Reality bites

Management of taxes | OMB

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Keith Gordon considers a recent tax credits case which turns on the definition of carrying on a trade

Key Points

What is the issue?

An individual started his own business and applied for working tax credits, but had to take the case to four stages of appeal before the UT judged that he should be allowed to claim working tax credits.

What does it mean to me?

In this case, persistence was necessary to take the matter to the Upper Tribunal which, in tax credits cases, will not put the appellant at risk of having to pay the other side's costs.

What can I take away?

Although Judges will always endeavour to do the best that they can with the material before them, an oral hearing is undoubtedly going to allow more facts to emerge.

In the interests of simplification, there should be some grateful acknowledgement of the fact that many of the concepts well known from the income tax legislation are replicated in the tax credits code. However, I do wonder whether the political expediency of having two entirely separate procedures is really justified and helpful.

Whatever the merits of that decision, this article discusses a case which concerns the meaning of self-employed for the purposes of tax credits. Until 5 April 2015, the tax credits definition more or less reflected an income tax practitioner's understanding of the term which was to be 'engaged in the carrying on of a trade, profession or vocation' (Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002, SI 2002/2005, regulation 2(1)). However, presumably in order to reduce the availability of tax credits, the test was revised from 6 April 2015, adding the requirement that the activity be carried on 'on a commercial basis and with a view to the realisation of profits'.

Although the words are new for tax credits purposes, they are of course familiar and were no doubt taken from the rules which restrict the availability of trading losses in what is often known as 'sideways relief' claims. In the context of income tax, the test is to ensure that losses can be set off against income from other activities only if the losses were incurred in the course of an activity in which (taxable) profits were intended and likely to be made. It is not hard to see a similar rationale for the narrowing of the definition of self-employed in cases where the carrying on of a self-employment is one route to entitlement to tax credits.

There is some limited authority on the meaning of these words in the income tax context. The Upper Tribunal (Administrative Appeals Chamber) has now had to consider their meaning in the context of tax credits in the case of *JF v HMRC* [2017]

UKUT 334 (AAC).

Facts of the case

JF had been on jobseeker's allowance ('JSA'). He then decided to try to make a go of it and become a self-employed painter and decorator. He sought to generate work by advertising on Gumtree (which, for readers less familiar with the virtual world, is an online classified advertisements service, akin to Loot) as well as handing out leaflets on a door-to-door basis.

To assist cash flow (presumably part of the purpose of the tax credits legislation) and to make up for the loss of JSA, he claimed working tax credit. In response to the question as to whether there was any other information considered to be relevant, JF's application included the statement that he was 'just happy to be off JSA and hopefully make a go of something'. In addition, JF included copies of his advertising leaflets, his CITB skills certificates and some rough preliminary accounts (handwritten) showing a list of jobs including dates, addresses and prices charged, as well as his outgoings.

Rather surprisingly (I say from reading the facts as opposed to recent experience in this field) the application was rejected. The refusal letter asserted that there was insufficient information to show that the activity was regular and organised, commercial or carried on with a view to profit. As the Judge noted with some alarm, the letter also included the (presumably standard) wording that the decision does not preclude HMRC from taking further action if they suspect that the applicant has committed a criminal offence.

Showing the determination which one hopes will stand JF in good stead in his business endeavours, JF was minded to press on despite officialdom's initial shot across his bow. He addressed each of HMRC's complaints in his request for a mandatory reconsideration (which since 2014 has been a required precursor to any Tribunal proceedings).

As did the Judge, I reproduce JF's response in its entirety (without correction for any typos etc) because it is only his words which can precisely convey the facts of the case:

‘Point 1, my business is not regular/organised My business is still in very early stages of trade. to say I’ve only been trading for about 2 months I’m taking bookings well into next month, building up a customer base and getting my business in the public eye. I don’t know how much more organised i can be? my business is a simple idea, there is no need for complex and expensive business plans. For a first time sole trader work is coming in and organised as can be.

Point 2. my business is not commercial I’m offering a service that can be bought by the public, that is making a profit. what exactly is your definition of commercial?

Point 3, my business is not carried out with a view to profit Why would i even bother with any of this if i didn’t intend to make a profit? Do you think i’m doing this for fun? After being on Job Seekers alowance with no sight of a job, I decided to try and make a success of something instead of waiting for other people to give me a chance. i want to do it for myself. I’m in this for the long haul with the intention of being successful and making a profit. To summarize, i thought working tax credit was supposed to help people on low incomes. It’s difficult to forcast what my earning will be come the end of the tax year but i would greatly appreciate help in trying to make my business a success. From what I’m being led to believe my income are not high enough to be classed as a low income which makes no sense. I’m working the required hours and the required age for WTC and don’t see no reason why i don’t qualify for financial help.’

It appears that even this did not work because the case eventually found its way to the First-tier Tribunal. JF chose not to have an oral hearing (as the Upper Tribunal Judge explains ‘presumably as he was too busy to make a go of his fledgling business’). The First-tier dismissed the appeal and upheld HMRC’s refusal. In doing so, it highlighted a number of apparent deficiencies in JF’s case. For example, it commented upon the absence of evidence of:

- written quotations to prospective customers, invoices and payments for work done,
- a business bank account, or
- business insurance (vehicle and/or public liability).

It also remarked upon the lack of business plan but said that that was not determinative of the Tribunal's decision.

Finally, the Tribunal analysed JF's first three months' trading income and, on the assumption that he was working 30-hour weeks, calculated that he was working at a rate of just £2.39 per hour. The Tribunal concluded that this was evidence that JF was not engaged in remunerative work for at least 30 hours per week and therefore not entitled to the Working Tax Credit.

Still dissatisfied, JF then notified his further appeal to the Upper Tribunal.

The Upper Tribunal's decision

The case came before Judge Wikeley who had earlier granted JF permission to appeal. However, it should be noted that (perhaps unusually) the officer representing HMRC at the Upper Tribunal actually supported JF's appeal, pointing out some procedural errors that had arisen at the First-tier.

In any such appeal, there are two stages. First, the Upper Tribunal has to decide whether there has been an error of law in the First-tier's decision. Secondly, and only if the first stage is overcome, the Tribunal then has to decide whether to 'remit' the case back to the First-tier for a fresh decision or whether it can remake the decision itself.

Judge Wikeley quickly considered that an error of law had indeed occurred (in fact, more than one). He noted that First-tier had not adopted a sufficiently inquisitorial approach to the case (the Social Entitlement Chamber is supposed to take a more active approach in eliciting facts from parties than has traditionally been the case with the Tax Chamber, although recent case law shows that the latter should not avoid such an approach where justice dictates): this was compounded by the fact that HMRC had omitted some business receipts from the bundle of documents prepared for the First-tier hearing. Secondly, the First-tier had wrongly disregarded the time spent in setting up the business and going door-to-door when applying the 30-hour test. He therefore set aside the First-tier's decision.

So far as what to do with the case as a result, the Judge considered that (even with the limited paperwork before him) there was sufficient evidence to satisfy him on the balance of probabilities that JF was indeed self-employed within the meaning of

the test. As the Judge noted, JF's own words explained that he was seeking a profit; it was also organised and regular – the fact that it was rudimentary was unsurprising as the business had only just been commenced. Most importantly, it seems, was the fact that JF showed a regular time commitment to the work. The Judge also noted that JF had an accountant, although he stressed that this was not essential (but reinforced his view).

Commentary

If you are surprised (or shocked) that JF needed to take the case to four stages before he got this outcome, you will not be alone. The Judge himself was not happy with how JF had been treated. His criticism of the First-tier (which can also be extended to decision-makers within HMRC) was that they need to 'get real' – the evidence which typical tax credits claimants are likely to have to demonstrate their business activities is likely to be far 'more modest' than that that would be needed to 'pass muster on an MBA course or to withstand scrutiny in an episode of *Dragons' Den*'. It is hard to say any more than that.

As the Judge noted, however, the case should be treated with an element of caution. First, it was not contested by HMRC and, therefore, there has not been the benefit of full legal argument to consider the new statutory test. Secondly, there is no guarantee that future Tribunals will equate the statutory test with its loss relief equivalent, given the (slightly) different statutory context.

From my perspective, however, I consider that the two tests should be interpreted in precisely the same way as they are broadly serving the same essential purpose. Of course, the typical tax credits claimant is likely (but not necessarily) to be running a business different from that which might be the subject of a sideways loss relief claim. However, it does not mean that the tests have different meanings; instead, the different factual scenarios should merely lead to different expectations as to the kind of documentation that should exist to support an assertion that a business is being conducted commercially and with a view to profit. That, after all, is the application of reality to the statutory words.

What to do next

Ultimately, this is a further example of a case where what appears to be the obvious outcome seems to be constantly just out of reach. In this case, persistence was

necessary to take the matter to the Upper Tribunal which, in tax credits cases, will not put the appellant at risk of having to pay the other side’s costs. One possible lesson, however, is to hesitate before taking up the option of having a case decided on the papers. Although Judges will always endeavour to do the best that they can with the material before them, an oral hearing is undoubtedly going to allow more facts to emerge. The First-tier might not thank me for saying this, but perhaps the exceptional circumstances of this case should serve as a warning not to take what might seem like the easy option.