

THE SPECIAL COMMISSIONERS

**(1) SIMON HINSLEY
(2) JEREMY MILSOM**

Appellants

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS**

Respondents

SPECIAL COMMISSIONER: Charles Hellier

Sitting in public in London on 4 September 2006

David Southern of Counsel, instructed by Simpson Millar for the Appellant

Nicola Shaw of Counsel, instructed by the Acting Solicitor for HM Revenue and Customs, for the Respondents

DECISION

1. These are the appeals of two commercial airline pilots. The appeals were heard together. At different times each Appellant left the employ of one airline and went to be employed by another. Each of them had received training free of charge from their old employer.

2. But in each case the pilots' contract of employment with the old employer provided that if the pilot should leave employment within a fixed period after receiving that training the employee should pay a sum to that employer. This provision was inserted in most airline's pilots' contracts to avoid one airline bearing the cost of training which benefited another airline.

3. Both Mr Milsom and Mr Hinsley paid as they were obliged to. Each then sought to set the amount of that payment against his employment income. The Respondents claim that an expense of this nature is not deductible because it is not an expense incurred which was wholly necessary and exclusively expended in the performance of the employee's duties.

4. Before turning to the detail of the case I note that had the remuneration contractually payable to the pilot during his notice period been reduced by the amount of the training payment, then there would have been no question that his taxable remuneration should be treated as a larger sum and the reduction treated as an expense: he would have been taxable on the reduced emolument to which he was entitled and which he received. Likewise if the new employer had paid a lower wage to the newly taken on pilot, but pursuant to a general agreement in relation to such matters with the employer had made the training payment to the old employer, there would be no doubt that the emoluments of the employee would be what he actually received from the new employer and not that sum inflated by an amount equal to the training payment but subject to the making of a notional training payment as an expense. In each of these cases the pilot would have been taxable on the reduced sum to which he was entitled. In the circumstances of what actually happened he is taxable on a net sum only if the payment he made is properly deductible as an expense. It seems to me however, that what might have happened is no sure guide to the taxability of what did happen: the fact that two different transactions have the same economic result does not mean that they should (or do) have the same tax result.

5. There is an issue which relates to the period in which or for which each deduction was claimed. I shall deal with that issue at the end of the decision.

The Evidence

6. There was an agreed statement of facts; copies of the relevant contracts and copy correspondence between the parties. I heard oral evidence from Mr Milsom (the second Appellant) and from Reginald Dennis Allen, head of legal services at the British Airline Pilots Association. Both gentlemen provided witness statements.

7. There was also a Witness Statement from Mr Hinsley who did not give oral evidence. The Appellants had served notice on 23 August that they intended to rely on that Witness Statement. Miss Shaw said that to the extent it was inconsistent with the agreed statement of facts or otherwise confusing I should not have regard to it and that therefore I should disregard the whole of it. There was only one issue which arose from Mr Hinsley's statement where his was the only evidence. I deal with that at paragraph [●] below. In all other respects Mr Hinsley's statement corroborated other evidence, documents or agreed facts before me. I accept it as further evidence of those matters.

The Facts

8. From the evidence I find the following facts.

(1) Mr Hinsley was an airline pilot employed by Cityflyer Express Limited ("Cityflyer"). His employment with Cityflyer commenced on 21 October 1998.

(2) Following the commencement of his employment and at the expense of Cityflyer, Mr Hinsley undertook a training course on the RJ100 aircraft.

(3) Clause 9 of his employment contract with Cityflyer provided that:

"In the event that within three years of the date of course commencement either:

- (i) you voluntarily terminate your employment with [Cityflyer]; or
- (ii) [Cityflyer] lawfully dismisses you...

then you shall be liable on leaving [Cityflyer] to pay to [Cityflyer] as a contribution to the Training Cost the sum of £416.66 for each complete month (and *pro rata* for part thereof) remaining between the date of termination of your employment and the third anniversary of the date of course commencement."

(4) Mr Hinsley tendered his resignation from Cityflyer on 19 July 2000. Under clause 1 of the employment contract, Mr Hinsley was required to give 20 weeks' notice of termination of his employment. Mr Hinsley then took up employment with Easyjet.

(5) The termination of Mr Hinsley's employment with Cityflyer gave rise to a liability to repay £8,000 under clause 6 of the employment contract. British Airways (of which Cityflyer is a subsidiary) acknowledged receipt of the payment of £8,000 from Mr Hinsley by a letter dated 28 February 2002.

(6) In his self-assessment tax return for 2001/02 Mr Hinsley included the £8,000 as a deduction from his taxable income.

(7) On 13 October 2003 the Inspector opened an enquiry under s.9A TMA 1970 into Mr Hinsley's 2001/02 return. The enquiry was closed, and an HMRC amendment made, on 14 October 2003. The Inspector refused relief for the £8,000 on the basis

that the payment was no an expense “necessarily incurred in the performance of the duties of the employment” for the purposes of s.198 ICTA 1988.

Mr Milsom

- (8) Mr Milsom was an airline pilot employed by Airtours International (“Airtours”). His employment with Airtours commenced on 15 July 1996.
- (9) Following the commencement of his employment and at the expense of Airtours, Mr Milsom undertook a Boeing 757/767 type-rating course between 25 July 1996 and 29 August 1996.
- (10) The terms of his employment contract included a Bonding Clause pursuant to which it was a condition of his employment that should his employment with Airtours terminate at time within three years of the commencement of his employment he would be required to reimburse Airtours of a proportion of the training costs incurred.
- (11) Airtours accepted Mr Milsom’s resignation on 4 July 1996, thereby terminating his employment. Mr Milsom then took up employment with British Airways.
- (12) The termination of Mr Milsom’s employment with Airtours gave rise to a liability to make a repayment of vocational training costs to Airtours under the bonding clause in the amount of £9,062.52. Airtours acknowledged receipt of the payment of £9,062.52 from Mr Milsom by a letter dated 28 October 1997.
- (13) By a letter dated 20 October 2003, Mr Milsom claimed a repayment of tax at a rate of 40% on the payment of £9,062.52 for the year 1997/98. HMRC treated Mr Milsom’s letter as a claim to “error or mistake relief” under s.33 TMA 1970, the alleged error being Mr Milsom’s failure to include relief for the £9,062.52 in his self-assessment for 1997/98.
- (14) By a letter dated 24 March 2005 the Commissioners refused Mr Milsom’s claim to relief on the basis that the £9,062.52 repaid to Airtours in the year 1997/98 was not an expense incurred in the performance of his duties pursuant to s.198(1) of ICTA 1988.
- (15) Before a person may fly an aircraft of a particular type for hire or reward he must hold an appropriate licence:
 - (i) if he is to fly as captain of the aircraft he has to hold a Full ATPL (Air Transport Pilot’s Licence) which has been endorsed to indicate that it covers that particular type of aircraft (“type-rated”).
 - (ii) if he is to fly as co-pilot of the aircraft the minimum requirement is that he should hold a “frozen” ATPL (or a Commercial Pilot’s Licence) type-rated for that particular type of aircraft.

Thus the prospective commander of a passenger aircraft will undergo three stages of training and gathering of experience. At the first stage he will undertake a course of approved training, air time and tests: at the end of this he hopes to obtain a “frozen” ATPL (type-rated for the smaller type of aircraft on which he will have trained). Then he will need to get type-rated for the type of aircraft he is to fly. This will involve

about five weeks of simulator training together with a number of supervised take offs and landings. Now he will be able to fly that type of aircraft as a co-pilot.

Finally he will need 1,500 hours flying experience. Once he has obtained this his licence is unfrozen and he is authorised to command a passenger aircraft of the relevant type for reward.

In practice commercial airlines will also impose other requirements. They will require the pilot to train in their own standard operating procedures before flying as a co-pilot or a captain, and may require more than the minimum 1,500 hours flying time and the completion of a command course before permitting the pilot to command an aircraft.

(16) In Mr Milsom's case, after leaving the navy, he obtained an ATPL by undertaking training at his own expense. The training cost some £12,000. He was then recruited by Airtours to fly Boeing 757's. But he was not type-rated for Boeing 757's. Therefore after joining Airtours he undertook type-rating training for Boeing 757s. After that he was able to fly Boeing 757's for reward, but before Airtours permitted him to do so it also required him to undertake its standard operating procedure course. That course followed on straight after his type rating course. The training in each case was arranged and paid for by Airtours.

(17) Had Mr Milsom joined Airtours with an ATPL already type-rated for Boeing 757's, he would not have been required to go on the type-rating course, but would have been required to go on the Airtours standard operating procedures course.

(18) Mr Hinsley joined CityFlyer Express with a commercial pilot's licence which, like Mr Milsom, he had obtained at his own expense. He was recruited to work as a pilot on ATR aircraft. But, because he was not typed-rated for ATR aircraft he could not fly these unless trained. His contract with CityFlyer provided that the company would provide the training; and it did and his licence was appropriately type-rated. But then in February 2000 CityFlyer started flying RJ100 aircraft. Before Mr Hinsley could be permitted to fly such aircraft he needed his licence type-rated for them. He needed to go on another training course. CityFlyer agreed to provide the necessary training; Mr Hinsley completed it and his licence was type-rated for RJ100 aircraft.

(19) Type-rating training is expensive. An airline could attempt to avoid the costs of type rating training by engaging only such pilots as already held ATPLs or CPLs with the requisite type-rating: enticing away for a higher salary from other airlines appropriately trained pilots. Airlines who provided training would risk losing trained pilots to these other airlines. As a result almost all airlines provide in their contracts with pilots that, if the pilot leaves employment within a set period of the type-rating training, compensation will be made to the airline for all or part of the cost of the training. In Mr Hinsley's case the provision was as set out at paragraph (3) above; in Mr Milsom's case the relevant words were:

“To offset the substantial expenditure associated with initial type training, it is a condition of employment that should a pilot's employment ... terminate within three years of commencement ... he or she will be required to reimburse to the Company a

proportion of the training costs incurred. The sum required to be paid will be £15,000 regardless of type and such payment, by way of reimbursement, will be reduced by $\frac{1}{36}^{\text{th}}$ for each completed month of service since ... commencement”.

(20) I said that “almost all” airlines make provision for recovery of type training costs in their pilot’s employment contracts. One exception is BA (but not British Airways Citiexpress). BA recognises that pilots will rarely wish to leave its employ to go to another airline and therefore imposes no training cost recovery condition if they do.

(21) The contractual terms by which airlines obtain recovery of type-training costs vary between the airlines. I was shown a number of examples including the following:-

(i) a Monarch airline contract which required the pilot to sign a promissory note for the full contribution, and Monarch agreed not to enforce it if the pilot worked for Monarch for 18 months;

(ii) an Air contractors (UK) contract under which the pilot signed a separate deed providing for payment of between £3,000 and £12,000 depending upon the length of later service;

(iii) a Thomas Cook Airlines contract under which the pilot signed a separate promissory note, and Thomas Cook Airlines agreed not to enforce it if the pilot remained employed for 2 years;

(iv) a British Airways Citiexpress contract under which the pilot signed a separate agreement to pay the stipulated sum, but that sum was reduced for every calendar month the employee remained employed.

In each case it was clear that the cost recovery arrangement was part of the employment contract. (Such contractual provisions were referred to as “bonding”).

(22) There are between 12,000 and 14,000 pilots employed in the airline industry. On average in each year there will be about 500 new entrants. About 90% of these will be obtaining their first employment as a pilot with an operator other than BA. The vast majority of these new entrants will not be type-rated for the aircraft they have been employed to fly. As a result (since 90% go to operators other than BA) round about 90% of them will enter into contracts enabling the airline to recover type training costs.

(23) Once type-rated for a particular aircraft a pilot may wish or be required to be type-rated for another type of aircraft. That may be because of a change in the airline fleet, because other opportunities are offered by the airline if additional type rating is obtained, or because the airline requires the change. In many such cases the pilot undertakes a new bonding obligation on undertaking such training.

(24) In about 20 cases each year pilots make payments under bonding arrangements. The number is small because few pilots move. That is because the seniority system operated by airlines acts as an incentive to stay rather than move.

9. It was clear to me that the training undertaken by Mr Milsom and Mr Hinsley was undertaken in time when they were at the disposal of their employer. It was not something done in their spare time. The training was also organised and paid for by their employers.

10. Although the extracts from Mr Milsom's contract which were in the bundle before me do not expressly so provide, I think it highly likely that it would have been a term of his contract that he was required to undertake the training: there would be little point in having employed him as a pilot if undertaking the training were not required. Clearly, he would have been required to undertake the Airtours Own Operating Procedures training as an obligation of his contract; I can see no reason for any conclusion that he was not required to undertake the type training.

11. Mr Hinsley's case is different. I accept the evidence in his witness statement that he started employment with CityFlyer Express in October 1998 and became type-rated for ATR aircraft, and that in 2000 he undertook new training for RJ100 aircraft. It was not clear to me from his Witness Statement whether CityFlyer were changing its whole fleet and required (if it could do so) Mr Hinsley to acquire a new type rating, or whether voluntarily he chose to retrain so that he could fly RJ100's. I shall deal with this aspect in the alternative.

12. I find however that Mr Hinsley entered into a new contract of employment with CityFlyer in 2000 and that under that contract (a) he became bonded, and (b) it is most likely that he was required to undertake the training at the times arranged by the employer.

Statutory Provisions

13. Section 198(1) TA 1988 provided for the year of assessment 1997/1998:

“If the holder of an office or employment is necessarily obliged to incur and defray out of the emoluments of that office or employment the expenses of travelling in the performance of the duties of the office or employment,... or otherwise to expend money wholly, exclusively and necessarily in the performance of those duties, there may be deducted from the emoluments to be assessed the expenses so necessarily incurred and defrayed.”

But for the years 1998/1999 to 2002/2003 it provided:

“If the holder of an office or employment is obliged to incur and defray out of the emoluments of the office or employment -

(a) qualifying travelling expenses; or

(b) any amount (other than qualifying travelling expenses) expended wholly, exclusively and necessarily in the performance of the duties of the office of employment,

there may be deducted from the emoluments to be assessed the amount so incurred and defrayed.”

14. (Elsewhere in this decision I use the term “eligible expense” to mean an expense falling within paragraph (a) or (b).)

15. No point was taken by Mr Southern or by Miss Shaw on the difference between the wording, but I note with regard to expenses the following differences: in relation to expenses wholly exclusively and necessarily in the performance of duties, distinction is (with my emphasis) :

(a) in the old form: that the holder “is necessarily obliged to... expend” them; and

(b) in the new form: that the holder “is obliged to incur and defray... any amount... expended” on them.

16. All the cases to which I was referred dealt with the old form of this provision. I deal below, in the section relating to the authorities, with the issue of whether the conclusions in those authorities apply equally to the new wording.

17. The question in this appeal is whether the Appellants were obliged to incur and defray the amounts paid to their employees wholly exclusively and necessarily in the performance of the duties of their respective employments.

The Parties’ Arguments

18. Mr Southern said that the central question was whether a contingent liability is an expense of the employment when it becomes an actual liability. He puts the question thus: where an employee incurs a prospective liability, will that liability be an allowable expense when it crystallises if it would have met the relevant conditions at the time it became a potential liability? He invited me to answer that question “yes”, and to hold that had the expense been incurred when it was contingently incurred it would have been deductible.

19. So far as the first limb of this argument goes, he says that in applying the statutory test the factor of contingency should be ignored. Although the resignation of the pilot makes the prospective liability actual that does not mean that the expense does not arise from performing the duties of the employment. The source of the liability is the contractual obligation under the contract of employment. He referred me to *Law Society v Sephton & Co* [2006] 3 ALL ER 401. In that case the House of Lords held that for Limitation Act purposes a contingent liability was not as such damage until the contingency occurs. The effect of the House of Lords decision in that case was, when applied to the pilot in this case, that the payment obligation relates back to the contractual obligation although it becomes actual when it becomes payable: a liability to damages arises when it is “incurred”, but the damage “occurred” when the liability crystallises. Thus the question should be whether the expense as actually expended was, when the liability to it was incurred an expense which would have satisfied the relevant tests.

20. So far as the second question goes, Mr Southern says that:

(1) the obligation arose under the terms of the employment;

(2) that obligation arose because of the nature of the employment. This was a case where one could not distinguish the training from the duties - there was a seamless overlap. He said that the question was - is this obligation a necessary characteristic of the employment when objectively viewed? And the answer was “yes”;

Yes, because the obligation was in fact imposed on virtually all new entrants to the industry. Yes, because the imposition of the obligation was something required by employer airlines because of the nature of the industry. Yes, because the obligation generally applied to all those training or retraining during their employment.

(3) the expense is wholly and exclusively referable to the duties of the employment. There is no private benefit.

(4) this is not an expense incurred to do the job better, it is an expense incurred to enable the job to be done. Without the training the job *could not* be done;

(5) neither is it an expense of preparing to do the job, because it is done as part of the job during the course of the employment;

(6) the test for “necessary” was: if you do not incur the expense can you do the job? In *Simpson v Tate* [1925] 2 KB 214 and *Fitzpatrick v IRC* [1994] STC 237 the answer was “yes”; but here it was clearly “no”.

(7) training was an essence of the employment not an “add-on”, It was a statutory requirement that the pilot be type-rated. The duties of the pilots were not capable of being performed without this training;

(8) if you ask (echoing the words of Rowlatt J in *Nolder v Walters* and Lord Templeman in *Fitzpatrick* at p.526E): “are you doing what you were paid to do when you incurred this expense?” the answer was “yes”.

(9) this was an expense like the costs of the six monthly medicals required for the renewal of pilots’ licences which, in *Nolder v Walters* 15 TC 380, were allowed.

21. Miss Shaw says that the expenses were not necessarily incurred. “Necessary” meant that every such employee would have had to have incurred the expense, and that was not the case: any recruit who already had the requisite type-rating would not have incurred the training costs, and only those employees who terminated their contracts within the specified period had to make payment: and the evidence was that there were few such employees. The duties of the employment did not require the expense.

22. In fact it was the termination of (or the giving notice to terminate) the contract rather than the performance of the duties under it which gave rise to the expense. It could not be referable to any duties.

23. Even if the payments could be regarded indirectly as payments of training costs, they would not be deductible. Undertaking the training was not something in the course of the employment but something which was a pre-requisite to enable a pilot to carry on the duties. All the employer cared about was the pilots flying the planes. The sample contracts spoke of the training “enabling” the pilot to fly; “enabling” was not performing the duties of the employment.

The Authorities

24. I was referred to a number of authorities by Mr Southern and Miss Shaw. I address below those which seem most relevant in relation to the question as to whether expenses are incurred in the performance of duties, and whether they are necessarily so incurred. The issue of whether they were wholly and exclusively so incurred seems to me to be less relevant in this case.

25. *Ricketts v Colquhoun* 10 TC 118 concerned the travelling and hotel expenses of a Recorder. Deductibility was governed by a Rule in words of the old form of section 198. In the House of Lords’ consideration was given:

- (a) in the context of the travelling expenses, to whether the Recorder was “necessarily obliged to incur....[them] in the performance of” his duties; and
- (b) in the context of the hotel expenses, to whether the Recorder was “necessarily obliged to expend [the] money wholly exclusively and necessarily in the performance of” his duties.

26. I note this dichotomy because as explained above, in the new version of section 198 the adverb “necessarily” no longer precedes “obliged”, and there are passages in their Lordships’ opinions which deal expressly with the conjoined “necessarily obliged” which no longer appears in the statute. Thus Viscount Cave, when dealing with the travelling expenses (where the only occurrence of “necessarily” in the statutory formula (where the only occurrence of “necessarily” in the statutory formula was as a precursor to “obliged”) said:

“ In order that travelling expenses may be deductible under this Rule... they must be expenses which the holder of the office is necessarily obliged to incur, - that is to say, obliged by the very fact that he holds the office, and has to perform its duties,...”

27. In relation to the hotel expenses, Viscount Cave confined himself to the later requirement of the rule: that the expenses be expended “wholly exclusively and necessarily in the performance of his duties”. He commented that a man must eat and sleep somewhere and that if he elected to live away from work it was his own choice and accordingly his expense of board and lodging away from home was “not by reason of any necessity arising out of his employment.”

28. Lord Blanesburgh started by looking at the Rule in the round and noted “the jealously restricted language [of the rule], some of it repeated apparently to heighten

its effect.” (It seems to me that the most striking repetitions are that of “necessarily” and “in the performance of the duties”.) He then said:

“But I am also struck by this, that, ... the language of the Rule points to the expenses with which it is concerned as being confined to those which each and every occupant of the particular office is necessarily obliged to incur in the performance of its duties, to expenses imposed upon each holder *ex necessitate* of his office and to such expenses only. It says: - “If the holder of an office” - the words be it observed are not “if any holder of an office - “is obliged to incur expenses in the performance of duties of the office” - the duties again are not duties of his office... the terms employed are... not personal but objective.”

29. Having thus dealt with the Rule as a whole, he then considered the travelling expenses and the hotel expenses separately, holding that the travelling expenses fell foul of the Rule both because of the interpretation he set out above, and because they were not expended in the performance of the duties; and that the hotel expenses were not wholly exclusively and necessarily incurred in the performance of those duties.

30. It seems to me that despite the fact that both Viscount Cave’s and Lord Blanesburgh’s comments expressly embrace the phrase “necessarily obliged” and in that context make no reference to the second appearance of “necessarily” where it appears in conjunction with “wholly and exclusively”, the restriction they both read from the words of the provision in its old form remains properly to be read from the new framing of the provision so far as concerns expenses other than travelling expenses. I reach that conclusion for the following reasons:

- (i) Lord Blanesburgh’s comment that the provision refers to “an office” rather than “his office”, and his reliance upon that emphasis for an objective test, is not dependent upon the presence of “necessarily” before “obliged”;
- (ii) Lord Blanesburgh notes the repetition in the section: “necessarily” is repeated. The second appearance of “necessarily” must carry with it at least some of the force of the first; and
- (iii) the requirement that the amount be expended necessarily in the performance of the duties carries with it the restrictions described by reference to a necessary obligation of an office or employment.

31. I am further strengthened in that conclusion by the approach taken by Lord Wilberforce in *Taylor v Provan* 1975 AC 194 at page 215 in relation to the effect of “necessarily” in the phrase “wholly exclusively and necessarily” which he regards as imposing an objective test of what the nature of the job requires. (Although Lord Wilberforce was dissenting, his dissent did not turn on this interpretation.)

32. Further, in *Brown v Bullock* 40 TC 1, Donovan LJ, referring to the requirement that the expenses be *inter alia* necessarily incurred in the performance of the duties, put the test thus (at p.10):

“The test is not whether the employer imposes the expense but whether the duties do, in the same way that irrespective of what the employer may prescribe, the duties cannot be performed without incurring this particular outlay... the test is the strictly objective one...”

33. I therefore conclude that for the years of assessment relevant to these appeals the relevant requirement imposed by section 198 is that the nature of the duties of the employment objectively viewed requires the expense. The expense must also be incurred wholly and exclusively in the performance of the duties.

34. Of course that leaves the question: what are the duties of the employment objectively determined? That issue arose in *Taylor v Provan* [1965] AC 125. In that case Lord Reid regarded an essential feature of a particular office to be that it could be filled only by one particular person. Lord Morrison said “there was probably no-one else who could have filled it”. Thus the duties were to be determined by reference to that person’s particular circumstances. Lord Wilberforce and Lord Simon dissented, they could not see the office as being objectively determined by reference to the circumstances of the person who filled it.

35. The difficulty is describing the office: if you are a person appointed to entertain clients of a bank at a golf course, and also to manage the branch of a bank, is your office, or are its duties objectively determined, the same as those of a person appointed to manage the branch of a bank, and also to entertain clients of the bank at a golf course? A journalist’s work may not include reading other papers, but the work a person employed to review other papers may be different. Because the test is not whether the employer imposes the expense but whether the duties to it may be necessary to wield a razor to detach from the requirements imposed by the employer those which are not necessary for the duties of the employment objectively viewed. Lord Templeman’s speech in *Fitzpatrick* suggests a robust approach to this exercise.

36. I also note the following propositions from the cases to which I was referred:

- (i) an expense incurred to enable duties to be performed is not an expense in the performance of duties (see Lord Salmon in *Taylor v Proven* at page 226 and Lord Templeman in *Fitzpatrick* at page 525);
- (ii) “in the performance of the duties” means, per Rowlatt J in *Nolder v Walters* 15 TC 380, “in doing the work of the office, in doing the things which it is his duty to do while doing the work of the office”. But I note that this description leaves at large the question of what *is* the work of the office, and does not address the question of what is *necessary* in that work. These last questions are in my view addressed in the authorities referred to above;
- (iii) the requirement that the expense be wholly and exclusively incurred means that no personal benefit can be derived from the payments by the employee.

Reasons for Decision

(i) When do the conditions of s198 have to be satisfied: on payment or when the contingent liability is incurred?

37. It seems to me that the words of the statute answer Mr Southern's question as to when the statutory test of wholly exclusively and necessarily should be applied. The statute starts by speaking about a person being "obliged to incur and defray" something (or in the older version necessarily being obliged to expend something). So the first question for me is: has the employee become obliged to incur something? In both Mr Milsom's case and Mr Hinsley's I can answer that question "yes". But the next question to be answered is whether what has been incurred is "an amount expended" of the appropriate nature. This phrase relates to the actual expending of the amount - it is not about a possible obligation to expend but an actual expense. In answering the question I must look at the actual expense and ask whether that expense has been wholly expended exclusively and necessarily in the performance of the duties.

38. Whereas the obligation to incur may have been contingent the expense for which relief is given can only be actual. So long as it can be fairly said that the actual expense is expended pursuant to an obligation it does not matter when that obligation arose or crystallised. Thus in my view the proper question for me is whether the payment made by the pilots was "expended... in the performance of" their duties not whether the liability to pay was *incurred* in such performance.

39. As a result I find no help in *Sephton*: it matters not in my judgment when the liability was incurred or when it arose, the question is simply whether the actual amount was expended wholly exclusively and necessarily in the performance of the duties of employment.

40. However, in case I am wrong in my conclusion on this issue, I address in (iii) below the question of whether, had the payment been expended during the term of the contract at the time of the training, it would have been expended wholly exclusively and necessarily in the performance of the duties of employment.

(ii) Was the actual payment made expended wholly exclusively and necessarily in the performance of the pilot's duties?

41. It seems to me that it was not.

42. It was not paid as a necessary consequence of continuing (after notice to terminate was given) to perform the duties of the contract. It was not expended in the activities thereafter required to perform those duties.

43. It may have been expended as a consequence of the contract pursuant to which the remainder of the duties were performed, but objectively viewed those duties were those of an airline pilot not those of someone obliged to make a payment. In these cases it is easy to wield the razor and detach a specific duty to pay which arose from termination of the contract and certain earlier activities, from the continuing duties of

a person employed to fly aeroplanes. This is not a case where the nature of the office required it to be subject to an obligation at that particular time - the time of giving notice - to do something which required the making of the payment. That was not necessary to being what was required by the employer or undertaking the duties of a pilot. As a result the expenditure cannot be described as being either in the performance of those duties or necessarily expended in such performance.

44. What indications are there that the objective nature of the offices did not at the time of payment require such payment? One of the more compelling is that in any year will be only 20 or 30 pilots who had to make that payment among 10,000. That is not conclusive but it suggests that the objective nature of this employment was not such as would compel the expense. Another is that the obligation to pay arose because of the termination of the contract: the expenditure was incurred on termination, rather by virtue of the nature, of the employment. That conclusion is unaffected by the benefit the payment represented - namely the training costs: even if the acquisition of the training was, objectively, part of the duties of the employment, payment for that benefit was not part of those duties.

45. In relation to Mr Milsom this conclusion together with that set out in (i) above means that his expense is not deductible. The same reasoning applies to Mr Hinsley whether the retraining was required by his employer or undertaken voluntarily (see paragraph 9 above).

(iii) If the payment had been made when the training was undertaken would it have been deductible?

46. I consider under this heading whether, had the pilot been required to reimburse the costs of training when the training was undertaken, that expense would have been deductible under section 198.

47. I accept that the obligation to undertake the type-training arose under the terms of each pilot's employment and that each pilot was required by his employer to undertake the training as part of his duties. I also accept that without the training the pilot could not fulfil all of the duties for which he was employed: without the training the pilot could not do the job.

48. Thus the expense would not have been one incurred merely to prepare to do the job or to do it better. It was necessary for a pilot to have undertaken the training before he could do the job.

49. But none of this means that the expense would have necessarily been incurred in the performance of the duties of the job viewed objectively. It is true that for these two pilots the expense was necessary, but the nature of the job did not compel the expense because the job was not that of going on training courses, but that of flying aircraft.

50. It is not the case that every pilot would also have had to have incurred this expense while doing his job. There is a difference between an expense which each

and every occupant of the employment must incur as part of his duties, and a one off expense which a particular employee must incur if he is to be able to do the job. A pilot who was already type-rated for the aircraft he was to fly before he became employed to fly them would not be required to incur this expense. Thus even if the expense is incurred in the performance of these particular pilots' duties, it is not an expense which the nature of the employment requires and is thus not an expense necessarily incurred in the performance of those duties.

51. I am not persuaded that the prevalence of bonding terms in airline pilots' contracts affects this conclusion. Those terms show that if a pilot needs training, then the practice is generally to require him to pay for it if he leaves early. That is not the same as saying that it is in the nature of a pilot's job to undertake such training. Those terms also show that it was common for pilots to need training. But that is not the same as saying that every person employed as a pilot of a particular aircraft would require training in the course of his employment.

52. Neither would the fact that virtually all new pilot entrants to the industry would require such training mean that such training is a necessary requirement of the employment. That is because this fact looks at the circumstances of the individual employees rather than the requirements of the job of an airline pilot. I can see that if there was a legal requirement for each pilot to have a week's in-house training each year and that if the pilots were required to pay their employer the costs of that training then the nature of the job would always require that cost to be incurred. But in that case the necessity arises from the duties of any pilot; in this case the expense arises because of the circumstances of the employee - albeit that most *new* pilots will be in the same circumstances.

53. Neither is it relevant that the expense arises from performing the duties, or that the source of the liability is the employment. The test is whether the duties of such an employment could objectively be said to require the expense. For the reasons set out above I do not believe they do.

54. Mr Southern also relies upon the context of the airline industry. He says that the bonding system is well understood by pilots and works in the interest of the pilots, airlines and the public. This general understanding coupled with the fact that the overwhelming majority of pilots will be bonded, he implies, means that, objectively viewed the job requires the training. I do not believe that this is enough. These factors explain why contracts generally have bonding terms, but they do not show that the incurring of the expense of type training is a necessary requirement of the performance of the duties of employment of every pilot. Indeed, the existence of the practice of bonding indicates the opposite: once trained the pilot no longer needs type training in a new job.

55. I mentioned at paragraph 9 above that it was not clear whether Mr Hinsley was required by his employer to retrain for the RJ100 or whether the decision to retain was voluntary.

56. If CitiFlyer had changed all its aircraft to RJ100s with the result that from the date of the completion of the change Mr Hinsley would not, without new training, have been able to perform his duties then it seems to me that it is possible that the expense may be said to have been necessarily incurred in the performance of those duties. But that, it seems to me, would only be the case where the nature of his job was to fly all and any aircraft in the CitiFlyer fleet and to undergo such training as the employer required at the expense of the employee in order to fly any new aircraft. That would be the case, not just because the contract required the expense to be incurred (although that would be a necessity before the employee could be said to be obliged to incur and defray the cost) but because the nature of the contract objectively viewed would be to require pilots to retrain when the fleet changed. In that case the fact that there would, on some changes of fleet aircraft, be some pilots who might not need retraining would not be relevant, because the nature of the contract would be such that any pilot could be required to undergo the expense as the fleet changed.

57. However, Mr Hinsley's Witness Statement indicates that such was probably not his situation. He says that he had no choice but to accept the terms offered for retraining and indicates that there were not existing terms but new ones. That suggests that the nature of the duties under contract was not such as I have described above. On that basis, it seems to me that Mr Hinsley's expense would not have been deductible if paid at the time the training was undertaken.

Conclusion

58. For those reasons therefore, it seems to me that these appeals should be dismissed:

- (i) the issue of the nature of payment should be judged by reference to the factors applying at the date of the payment;
- (ii) by reference to these factors, even though the obligation was incurred in the course of the employment, under his contract of employment, and by reference to activities the employee was required to do by that contract, the payment itself was not expended in the performance of the duties of that employment, or necessarily expended in such performance; and
- (iii) even if the issue falls to be determined by reference to the circumstances applicable when the contingent obligation was incurred, the expense, if treated as incurred or defrayed at that time, or the obligation incurred at that time, would not have been expended necessarily in the performance of the duties of the employment.

The Period of Assessment Issue

59. Mr Milsom's employment terminated on 4 July 1997 in the 1997/98 tax year. He made the bonding payment to Airtours in October 1997 in the same tax year. He made his claim for relief in a letter dated 20 October 2003, claiming relief for the year 1997/98.

60. Mr Hinsley's employment terminated in November 2000, in the 2000/2001 tax year. He made the bonding payment in February or March 2002, in the 2001/2002 tax year. In his self-assessment tax return for 2001/2002 Mr Hinsley included the payment under the heading "expenses incurred in doing your job", but prior to the submission of the return had written on 21 January 2003 claiming relief for the payment without specifying the tax year for which the relief was claimed.

61. Two issues arise from this chronology.

62. First, in relation to Mr Hinsley, Miss Shaw says that the expense was not paid until the year after his employment terminated, and cannot therefore be deducted in that year against the income from a different employment. This issue does not arise in relation to Mr Milsom. Miss Shaw said however that if I decided that in principle Mr Hinsley's payment was deductible the Respondents would in practice treat it as a deduction from Mr Hinsley's income for the tax year 2001/2002 even though it would strictly have been deductible in respect of 2000/2001.

63. Section 198 provides for a deduction from the emoluments to be assessed of an eligible amount which the taxpayer is obliged to incur and defray out of the emoluments. There is no express time prescription in this provision. If the expense is paid in year 2, it does not expressly require the deduction to be made against the emoluments of year 2. But income tax is an annually imposed tax and it is necessary so far as possible to construe the provision so as to enable the amount of income for a tax year to be calculated without deducting or taxing the same amount twice in different years.

64. The deduction permitted by the section is against "the" emoluments. That in my view is a reference back to the emoluments of the office the taxpayer holds. Thus, if the taxpayer does not hold a particular office or employment in a tax year, then there is nothing against which an eligible deduction which is properly attributable to that year and that office or employment could be set. This requirement is underlined by the limitation in the opening words of the section to things defrayed "out of the emoluments" of the office of employment.

65. Thus the benefit of an eligible deduction properly attributable to a tax year and an employment is available for that tax year only if the employment is held in that tax year and produces emoluments in that year from which it may be deducted. Mr Hinsley's expense cannot be deducted from his Easyjet emoluments.

66. But this does not help in determining to which tax year an eligible deduction should be treated as properly attributable. Section 198 provides that the deduction is for the amount "so" incurred or defrayed. In the old version the text reads "so necessarily incurred or defrayed" referring clearly back to the obligations which had to be "necessarily incurred". It is to be noted that it does not say "so expended". It seems to me that "so" is a reference back, not to the description of the amount in subparagraph (a) and (b), but to the fact that the taxpayer must be obliged to incur and defray it. "So" responds to the question, not the question "what?". The limitation on

the amount to be deducted is achieved by the definite article preceding “amount” thus referring back to paragraphs (a) and (b)).

67. Thus the deduction is attributable in my view to the year in which the unconditional obligation to incur and defray arose, not when the expense was paid. I accept that this construction may mean that it will not always be possible to determine whether a deduction is available for a tax year in circumstances where the obligation has been incurred but the amount not yet defrayed - for the deduction is available only if and once there is a defrayment. But the time of defraying does not in my view affect the tax period for which the section permits a deduction and that is the year of assessment in which the obligation to incur and defray was incurred. I am comforted in this conclusion by the fact that it avoids the patently unfair possibility of an employee incurring an obligation to pay eligible expenses just before he leaves employment, on say, 1 April, paying them on 10 April and being entitled to no deduction. And, were there two equally tenable interpretations (which in my view there are not) then that which avails that result should be preferred.

68. Accordingly, were Mr Hinsley’s payment eligible for deduction, it would in my view have been deductible in 2000/2001 not 2001/2002 against his income from Cityflyer in that year.

69. The second issue relates to the formalities of the appeals. In Mr Hinsley’s case the relief for the expense was sought in his self-assessment return for 2001/2002. His appeal is against an amendment to that return by the Respondents by virtue of which the relief was denied.

70. For the reasons I have given above it seems to me that if Mr Hinsley’s expense had been eligible for deduction it would have been deductible in 2000/2001 and not in the year in which the amendment to the self-assessment return was made. The fact however does not deprive me of jurisdiction under section 31 and 31C TMA 1970 in relation to the amendment to the 2001/2002 return.

71. In Mr Milsom’s case he sought relief in October 2003 against his income from Airtours in 1997/98. in the copy correspondence before me the Respondents say that because Mr Milsom’s “1997 - 199 self-assessment return was final and conclusive when [he wrote seeking relief], the only way a deduction is permitted is by a claim to error or mistake under section 33 TMA 1970.” The claim was accordingly so treated. Mr Southern in his skeleton argument however suggested that Mr Milsom had not been required to make a self-assessment return for 1997/1998.

72. Mr Southern noted that Section 42(2) TMA provided that where a person had been required by section 8 TMA to provide a self-assessment return, any claim should be made only by being included in a return. Miss Shaw noted that the right to deduct eligible expenses was not required to be made by a “claim”. She also indicated that the Respondents did not dispute my jurisdiction to hear this appeal.

73. In the light of the parties’ agreement that I had jurisdiction to hear Mr Milsom’s appeal I shall deal with this issue shortly. It seems to me that if Mr Milsom made a

return (as appears to be accepted by the Respondents) that the making of a claim under section 33 TMA is not required to be made as a claim subject to the provisions of section 42. That is because section 33 contains its own specific provisions relating to the making of such claims and appeals against them. Mr Milsom's letter was a notice in writing within section 33 which the Board determined against him. The appeal under section 33(5) to this tribunal was thus properly constituted.

74. The Appeal is dismissed.