DECISION ON THE APPEAL OF THE UPPER TRIBUNAL (ADMINISTRATIVE APPEALS CHAMBER)

The DECISION of the Upper Tribunal is to allow the appeal by the Appellant.

The decision of the Liverpool First-tier Tribunal dated November 24, 2016 under file reference SC068/16/03761 involves an error on a point of law. The Tribunal's decision is therefore set aside.

The Upper Tribunal is in a position to re-make the decision under appeal. The decision that the First-tier Tribunal should have made is as follows. The Upper Tribunal re-makes the decision accordingly:

> **"***The Appellant's appeal against HMRC's decision dated August 7, 2016 (and communicated by letter dated August 9, 2016) is allowed. HMRC's decision refusing entitlement to working tax credit is set aside.*
>
> *The reason for this is that the Appellant is "self-employed" within the terms of the definition in regulation 2(1) of the Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002 (SI 2002/2005). It follows he is engaged in qualifying remunerative work for the purposes of regulation 4 of those Regulations and section 10 of the Tax Credits Act 2002.*
>
> *The case is remitted to HMRC for calculation of the Appellant's entitlement to working tax credit."*

This decision is given under section 12(2)(a) and 12(2)(b)(ii) of the Tribunals, Courts and Enforcement Act 2007.

REASONS FOR DECISION

The central legal question raised by this appeal

1. What is meant by the term "self-employed" in the context of entitlement to working tax credit?

2. This case is not concerned with the distinction between being "employed" and "self-employed", which has generated a considerable body of case law in a number of different legal contexts.

3. Instead, this question is concerned more narrowly with the definition of being "self-employed" that has applied in the context of entitlement to working tax credit since April 6, 2015. To the best of my knowledge, this is the first time this issue has been addressed by the Upper Tribunal since the relevant legislation was amended.

A summary of Upper Tribunal's decision

4. I am allowing the Appellant's appeal. The First-tier Tribunal ("the Tribunal")'s decision involves an error on a point of law. That Tribunal's decision is set aside. Fortunately I can make the decision that the Tribunal should have made and do so. Although this is a supported appeal, I am giving my reasons in some detail as the

circumstances of the present appeal are likely to be fairly typical of a significant number of other cases that fall for decision by the First-tier Tribunal.

The background to the appeal to the First-tier Tribunal

5. The Appellant had previously been on jobseeker's allowance (JSA). He decided to go into business on his own account as a painter and decorator. He made a claim for working tax credit. Her Majesty's Revenue and Customs (HMRC) sent him a questionnaire to complete. On this form he explained that his business was "still in very early stages. Trying to keep it simple to keep cost down." In answer to a question about how he was advertising his business, he stated "taken out an advert on gumtree. Going door to door handing out leaflets". In response to a final and catch-all question, namely "tell us any other information that is relevant to your self-employment", he added: "Just happy to be off JSA and hopefully make a go of something". He included copies of his leaflets, his CITB skills certificates and very rough handwritten preliminary accounts (essentially a list of jobs detailing dates, addresses and prices charged along with outgoings).

6. HMRC, or rather one of HMRC's compliance officers, then sent the Appellant a letter refusing his claim for working tax credit. The relevant passage in the refusal letter read as follows:

> "I've decided that you're not entitled to Working Tax Credit. This is because the information you've given me does not show:
>
> - [your] trade, profession or vocation is regular and organised
> - [your] trade, profession or vocation is commercial
> - [your] trade, profession or vocation is carried out with a view to profit
>
> As a result of not meeting our definition of a self-employed person you are not treated as being engaged in qualifying remunerative work."

7. Rather alarmingly, the (presumably stock) letter also added "My decision does not affect any other action we may take if we suspect that you have committed a criminal offence. For example, we may take criminal proceedings against you."

8. Undeterred, the Appellant asked HMRC for a mandatory reconsideration of its decision to refuse his claim for working tax credit. Along with the relevant official form, he included a handwritten note by way of response to the bullet points in the refusal letter. I include that note in its entirety, with no corrections for spelling or grammar. I do so as I believe the Appellant should have his own voice clearly heard, and in recognition of the articulate way he has put his case, both with regard to his own particular circumstances and the wider policy objectives behind working tax credit:

> *"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 credits 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."

The First-tier Tribunal's decision

9. The Tribunal dealt with the appeal on the papers. The Appellant did not ask for an oral hearing (presumably as he was too busy trying to make a go of his fledgling business).

10. The Tribunal dismissed the appeal and confirmed the HMRC refusal decision. The Tribunal's decision notice stated that the Appellant "was unable to provide sufficient evidence to show that his self employment was commercial, profitable, regular and organised." It added that while the Appellant "did provide some evidence of that nature it was lacking in what might be expected to be available as part of normal business activity such as receipts and expenses and records of sales and purchases together with details of planned work and profit projections among other information".

11. In its subsequent statement of reasons, the Tribunal explained its decision in these terms:

> "16. In determining this appeal, the Tribunal looked at the matter entirely afresh and put itself in the shoes of the Respondent. The issue for the Tribunal, therefore, was whether the Appellant provided sufficient evidence of the nature set out in the preceding paragraph [*i.e. to show that he met the new statutory definition of being 'self-employed'*]. Despite the fact that the Appellant's submissions held a certain attractiveness, the Tribunal concluded, on the balance of probabilities, that in the absence of evidence such as written quotations provided by the Appellant to prospective customers; invoices for work done; evidence of payments actually received for work done; evidence of a business bank account and vehicle and/or public liability insurance in respect of the business, there was insufficient evidence to be satisfied that the Appellant met the criteria set out in Regulation 2 of the Regulations. The Tribunal did not consider that the absence of business plans in all of the circumstances of this case was critical but was one other factor in the Tribunal reaching its decision.
>
> 17. Finally, the Tribunal attached very great significance to the fact that an analysis of the profit figures submitted by the Appellant for the months of July to

> September 2016, inclusive, showed that the Appellant had to have been working for a rate of just £2.39 per hour – if the Appellant was engaged in qualifying work for at least 30 hours per week. In the absence of evidence to the contrary, the only conclusion the Tribunal could reach was that the Appellant was not engaged in remunerative work as a self-employed earner for at least 30 hours per week. And was not, therefore, entitled to WTC."

12. At this stage it may be helpful to examine the relevant law (and associated guidance) in more detail.

A digression: the relevant legislation

13. Entitlement to working tax credit depends on being in "qualifying remunerative work" (Tax Credits Act (TCA) 2002, section 10(1)). Statute also provides that regulations may further define that term (TCA 2002, section 10(2)).

14. According to the regulations, the 'first condition' of entitlement to working tax credit is that the claimant "is employed or self-employed" and is either working at the date of claim or has accepted an offer of work which is expected to start within 7 days of the date of claim (Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002 (SI 2002/2005), regulation 4(1); "the WTC Regulations").

15. From the outset of the tax credits scheme until April 5, 2015, the definition of being in self-employment was a simple one: ""self-employed" means engaged in the carrying on of a trade, profession or vocation" (regulation 2(1) of the WTC Regulations).

16. However, the Chancellor of the Exchequer announced a change to this rule in the 2015 Budget. As a result of an amendment made by regulation 3 of the Working Tax Credit (Entitlement and Maximum Rate) (Amendment) Regulations 2015 (SI 2015/605), and with effect from April 6, 2015, regulation 2(1) of the WTC Regulations now includes the following substituted definition:

> ""self-employed" means engaged in carrying on a trade, profession or vocation on a commercial basis and with a view to the realisation of profits, either on one's own account or as a member of a business partnership and the trade, profession or vocation is organised and regular;".

17. HMRC explained the purpose of this amendment as follows (see HMRC, *Revenue and Customs Brief 7 (2015): new rules for the self-employed claiming Working Tax Credit*, March 25, 2015):

> "From 6 April 2015, all new claimants who are using self-employed work to meet the qualifying remunerative work test for WTC, must show that they are trading on a commercial basis and their business is done with a view to achieving profits. The self-employment should also be structured, regular and ongoing.
>
> For example, if their business activity is a hobby it is not likely to be considered commercial or have an expectation of realising a profit.
>
> These checks are about ensuring HM Revenue and Customs (HMRC) only pay tax credits to those who are entitled. WTC will continue to support those who are carrying on a genuine business activity. These changes will not affect the rules for claiming Child Tax Credit."

18. The same HMRC policy paper set out how the rules would be applied:

> "Self-employed WTC claimants with earnings below a threshold (this will be based on working hours and the National Minimum Wage) will be asked by HMRC to provide evidence that they are in a regular and organised trade, profession or vocation on a commercial basis and with a view to achieving a profit.
>
> The information we ask for should be available as part of normal business activity, for example receipts and expenses, records of sales and purchases. We may also ask for supporting documents such as a business plan, planned work, cash flow and profit projections.
>
> During the early stages of self-employment it may prove difficult to make a profit. If someone in this situation claims WTC they may be asked to show that they have a commercial approach and how their business would become profitable. This could be demonstrated in a business plan.
>
> HMRC will use the information provided to reach a decision about the claimants' current WTC award.
>
> Claimants may lose their WTC if they cannot provide the evidence we ask for and may have to repay any tax credits they are not entitled to.
>
> Claimants who disagree with our decision can ask for us to look at the decision again."

19. I simply make the obvious point here that this is a statement as to what HMRC understand the law to be and how they propose to apply it. It does not purport to be an authoritative statement of what the law actually is.

Permission to appeal as given by the Upper Tribunal

20. Returning to the chronology of the present appeal, the Appellant applied for permission to appeal to the Upper Tribunal, having been refused by the First-tier Tribunal. His complete grounds of appeal were stated as follows, understandably in a lay person's terms:

> "AGAIN I am not happy. As far as my accountant is concerned I should qualify; again you have not given me a reason just tell me in simple terms why I have not qualified. I am just trying to get on in life and need a bit of help. I do not agree with this decision. IF I DO NOT get this appeal please let me know why, thank you."

21. I gave the Appellant permission to appeal in these terms:

> *'The application for permission to appeal: the Appellant's case*
> 3. The Appellant's case is quite simple. He says that he has come off JSA and is trying to make a go of being a one-man painter and decorator business. Her Majesty's Revenue and Customs (HMRC) decided he did not meet the legal definition of being "self-employed". The FTT agreed with HMRC. The Appellant still cannot understand why he does not qualify for working tax credit (WTC).
>
> *The new test for being self-employed under WTC law*
> 4. HMRC decided the Appellant did not meet the (relatively new) test of being "self-employed" (as set out in regulation 2(1) of the WTC (Entitlement and

Maximum Credit) Regulations 2002 (SI 2002/2005), as amended). The Appellant had to show he was self-employed under that definition so as to be in "qualifying remunerative work" (TCA 2002, section 10), in turn as defined by regulation 4 of the 2002 Regulations.

5. The test of being self-employed is defined in these terms:

> *"self-employed" means engaged in carrying on a trade, profession or vocation on a commercial basis and with a view to the realisation of profits, either on one's own account or as a member of a business partnership and the trade, profession or vocation is organised and regular.*

The reasons why I am giving permission to appeal

6. I am giving permission to appeal as it is arguable the Tribunal went wrong in its legal approach to this question. I have three particular concerns.

7. First, did the Tribunal take sufficient account of the particular circumstances of the Appellant's business, being a start-up? The evidence was that he had only started this work on June 20, 2016 (p.26). It was therefore in its very early stages. He only had rudimentary accounts for June, July, August and September 2016 when he appealed (pp.13-14, 33-34). The FTT hearing was in November 2016. The Judge recognised this point at paragraph [7] of his statement of reasons but then made no mention of it in paragraph [16].

8. Second, did the Tribunal simply expect too much of a new one-man business such as this? The type of evidence available must necessarily depend on the type and size of the business. To take a simple example. If a person sets up as a self-employed trader running a car wash business, employing casual staff and leasing commercial premises, one would expect plenty of documentation to support the claim he was "self-employed". However, an individual starting up business going door-to-door as a car-washer will necessarily have far less paperwork and so a much more limited audit trail. In the same vein, whilst the Judge said that the absence of a business plan was just one factor, why was it a factor at all? A person might have to have a business plan as a means of getting support from some DWP work programme or in order to borrow money from a bank. But if the Appellant did not need a business plan, why should the absence of one be held against him? In other words, "organised" must surely be context specific?

9. Third, I note that the fact that the Appellant was supposedly working for £2.39 an hour has been regarded by the FTT as of "very great significance". There are two potential objections to this approach.

10. The first objection is that £2.39 an hour is based on his *profit* figures for the first 3 full months, not his turnover. However, this was a new business and he had a substantial outlay on materials in August. If one makes the calculation on the basis of the time he charged out, then he was working for £4.61 an hour, almost twice as much, which is getting closer to the national minimum wage (£460 + £850 + £490 divided by 390 (= 13 weeks x 30 hours)).

11. The second objection is that any such calculation is based only on his charged out hours. But it is inevitable in any business, especially a new business, that there will be hours spent working which are not remunerated (giving quotes, advertising, doing paperwork, etc etc). The HMRC submission to

> the FTT asserted that activities spent in setting up the business (e.g. leafleting) do not represent remunerative work for the purpose of claiming WTC" (p.G at front of the bundle). Is that really the case? It has long been established in relation to means-tested benefits that for the purpose of counting the number of hours of self-employment one can include hours which are essential to the undertaking, and not simply hours which are costed and charged out to clients (see e.g. Commissioner's decision R(FIS) 6/85). Is the position any different under the new regulation 2 test?
>
> 12. It follows there is certainly enough here to justify giving the Appellant permission to appeal.'

The HMRC response to the appeal before the Upper Tribunal

22. I am indebted to the HMRC representative (Mrs E Collins), who supports the Appellant's appeal to the Upper Tribunal, for her detailed and helpful response to the appeal. She notes, quite correctly, that this case involved a fresh claim for working tax credit. Accordingly, the onus of proof of entitlement rested with the Appellant, subject to the recognition that the Tribunal proceedings were inquisitorial and not adversarial (see *Kerr v Department for Social Development* [2004] UKHL 23). In that context she very fairly observed that HMRC had apparently returned some business-related receipts to the Appellant which did not find their way into the tribunal bundle. In addition, HMRC's correspondence did not explain adequately what was needed and why the claim had failed. As Mrs Collins comments, "It is therefore difficult to imagine how the claimant knew precisely what HMRC required of him".

23. Mrs Collins's conclusion is that in fairness the Tribunal should have exercised its case management powers to adjourn the hearing for further fact finding, and its failure to do so amounted to a material error of law. She also agrees with my observation when giving permission to appeal to the effect that, as she puts it, "the sentiments of R(FIS) 6/85 are still applicable". Furthermore, "the crux of how far this applicability extends is entirely dependent upon the circumstances in the individual case. What is important is that any non-remunerated hours are not automatically disregarded without due consideration." She invites me to allow the appeal, to set aside the Tribunal's decision and to remit the case to a fresh Tribunal for further fact-finding.

The Upper Tribunal's analysis

24. I can keep this part of the decision relatively short. The Tribunal's decision involves a material error of law. It matters not quite how this is characterised. One view, as Mrs Collins advocates, is that there was a failure on the part of the Tribunal to adopt a sufficiently inquisitorial approach as regards fact-finding, not least given the deficiencies in the compilation of the original HMRC response to the Tribunal. Another view is that the Tribunal erred in law by disregarding hours spent in setting up the business. The HMRC assertion in the original response, apparently accepted by the Tribunal, to the effect that "time spent in setting up the business and handing out leaflets door to door … do not represent remunerative work for the purpose of claiming WTC" was simply wrong as a matter of law (see R(FIS) 6/85). I therefore allow the Appellant's appeal to the Upper Tribunal and set aside the First-tier Tribunal's decision.

Disposal of the appeal

25. Mrs Collins suggests I send this case back to the First-tier Tribunal for re-hearing. I consider that would simply increase delay and provide no added value. Having reviewed the (incomplete) evidence on file, I am nonetheless satisfied on the balance of probabilities that as at the date of the original HMRC decision the

Appellant was self-employed for the purposes of the amended definition in regulation 2(1) of the WTC Regulations.

26. In summary, I reach that conclusion having found the following facts and for these reasons. The Appellant was working on his own account as a painter and decorator. That occupation is plainly "a trade, profession or vocation". Although he had only just started off in business, he was also working "on a commercial basis and with a view to the realisation of profits", essentially for the reasons that the Appellant himself gave so eloquently when he applied for a mandatory reconsideration of HMRC's refusal decision. His trade was also "organised and regular" – it was organised, albeit on a fairly rudimentary basis (unsurprisingly given he had only just started self-employment) and it was regular in terms of his time commitment to the work. I also rely on the fact that the appeal file shows the Appellant has an accountant.

27. However, I must stress that not having an accountant would not itself be taken as an indicator that the Appellant had failed to meet the "self-employed" test (ditto the absence of a business plan). I say that as empirical evidence shows that most self-employed people on low incomes do not have accountants. Indeed, "the evidence from people's experiences of claiming tax credits and keeping financial records points to the need for procedures to be designed so that they can be managed by inexperienced, self-employed people who lack specialist accounting knowledge or access to professional help" (R. Sainsbury and A. Corden, *Self-employment, tax credits and the move to Universal Credit*, DWP Research report no. 829 (2013), p.42).

28. It follows that the decision the First-tier Tribunal should have made was as follows:

> *The Appellant's appeal against HMRC's decision dated August 7, 2016 (and communicated by letter dated August 9, 2016) is allowed. HMRC's decision refusing entitlement to working tax credit is set aside.*
>
> *The reason for this is that the Appellant is "self-employed" within the terms of the definition in regulation 2(1) of the Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002 (SI 2002/2005). It follows he is engaged in qualifying remunerative work for the purposes of regulation 4 of those Regulations and section 10 of the Tax Credits Act 2002.*
>
> *The case is remitted to HMRC for calculation of the Appellant's entitlement to working tax credit.*

Guidance to First-tier Tribunals more generally

29. Given this is a supported appeal, and so the new definition of "self-employed" has not been fully tested in argument, I simply make two observations of more general application.

30. The first is that, as Mrs Collins accepts on behalf of HMRC, the principle set out in R(FIS) 6/85 still holds good in the context of the new definition of "self-employed". In that decision Mr Commissioner Reith agreed with the Commissioner in R(FIS) 1/83 to the effect that, in the context of self-employment, remunerative work means "work carried out with the desire, hope and intention of claiming a reward or profit" (at paragraph 6). Furthermore, and more particularly, "activities in the course of remunerative work are not in respect of the self-employed restricted only to these activities which are costed" (also at paragraph 6). As Mrs Collins submits, this is

ultimately a fact-specific question and "what is important is that any non-remunerated hours are not automatically disregarded without due consideration".

31. The second point is that tribunals need to "get real". Empirical evidence demonstrates the heterogeneity of the many different forms of self-employment (see further Sainsbury and Corden, paragraph 27 above). Self-employed working tax credit claimants (typically) are not putting together business proposals of sufficient rigour to pass muster on a Masters of Business Administration course or to withstand scrutiny in an episode of *Dragons' Den*. Usually they are much more modest enterprises, as in the present case, and expectations about the documentary paper trail should be adjusted accordingly.

The wider legislative context

32. The new definition of "self-employed" has not been plucked out of thin air by those responsible in HMRC for drafting secondary legislation. For example, under section 64 of the Income Tax Act 2007 a taxpayer may claim 'sideways' loss relief (trade loss relief against general income). However, section 66 of the same Act provides that trade loss relief against general income is not available unless the trade is carried on throughout the relevant period "on a commercial basis" and "with a view to the realisation of profits of the trade". These statutory phrases have, inevitably, generated a considerable body of revenue case law. It is a question for another day as to how far those authorities can be read across to apply in the present and rather different statutory context.

Conclusion

33. The Appellant's appeal to the Upper Tribunal is allowed. I conclude that the decision of the First-tier Tribunal involves an error of law. I allow the appeal and set aside the decision of that tribunal (Tribunals, Courts and Enforcement Act 2007, section 12(2)(a)). The FTT's decision is now of no effect. I re-make the FTT's decision in the terms as set out above (section 12(2)(b)(ii)).

Signed on the original
on 10 August 2017

Nicholas Wikeley
Judge of the Upper Tribunal