provisions of ITEPA

Part 2 of ITEPA

7. Section 6 provides for the charge to tax on employment income:

> **6 Nature of charge to tax on employment income**
>
> (1) The charge to tax on employment income under this Part is a charge to tax on—

(a) general earnings, and

(b) specific employment income.

The meaning of 'employment income', 'general earnings' and 'specific employment income' is given in section 7.

(2) The amount of general earnings or specific employment income which is charged to tax in a particular tax year is set out in section 9.

8. Section 9 provides for the amount on which tax is charged to be the net taxable earnings:

9 Amount of employment income charged to tax

(1) The amount of employment income which is charged to tax under this Part for a particular tax year is as follows.

(2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year.

(3) That amount is calculated under section 11 by reference to any taxable earnings from the employment in the year (see section 10(2)).

9. Section 11 provides for the calculation of net taxable earnings:

11 Calculation of 'net taxable earnings'

(1) For the purposes of this Part the 'net taxable earnings' from an employment in a tax year are given by the formula—

TE − DE

where—

TE means the total amount of any taxable earnings from the employment in the tax year, and

DE means the total amount of any deductions allowed from those earnings under provisions listed in section 327(3) to (5) (deductions from earnings: general).

(2) If the amount calculated under subsection (1) is negative, the net taxable earnings from the employment in the year are to be taken to be nil instead.

Part 3 of ITEPA

10. Part 3 deals with earnings. The effect of sections 70 to 72 is that amounts paid in respect of expenses are treated as earnings:

70 Sums in respect of expenses

(1) This Chapter applies to a sum paid to an employee in a tax year if the sum—

(a) is paid to the employee in respect of expenses, and

(b) is so paid by reason of the employment.

(2) This Chapter applies to a sum paid away by an employee in a tax year if the sum—

(a) was put at the employee's disposal in respect of expenses,

(b) was so put by reason of the employment, and

(c) is paid away by the employee in respect of expenses.

(3) For the purposes of this Chapter it does not matter whether the employment is held at the time when the sum is paid or paid away so long as it is held at some point in the tax year in which the sum is paid or paid away.

(4) References in this Chapter to an employee accordingly include a prospective or former employee.

(5) This Chapter does not apply to the extent that the sum constitutes earnings from the employment by virtue of any other provision.

71 Meaning of paid or put at disposal by reason of the employment

(1) If an employer pays a sum in respect of expenses to an employee it is to be treated as paid by reason of the employment unless—

(a) the employer is an individual, and

(b) the payment is made in the normal course of the employer's domestic, family or personal relationships.

(2) If an employer puts a sum at an employee's disposal in respect of expenses it is to be treated as put at the employee's disposal by reason of the employment unless—

(a) the employer is an individual, and

(b) the sum is put at the employee's disposal in the normal course of the employer's domestic, family or personal relationships.

72 Sums in respect of expenses treated as earnings

(1) If this Chapter applies to a sum, the sum is to be treated as earnings from the employment for the tax year in which it is paid or paid away.

(2) Subsection (1) does not prevent the making of a deduction allowed under any of the provisions listed in subsection (3).

(3) The provisions are—

section 336 (deductions for expenses: the general rule);
section 337 (travel in performance of duties); …

Part 5 of ITEPA

11. The definition of DE in section 11(1) refers to section 327, which is in Part 5:

327 Deductions from earnings: general

(1) This Part provides for deductions that are allowed from the taxable earnings from an employment in a tax year in calculating the net taxable earnings from the employment in the tax year for the purposes of Part 2 (see section 11(1)).

(2) In this Part, unless otherwise indicated by the context—

(a) references to the earnings from which deductions are allowed are references to the taxable earnings mentioned in subsection (1), and

(b) references to the tax year are references to the tax year mentioned there.

(3) The deductions for which this Part provides are those allowed under—

Chapter 2 (deductions for employee's expenses),
Chapter 3 (deductions from benefits code earnings),
Chapter 4 (fixed allowances for employee's expenses),
Chapter 5 (deductions for earnings representing benefits or reimbursed expenses), and
Chapter 6 (deductions from seafarers' earnings).

(4) Further provision about deductions from earnings is made in—

section 232 (giving effect to mileage allowance relief), and
section 262 of CAA 2001 (capital allowances to be given effect by treating them as deductions from earnings).

(5) Further provision about deductions from income including earnings is made in—

Part 12 (payroll giving), and
sections 188 to 194 of FA 2004 (contributions to registered pension schemes).

12. Other relevant sections in Part 5 are:

330 Prevention of double deductions

(1) A deduction from earnings under this Part is not allowed more than once in respect of the same costs or expenses.

333 Scope of this Chapter: expenses paid by the employee

(1) A deduction from a person's earnings for an amount is allowed under the following provisions of this Chapter only if the amount—

(a) is paid by the person, or

(b) is paid on the person's behalf by someone else and is included in the earnings.

(2) In the following provisions of this Chapter, in relation to a deduction from a person's earnings, references to the person paying an amount include references to the amount being paid on the person's behalf by someone else if or to the extent that the amount is included in the earnings.

334 Effect of reimbursement etc.

(1) For the purposes of this Chapter, a person may be regarded as paying an amount despite—

(a) its reimbursement, or

(b) any other payment from another person in respect of the amount.

(2) But where a reimbursement or such other payment is made in respect of an amount, a deduction for the amount is allowed under the following provisions of this Chapter only if or to the extent that—

(a) the reimbursement, or

(b) so much of the other payment as relates to the amount,

is included in the person's earnings.

> **336 Deductions for expenses: the general rule**
>
> (1) The general rule is that a deduction from earnings is allowed for an amount if—
>
> (a) the employee is obliged to incur and pay it as holder of the employment, and
>
> (b) the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.
>
> (2) The following provisions of this Chapter contain additional rules allowing deductions for particular kinds of expenses and rules preventing particular kinds of deductions.
>
> (3) No deduction is allowed under this section for an amount that is deductible under sections 337 to 342 (travel expenses).
>
> **337 Travel in performance of duties**
>
> (1) A deduction from earnings is allowed for travel expenses if—
>
> (a) the employee is obliged to incur and pay them as holder of the employment, and
>
> (b) the expenses are necessarily incurred on travelling in the performance of the duties of the employment.
>
> (2) This section needs to be read with section 359 (disallowance of travel expenses: mileage allowances and reliefs).

D. AR v Secretary of State for Work and Pensions and LR [2017] AACR 23

13. This is a decision of Upper Tribunal Judge Wikeley, in which he gave detailed reasons explaining why he had accepted a concession by the Secretary of State that he set out at [29]:

> For the avoidance of doubt, the Secretary of State's position is that where a person receives a sum of money on account of expenses which they can deduct from as the expenses arise, this would be income charged to tax within the meaning of regulation 36 of the Regulations, and the figure the Secretary of State would use to calculate maintenance would include this figure. However, the Secretary of State now concedes that in situations such as that of the Appellant, where the individual incurred expenses for which he has been reimbursed, so in effect he had not actually received any income or any sort of benefit in kind, these expenses would not be 'income on which the non-resident parent was charged to tax' (ie within regulation 36(1) of the CSMC Regulations 2012).

14. The facts of the case are sparse. They emerge only from the terms of the concession just quoted, which suggest that the non-resident parent was reimbursed expenses that he had incurred, and the judge's direction to the Secretary of State, which refers to the non-resident parent incurring expenses that were reimbursed after the event. That is all. There is nothing to show why the Secretary of State's representative referred to and distinguished sums paid on account.

15. The judge gave three reasons for accepting the Secretary of State's concession:

> 33. First, the Secretary of State's original position on Issue B and as had been set out in his first submission failed to have proper regard to both the full drafting and wider context of regulation 36 of the CSMC Regulations 2012. …

39. In a nutshell, revenue law deems payments of expenses to be part of an employee's earnings for income tax purposes, only to deduct allowable expenses before arriving at the amount of earnings which are 'charged to tax'. While regulation 36(2)(b) stipulates that a non-resident parent's ITEPA Part 2 employment income is to be assessed *before* allowable deductions under Part 5, that individual's historic income as identified by HMRC is the sum of the various income sources which is actually 'charged to tax'. The expenses payments here were not charged to tax and so did not form part of the father's historic income.

40. The second reason why I accept the concession as contained in the Secretary of State's second submission in these proceedings is that it is consistent with principles that are well established in the older revenue case law. In *Owen v Pook (Inspector of Taxes)* [1970] AC 244 the majority of the House of Lords held that, on the basis that a travelling allowance paid by an employer was a reimbursement for actual expenditure incurred, it was not an emolument of the taxpayer's office or employment and so did not fall to be charged to tax. Lord Pearce, in the majority, concluded his opinion in the following terms (at 259B):

> The reimbursements of actual expenses are clearly not intended by 'salaries', 'fees', 'wages' or 'profits.' It is contended that they are 'perquisites.' The normal meaning of the word denotes something that benefits a man by going 'into his *own* pocket.' It would be a wholly misleading description of an office to say that it had very large perquisites merely because the holder had to disburse very large sums out of his own pocket and subsequently received a reimbursement or partial reimbursement of these sums. If a school teacher takes children out for a school treat, paying for them out of his (or her) own pocket, and is later wholly or partially reimbursed by the school, nobody would describe him (or her) as enjoying a perquisite. In my view, perquisite has a known normal meaning, namely, a personal advantage, which would not apply to a mere reimbursement of necessary disbursements. There is nothing in the section to give it a different meaning. Indeed, the other words of the section confirm the view that some element of personal profit is intended.

41. Lord Pearson dissented as to the outcome of that appeal, holding that the reimbursement or car allowance was a benefit to the taxpayer and a perquisite, profit or emolument of the employment. However, his Lordship also added (at 266X) that:

> There is a quite different position when the employee incurs an expense in performing the duties of his employment – eg making a journey from head office to branch office and back to head office, or buying stamps and stationery for the firm – and has it reimbursed to him. In such a transaction there is no benefit – no profit or gain – to the employee. He does not receive any emolument.

42. Finally, I also observe – although I need not rely on this for the purposes of my decision – that the construction of regulation 36 adopted here is entirely consistent with the policy intention of the legislation, as acknowledged in the Secretary of State's second submission. This can also be seen in the paper issued by the Child Maintenance Enforcement Commission entitled *The Child Support Maintenance Calculation Regulations 2012: A technical consultation on the draft regulations*, which envisaged a non-resident parent's taxable income for the purposes of a child support calculation as

> including 'an employee's *taxable* expenses payments and benefits in kind' (emphasis added, Annex C, page 36, paragraph 13.2).
>
> 43. For the avoidance of doubt, I am satisfied that there is nothing in Judge Jacobs's decision in *FQ v Secretary of State and MM* [reported as [2017] AACR 24] which casts doubt on the above analysis. There is no direct analogy between the reimbursement of legitimate work-related expenses and the role of the personal allowance in the calculation of an individual's income as 'charged to tax'. …

E. The Commissioners' submissions on expenses and *AR*

16. The Secretary of State's submissions mainly relate to directions given before the Commissioners were joined as parties. Ms Ward, on behalf of the Commissioners, has explained the approach taken by Her Majesty's Revenue and Customs, which is to comply with regulation 36(2)(b). That was why there had been no deduction for the non-resident parent's fuel expenses in this case.

17. On Judge Wikeley's decision in *AR*, Ms Ward took no position on whether it was right, but she submitted:

> HMRC is now conscious that the decision in *AR* was accepted by the Secretary of State to be consistent with the policy intention behind the regulations. It is not however clear at present what if any function regulation 36(2)(b) is intended to perform on that analysis, as all deductions for allowance expenses under Part 5 of ITEPA are made before arriving at the figure that is charged to tax. HMRC would welcome clarification from the Tribunal on this issue.

F. The Secretary of State's concession in *AR*

18. This concession was in two parts. It seemed to me to draw a distinction between non-resident parents who meet expenses out of their wages and those who are provided with a float or payment on account by their employer from which they can draw as required. Ms Ward has submitted that the position under ITEPA is the same in each case. Drawing such a distinction would, in any event, cause administrative problems as the self-assessment return does not disclose the information necessary to draw this distinction. It may be that I have misunderstood what the Secretary of State's representative meant by the concession.

19. My understanding of the tax position is this.

20. Assume that the employee is paid wages of £X. They are earnings and charged to tax under section 6, but only to the extent that they are part of net taxable earnings under section 11. The employee has to pay part of those wages to meet expenses of £Y. Those expenses, if they meet the statutory conditions, are deductions under Part 5. As such they are disregarded in calculating net taxable earnings under section 11. If that is all, the employee is charged to tax on £X-Y, reflecting the reality that the employee is worse off by reason of having to meet expenses without reimbursement.

21. If the employer reimburses the amount spent by the employee, that amount also counts as part of the employee's earnings under sections 70(1) and 72(1). This is paid in respect of expenses, but it is not deductible under Part 5 as there is a bar under section 330 on double deduction for amounts in respect of the same expenses. The result is that the employee is charged to tax on £X-Y+Y = £X. In other words, the payment and the reimbursement cancel each other out, reflecting the reality that the employee is no worse off for having had to meet

expenses. This is not the analysis used in *Owen v Pook*, cited by Judge Wikeley, but it is, I think, the correct analysis under tax law as rewritten in ITEPA.

22. It does not make any difference if the employee is given a sum that can be drawn down to meet expenses as they arise, because this is treated as earnings under section 70(2) and 72(1) and taxed in the same way.

G. Analysis

23. It is essential that the Secretary of State and Her Majesty's Revenue and Customs share the same understanding of what information the latter has to supply.

24. There is no doubt what ITEPA provides. There is a charge to tax on general earnings (section 6), which means the net taxable earnings (section 9), which is obtained by taking deductions made under section 327, which is in Part 5, from total taxable earnings (section 11). In other words, the amount that is charged to tax excludes deductions. There is no doubt that regulation 36 appears to say the opposite: the amount that is charged to tax includes any amounts that fall to be deducted.

25. There seem to me to be only three possibilities:

- regulation 36(2)(b) has to be given effect with the result that a child support calculation is based in part on income that is not charged to tax.
- it has to be given some other meaning.
- it has to be rejected as contradictory and redundant.

26. Broadly, I agree with Judge Wikeley's reasoning, although the points he made are not necessarily decisive. How does my test of producing a result that is rational, coherent and workable apply? There is nothing necessarily irrational or incoherent or unworkable in defining income differently for different purposes. But …

27. First, the language of regulation 36 follows the language of ITEPA. But the way in which it is deployed suggests confusion. Why adopt a concept of 'charged to tax' and then in effect redefine what it means? That suggests to me that something may have gone wrong with either the drafting or the policy that the drafting was supposed to implement. Judge Wikeley's final point about the consultation on the draft regulations provides some confirmation for this; it suggests that the problem lies in the drafting, which does not implement the policy.

28. Second, it is not rational to base a calculation of liability on an amount that (i) by definition the non-resident parent does not have available as it has been expended for the benefit of the employer and (ii) will not be uniform in its effect as between parents, in contrast to say the rate of income tax or national insurance. Gross income will vary from parent to parent and that is reflected in the calculation, but beyond that the calculation does not descent into detail about the make-up of the income. It proceeds, no doubt, on policy assumptions about the amount that should be available to the parent after legal liabilities for tax and national insurance have been met. I can see no rational reason for taking account of this type of income that by its nature is not available to the parent.

29. Third, it is apparent from the terms and structure of regulation 36 that it is designed to make the administration less complex than it would be if the Secretary of State's decision-makers had to make their own calculations of income, and to do so by relying on the information gathered by Her Majesty's Revenue and Customs. That suggests a degree of coherence between the income used by both Departments. If there is to be a difference

between them, I would expect to find a rational basis for the departure and, like Judge Wikeley, I have not found one.

30. Fourth, administrative arrangements normally have to be made to meet legislative requirements. Here, however, the historic income provisions are designed to operate on the basis of 'information provided in a self-assessment return' (section 36(1)). For that reason, I accept Ms Ward's argument that it would be unworkable if there was any distinction drawn between different ways in which a non-resident parent is paid or reimbursed amounts in respect of expenses, as the self-assessment return does not disclose the information needed to draw this distinction.

31. To return to the possibilities I set out, regulation 36 is internally contradictory as between paragraphs (1) and (2)(b). I can find no way to reconcile the contradiction. The only way to remove it is to decide which has priority. In the overall structure, it is appropriate that paragraph (1) has priority. That leaves paragraph (2)(b) as redundant. The Secretary of State will now have to decide whether any amendment to the regulation and any change to the arrangements with Her Majesty's Revenue and Customs are required.

H. The decision in *AR*

32. How does this relate to the decision in *AR*? It seems to me that this conclusion is the same as that reached by Judge Wikeley. The difference may lie in nothing more than my blunt statement that regulation 36(2)(b) is of no effect. The problem with *AR*, if there is one, lies in understanding why the Secretary of State's representative distinguished between different ways in which payments are made to an employee. To the extent that Judge Wikeley intended his decision to embody that distinction, I disagree.

I. The non-resident parent's pension contributions

33. This was an issue when the case was before the First-tier Tribunal, but the non-resident parent now accepts that these have been properly taken into account.