

# **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 2: Deductions for employee's expenses*

##### **Overview**

1427. This Chapter deals with the most familiar situation in which deductions from earnings are allowed – where the employee has paid an expense of the employment. The Chapter also deals with the situation where someone else (usually the employer) pays the expense on the employee's behalf. The Chapter therefore deals with section 198 of ICTA, with the related provisions in Schedule 12A of that Act, and with a number of other provisions, such as sections 201, 201AA and 201A of ICTA, which allow deductions for particular expenses paid by the employee.

1428. The Chapter may be divided into the following components:

- introductory provisions (sections 333 to 335);
- the general rule governing the deduction of expenses (section 336);
- further rules allowing the deduction of particular expenses, grouped according to the type of expense involved (sections 337 to 352);
- special rules for earnings with a foreign element (sections 353 to 355); and
- rules which prohibit or restrict deductions (sections 356 to 360).

#### *Section 333: Scope of this Chapter: expenses paid by the employee*

1429. This section sets out the distinguishing condition for the deductions allowed under this Chapter: the amount in question must have been paid by or on behalf of the employee.

1430. *Subsection (1)* sets out this basic proposition.

1431. The most important single source for this section is section 198(1) of ICTA, which allows a deduction for an amount where the holder of an office or employment is obliged to “incur and defray” that amount. There are also a number of other provisions in Part 5 of ICTA which have similar wording.

1432. There is, however, another point that arises in relation to this part of section 198(1) of ICTA and other corresponding provisions. A deduction may be allowed where the employee has incurred the expense but the actual liability is met by someone else, usually the employer. Where the employee's pecuniary liability is met in this way it is an emolument. It is taxed under paragraph 1 of section 19(1) of ICTA. As the expense is met in a way that constitutes emoluments, it is accepted that it has been defrayed out of those emoluments. The employee, accordingly, is allowed a deduction if the liability met comes within the wording of section 198(1) of ICTA or some other corresponding provision. This, in practice, is how those provisions are operated. *Subsection (1)(b)* of this section therefore provides for a deduction to be allowed for such an amount if that amount is paid on the employee's behalf by someone else and is included in the earnings. See *Note 36(A)* in Annex 2.
1433. The source legislation does not state explicitly that a deduction is allowed where the employee incurs the expense but the liability is met by someone else. *Subsection (2)* makes the position clearer by providing that the employee is treated as paying the expense where the actual liability is met by someone else and constitutes earnings of the employee.
1434. To be allowed a deduction under this Chapter, an employee must satisfy subsection (1), read, if necessary, with subsection (2), although there are some provisions where it is perhaps unlikely that subsection (2) will be in point. The inclusion of these propositions here means that it becomes unnecessary to say something to the same effect in each of the individual deduction provisions in this Chapter.
1435. *Subsection (3)* deals with the two exceptions to subsection (1). In the case of these two exceptions, subsection (2) is also disappplied.
1436. *Subsection (4)* consists of a signpost to the following Chapter. That Chapter deals with deductions from benefits code earnings for costs that would have been deductible if the employee had paid them. It therefore covers cases where an expense is met by the employer in the form of a taxable benefit.

***Section 334: Effect of reimbursement etc.***

1437. This section contains provisions dealing with the effect of reimbursement.
1438. Under the source legislation, a reimbursed amount is dealt with for income tax purposes in either of two ways:
- if the reimbursed amount constitutes part of the earnings from the employment, the deduction is allowed in full; or
  - if the reimbursed amount does not constitute part of the earnings from the employment, the deduction of the expense is not allowed to the extent that reimbursement is made. The speeches of Lord Guest and Lord Pearce in *Pook (HM Inspector of Taxes) v Owen (1969) 45 TC 571* envisage that a reimbursed amount may be dealt with in this way.
1439. Against this background, this section has been included in this Act with the object of making explicit provision for cases where an amount is reimbursed. This section is not derived directly from the source legislation, but it reflects Inland Revenue practice in cases where amounts deductible for income tax purposes are reimbursed. See *Note 36(B)* in Annex 2.
1440. This section also includes wording to ensure that the provisions of this Chapter apply where a payment is made to the employee in respect of the expenses in question, and that payment is included in the employee's earnings. This wording guards against the argument that, in such a case, it is the person making the payment to the employee who pays the amount in question, and not the employee.

1441. *Subsection (3)* provides that this section does not apply to expenses allowed under section 351 (expenses of ministers of religion).
1442. *Subsection (4)* provides that this section is disregarded for the purposes of the deductibility provisions (as defined in section 332).

***Section 335: Application of deductions provisions: “earnings charged on receipt” and “earnings charged on remittance”***

1443. This section provides that the availability of certain deductions under this Chapter depends on whether or not the earnings are “earnings charged on receipt” or “earnings charged on remittance”.
1444. The section is new, but it draws on material in section 198(2) of ICTA.
1445. The expressions “earnings charged on receipt” and “earnings charged on remittance” are defined in *subsection (4)* for the purposes of this Part of this Act. The ambit of the expression “earnings charged on receipt” is the same as that of Cases I and II of Schedule E in paragraph 1 of section 19(1) of ICTA; and the ambit of the expression “earnings charged on remittance” is the same as that of Case III of Schedule E in section 19(1) of that Act.

***Section 336: Deductions for expenses: the general rule***

1446. This section states the general rule relating to deductions allowed from earnings.
1447. The section derives from section 198(1)(b) of ICTA. This provision has been the subject of much litigation.
1448. *Subsection (1)* states the general rule: a deduction from earnings is allowed for an amount if the employee is obliged to incur and pay it as holder of the employment, and the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.
1449. *Subsection (2)*, which is new, provides that the following sections in this Chapter contain additional rules allowing deductions for particular kinds of expenses, and rules preventing particular kinds of expenses from being deductible. This subsection, accordingly, emphasises the fact that deductions under the later sections in this Chapter do not depend on this section being satisfied first.
1450. *Subsection (3)* provides that no deduction is allowed under this section for an amount that is deductible under sections 337 to 342 (travel expenses).

***Section 337: Travel in performance of duties***

1451. This section allows a deduction from earnings for travel expenses if the expenses are necessarily incurred on travelling in the performance of the duties of the employment.
1452. The section is the first of two dealing with the proposition, contained in section 198(1)(a) of ICTA, that a deduction is allowed for “qualifying travelling expenses”. This section deals with the part of that definition in section 198(1A)(a) of ICTA.
1453. Although the label “qualifying travel expenses” appears in section 198(1)(a) of ICTA, that label is used only at the beginning of section 198(1A) of that Act. The label is not used in this Act.
1454. *Subsection (1)* provides that a deduction is allowed from earnings for the travel expenses. In *subsection (1)(b)*, the word “incurred” has replaced the word “expended”; but the practical application of this section should be precisely the same as that of the legislation it replaces: *subsection (1)(a)* provides that the travel expenses must be both incurred and paid.

1455. *Subsection (2)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

***Section 338: Travel for necessary attendance***

1456. This section allows a deduction from earnings for travel expenses if the expenses are attributable to the employee's necessary attendance at any place in the performance of the duties of the employment. However, the deduction allowed by this section is not available for the expenses of "ordinary commuting" or "private travel".
1457. The section is the second of two dealing with the proposition that a deduction is allowed for qualifying travelling expenses. This section deals with the part of that definition in section 198(1A)(b) of ICTA. That provision mentions "ordinary commuting" and "private travel" in section 198(1A)(b)(ii) but those expressions are only defined in paragraph 2 of Schedule 12A to that Act. Paragraph 3 of that Schedule contains a gloss on paragraph 2 and this section also deals with that gloss.
1458. This section derives from section 198(1)(a) and (1A)(b) of ICTA and from paragraphs 2 and 3 of Schedule 12A to that Act. The statutory material has been reorganised so that the definitions of "ordinary commuting" and "private travel" are placed near the propositions to which they apply; and the gloss upon the definitions has been incorporated in the subsections setting out the effect of "ordinary commuting" and "private travel".
1459. *Subsection (6)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

***Section 339: Meaning of "workplace" and "permanent workplace"***

1460. This section defines the terms "workplace" and "permanent workplace", which are used in the definitions of "ordinary commuting" and "private travel" in section 338.
1461. The section derives from paragraphs 2(3) and 4 to 7 of Schedule 12A to ICTA.

***Section 340: Travel between group employments***

1462. This section allows a deduction from earnings for travel expenses where an employee, who has employments with more than one company in the same group, travels from a place of employment with one group company to another place of employment with another group company.
1463. The section derives from section 198(1B) of ICTA, which provides that the travel expenses are treated as necessarily expended in the performance of the duties to be performed at the destination.
1464. *Subsections (2) to (5)* set out all the conditions that need to be met for the deduction to be allowed. The condition that it is the holder of the employment who is obliged to incur the expenses has not been included, because the Inland Revenue does not rely on this condition before the deduction is allowed. See *Change 83* in Annex 1.
1465. *Subsection (6)* defines the term "group" for the purposes of this section. The definition is more concise than in the legislation from which this subsection derives.
1466. *Subsection (7)* does not set out the general proposition, to be found in the source legislation, that the travel expenses are necessarily expended in the performance of the duties to be performed at the destination. Instead, the operation of the provision has been confined to the two sections (mentioned in this subsection) where this proposition may have an impact.

1467. *Subsection (8)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

***Section 341: Travel at start or finish of overseas employment***

1468. This section allows a deduction from earnings for starting travelling expenses and finishing travelling expenses if the duties of the employment are performed wholly outside the United Kingdom.
1469. The section derives from section 193(2) and (3) of ICTA.
1470. Section 193(3) begins with the words “For the purposes of section 198(1)”. This section sets out all the conditions that have to be met in each case, as opposed to referring to section 336, the successor provision to section 198(1).
1471. *Subsections (2) to (4)*, however, do not reproduce the condition from section 198(1) that the holder of the employment is obliged to incur and defray the expenses, because the Inland Revenue does not rely on this condition before allowing the deduction from earnings. See *Change 83* in Annex 1.
1472. *Subsection (4)* is one of the provisions that make use of the new term “foreign employer”, defined in section 721 for the purposes of this Act as a whole.
1473. *Subsections (6) and (7)* derive from section 132(2) of ICTA. These subsections ensure that a deduction under this section is still available if duties of the employment are performed in the United Kingdom which are merely incidental to the duties of the employment performed outside the United Kingdom. See also *Change 101(B)* in Annex 1.
1474. *Subsection (8)* defines the new terms “starting travel expenses” and “finishing travel expenses”, which describe travel to take up an overseas employment and travel home after it has finished. This subsection also extends the meaning of the term “employee” to include a person who is to be, or has ceased to be, an employee.
1475. *Subsection (9)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

***Section 342: Travel between employments where duties performed abroad***

1476. This section allows a deduction from earnings for travel expenses where an employee, who has performed duties of one employment at the place of departure, travels to perform duties of another employment at the destination, and the place of departure or the destination, or both, are outside the United Kingdom.
1477. The section derives from section 193(5) and (6) of ICTA.
1478. Section 193(6) begins with the words “For the purposes of section 198(1)”. This section sets out all the conditions that have to be met in each case, as opposed to referring to section 336, the successor provision to section 198(1).
1479. *Subsections (2) to (7)*, however, do not reproduce the condition from section 198(1) that the holder of the employment is obliged to incur and defray the expenses, because the Inland Revenue does not rely on this condition before the deduction is allowed. See *Change 83* in Annex 1.
1480. *Subsection (7)* is one of the provisions that make use of the new term “foreign employer”, defined for the purposes of this Act as a whole in section 721.

*These notes refer to the Income Tax (Earnings and Pensions)  
Act 2003 (c.1) which received Royal Assent on 6th March 2003*

1481. *Subsection (9)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.