

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Example 3

Ne = £5,000; Da = 183; De = 183; Smg = 0

Part 5: Employment income: deductions allowed from earnings

Overview

Chapter 1: Deductions allowed from earnings: general rules

Overview

1390. This is the first of six chapters dealing with deductions allowed in charging earnings to income tax.
1391. After the introductory section 327, this Chapter sets out some general propositions which are applicable to most of the deductions dealt with in the next five chapters. Those propositions relate to:
- the income from which deductions may be made (section 328);
 - the general prohibition on deductions exceeding earnings (section 329);
 - the prevention of double deductions (section 330); and
 - the order in which deductions are to be made (section 331).
1392. This Chapter concludes with section 332, which lists “the deductibility provisions”.

Section 327: Deductions from earnings: general

1393. This section sets the scene. It gives information about the contents of this Part, and places this Part within a wider context.
1394. The section is new, although it draws on material contained in section 131(1) of ICTA.
1395. *Subsection (1)* provides the essential link between this Part of this Act and section 11(1), which is in Part 2. The subsection states that this Part provides for deductions that are allowed from the taxable earnings from an employment in a tax year for the purpose of calculating the “net taxable earnings” from the employment in the tax year for the purposes of Part 2 of this Act.
1396. *Subsection (2)* sets out how two key expressions are used in this Part. References to the earnings from which deductions are allowed are references to the taxable earnings

mentioned in subsection (1), and references to the tax year are references to the tax year mentioned there.

1397. *Subsection (3)* states that the deductions for which this Part provides are those allowed under Chapters 2 to 6; and the contents of those Chapters are indicated.
1398. *Subsection (4)* lists other provisions, not in this Part, which make further provision about deductions; and *subsection (5)* lists other provisions, not in this Part, which make further provision about deductions from income including employment income.

Section 328: The income from which deductions may be made

1399. This section is the first of four which sets out a general proposition relating to deductions from earnings. It deals with the income from which deductions may be made.
1400. The most important single source for this section is section 198(1) of ICTA, which includes the proposition that an amount paid “out of the emoluments of the office or employment ... may be deducted from the emoluments to be assessed”. This section also draws on a considerable number of other passages in Part 5 of ICTA and in section 50 of FA 1989.
1401. *Subsection (1)* sets out the general rule that deductions under this Part are allowed from any earnings from the employment in question, but not from earnings from any other employment.
1402. An example of how this rule operates in practice is given in Inland Revenue guidance in SE 31658:

An individual is employed as a teacher and separately employed as coach to a local youth football team. As coach she is paid £100 a year but she incurs expenses of £1,000 a year in travelling to away matches. She pays the expenses herself and is not reimbursed by her employer.

She is only allowed a deduction of £100 for her travelling expenses under section 198(1) of ICTA. She cannot claim a loss for the remaining £900 and nor can she deduct that amount from her teaching income.

1403. The general rule is subject to a number of qualifications. These are dealt with in the rest of this section.
1404. *Subsection (2)* deals with one case where the general rule is not wide enough. Expenses of a minister of religion (see section 351) are allowed from earnings from any employment as a minister of a religious denomination.
1405. *Subsections (3) to (5)* deal with cases where the general rule is too wide: for example there are some cases where the deductions are allowed only from earnings with particular characteristics – either relating to the source of the earnings or to the manner in which the earnings are charged to tax.
1406. *Subsection (3)* provides that deductions under section 368 are only allowed from earnings payable out of the public revenue.
1407. *Subsections (4) and (5)* deal with “deductions limited to specified earnings”: for, in the cases of some provisions, deductions are allowed from earnings from the employment which qualify as taxable earnings under certain of the charging provisions of Chapters 4 and 5 of Part 2, but not from other earnings from the employment.

Section 329: Deductions from earnings not to exceed earnings

1408. This section is the second of four which sets out a general proposition relating to deductions from earnings. It deals with the proposition that deductions from earnings may not exceed earnings.

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Act 2003 (c.1) which received Royal Assent on 6th March 2003*

1409. As in the case of section 328 the most important single source for this section is section 198(1) of ICTA, which allows a deduction for an amount if “the holder of an office or employment is obliged to incur and defray [that amount] out of the emoluments of the office or employment”. This section also draws on a considerable number of other passages in Part 5 of ICTA and in section 50 of FA 1989.
1410. *Subsection (1)* sets out the general rule that deductions may not exceed the earnings from which they are deductible. That general rule is then elaborated in *subsections (2)* to *(4)*.
1411. Inland Revenue guidance makes it clear that the employee does not generally have to demonstrate that an expense has literally been paid out of the emoluments rather than out of some other source of money. It is generally sufficient that the emoluments charged to tax in a particular tax year are equal to, or greater than, the deductions to be made from those emoluments. As the Inland Revenue does not generally trace the source of funds used by the employee to pay expenses, the requirement that the employee must pay the expenses out of the emoluments of the employment is not stated in general terms in this Act. See *Change 81* in Annex 1.
1412. *Subsection (5)* deals with a matter which follows on from the fact that this Act does not reproduce any general requirement that expenses must be paid out of the emoluments of the employment. This Act rewrites numerous provisions that refer to expenses that would be allowable if the employee paid them out of the emoluments of the employment. Those provisions (“the deductibility provisions”) are listed in section 332. Since the general requirement in *subsection (1)* that deductions from earnings are not to exceed earnings is assumed to be met in the deductibility provisions (because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments), this subsection provides that this section is to be disregarded for the purposes of the deductibility provisions.
1413. *Subsection (6)* provides a signpost to section 380 of ICTA, a section drafted on the basis that there may be Schedule E losses which may be set against other income of the tax year, or carried back to earlier tax years.

Section 330: Prevention of double deductions

1414. This section is the third of four which sets out a general proposition relating to deductions from earnings. It deals with the prevention of double deductions.
1415. The proposition in this section is not articulated in general terms in ICTA, although it seems true as a matter of income tax law. There are statements of this proposition in particular contexts in sections 194(9), 195(12) and 198(3) of ICTA.
1416. *Subsection (1)* sets out the general rule: a deduction from earnings under this Part is not allowed more than once in respect of the same costs or expenses.
1417. *Subsection (1)* is expressed to apply to “costs and expenses”. These words are intended to cover all potential deductions under this Part, even though the amount of the deduction may not be computed by reference to an actual amount of expenditure – as is the case under Chapter 4 of this Part, which deals with fixed allowances for employee’s expenses.
1418. *Subsection (2)* deals with the case where a cost or expense qualifies both for an allowance under Chapter 4 of this Part and for a deduction under some other provision. In such a case only one of the deductions is allowed. This provision codifies Inland Revenue practice on these topics. See *Change 82* in Annex 1.

Section 331: Order for making deductions

1419. This section is the last of four which sets out a general proposition relating to deductions from earnings. It deals with the order in which deductions may be made.

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1420. *Subsection (1)* sets out the general rule that section 835 of ICTA, which provides for deductions to be allowed in the order which results in the greatest reduction of liability to income tax, applies in the present context.
1421. *Subsection (2)* qualifies the general rule. The subsection specifies two provisions which impose a requirement to consider deduction provisions in a particular order.

Section 332: Meaning of “the deductibility provisions”

1422. This Act rewrites numerous provisions that refer to amounts or expenses whose deduction would be allowed if the employee incurred and paid them out of the emoluments of the employment (or in some cases just incurred or just paid them). See *Change 81* in Annex 1.
1423. The provisions of the Act that rewrite these provisions are listed in this section, where they are defined as “the deductibility provisions”.
1424. The requirement that amounts or expenses be incurred and paid out of emoluments of the employment is not, in general, being rewritten: so the deductibility provisions do not rewrite the words “out of the emoluments”. Instead, they refer to amounts or expenses that would be allowed as a deduction if the employee had incurred and paid them.
1425. Since the general requirement in section 329(1) that deductions from earnings are not to exceed earnings is assumed to be met in the deductibility provisions (because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments), section 329(5) provides that section 329 is to be disregarded for the purposes of the deductibility provisions.
1426. In the case of the deduction under section 353, where the requirement for payment out of earnings has survived, it is provided that, for the purposes of the deductibility provisions, the expenses are to be assumed to have been paid out of the earnings in question. (See section 353(4).)