[2019] AACR 23

(JW v HMRC [2019] UKUT 114 (AAC))

Judge Poole **CSTC/283/2018**
25 March 2019

Working tax credit − definition of "self-employed" in the Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002 − relevance of "profitability" and "genuine and effective"

The appellant was an author, musician, publisher and promoter of his own creative intellectual property. He had been in receipt of Working Tax Credit (WTC). He claimed WTC for the tax year 2017/2018. The Commissioners for Her Majesty's Revenue and Customs (HMRC) made an initial decision under section 14(1) of the Tax Credits Act 2002 to award him £2770.35 WTC, on the basis that he was working 30 hours a week in self-employment. On 13 November 2017, HMRC made a further decision, this time under section 16(1) of the 2002 Act, that the appellant was not eligible to receive WTC for the tax year 2017/2018. The appellant appealed to the First-tier Tribunal (F-tT). The F-tT refused the appeal against the section 16 decision finding that the appellant did not meet the entitlement condition for WTC of being self-employed, because his business activities were not carried on "on a commercial basis."

The appellant appealed to the Upper Tribunal (UT). The issues before the UT were: the definition of "self-employed" in the entitlement conditions in the Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002 and in particular what the requirement that a trade, profession or vocation is carried on "on a commercial basis" means.

Held, allowing the appeal, that:

1. it was an error of law to find that self-employment was not commercial on the basis it was unprofitable (paragraph 25);

2. the tests the tribunal actually has to apply are those set out in the legislation, including the full definition of self-employment and the various conditions in regulation 4 of the 2002 Regulations. "Genuine and effective" is not part of those tests and is best avoided (paragraph 27);

3. the tribunal's decision was made in error of law because it wrongly applied tests of profitability and genuine and effective to decide whether the claimant's business was carried on "on a commercial basis". What the tribunal should have done was apply all of the various conditions in the 2002 Regulations in order to decide whether the claimant was eligible for WTC (paragraph 28).

The Judge found that the F-tT erred in law and directed HMRC to have regard to her findings when making its further decision under section 18.

DECISION OF THE UPPER TRIBUNAL
(ADMINISTRATIVE APPEALS CHAMBER)

DECISION

The decision of the Upper Tribunal under section 12(2) (a) of the Tribunals, Courts and Enforcement Act 2007 is that, although the decision of the First-tier Tribunal made on 6 April 2018 at Glasgow involved an error of law, it is not set aside.

The respondent is directed to have regard to the reasons given for this decision when reviewing its decision made on 22 January 2019 in relation to the claimant's entitlement to working tax credit for the tax year 2017-2018.

REASONS FOR DECISION

Background

1. This case concerns working tax credit ("**WTC**") and the conditions which must be met for entitlement. It is principally about the definition of "self-employed" in the entitlement conditions in the Working Tax Credit (Entitlement and Maximum Rate) Regulations 2002 (SI No 2005) (the "**2002 Regulations**"), and in particular what the requirement that a trade, profession or vocation is carried on "on a commercial basis" means. The case decides that the First-tier Tribunal (the "**tribunal**") erred in law in finding that the business of the appellant (the "**claimant**") was not carried on a commercial basis because it was unprofitable; and in applying a test of "genuine and effective". A subsidiary issue arises about the appropriate disposal of the appeal, given that on January 2019 HMRC made a further decision in relation to entitlement to WTC for the tax year in question.

2. The claimant was born on 30 December 1957 and is an author, musician, publisher and promoter of his own creative intellectual property. He had been in receipt of WTC with effect from 23 February 2006. He claimed WTC for the tax year 2017/2018. During that tax year, on 16 June 2017, the Commissioners for Her Majesty's Revenue and Customs ("**HMRC**") made an initial decision under section 14(1) of the Tax Credits Act 2002 (the "**2002 Act**") to award the claimant £2770.35 WTC, on the basis that he was working 30 hours a week in self-employment. However, on 13 November 2017, HMRC made a further decision, this time under section 16(1) of the 2002 Act, that the claimant was not eligible to receive WTC for the tax year 2017/2018 (the "**Section 16 decision**"). He was awarded tax credit for one day only, £7.59, which I understand from other cases not a recognition of entitlement, but a practical workaround necessitated by HMRC's internal computer systems. No change was made on mandatory reconsideration, as HMRC confirmed in a letter dated 30 November 2017. The tribunal refused the claimant's appeal against the WTC decision on 6 April 2018, giving reasons for that decision on 17 July 2018. In essence, it was found that the claimant did not meet the entitlement condition for WTC of being self-employed, because his business activities were not carried on, on a commercial basis.

3. Permission to appeal was granted by the judge of the tribunal on 3 August 2018, it being arguable there was an error of law in relation to the tribunal's interpretation of "self-employed" as defined in the 2002 Regulations. Parties made initial submissions and were directed by the Upper Tribunal to provide further submissions on specific matters. Then, on 22 January 2019, HMRC made a further decision under section 18(6) of the 2002 Act, again finding that the claimant was not entitled to WTC (the "**Section 18 decision**"). That decision was not produced, but there was no dispute that it was to the same effect as the section 16 decision: the claimant was not entitled to WTC because he did not meet the definition of "self-employed" as his business activity was not considered to be commercial. The section 18(6) decision was based on the same evidence which was before the tribunal when making its decision in the appeal against the section 16 decision.

The effect of the Section 18 decision on this appeal

4. The structure of WTC under the 2002 Act involves a process of multiple decisions by HMRC in relation to any one tax year. In effect, provisional decisions are made by HMRC during the tax year ("in year" decisions), with a final decision being made as to entitlement after the end of the tax year in question, when it can be known what in fact the claimant earned. The initial in year award decision is made under section 14. Later in year decisions may be taken under section 16, revising the section 14 award, as happened in this case. Finally, assuming an award was made for the whole or part of the year, a final decision on entitlement is made under section 18 after the end of the relevant tax year. The underlying entitlement conditions for WTC contained in section 10 of the 2002 Act and regulation 4 of the 2002 Regulations are the same whether a decision is being made under sections 14, 16 or 18.

5. This appeal concerns a decision made under section 16 that the claimant was not entitled to an award of WTC. Section 16 of the 2002 Act allows HMRC to amend or terminate an award of WTC where there are reasonable grounds for believing:

> "(a) that the rate at which the tax credit has been awarded to him or them for the period differs from the rate at which he is, or they are, entitled to tax credit for the period: or
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> (b) that he has, or they have, ceased to be, or never been, entitled to the tax credit for the period."

6. It has been held by a three judge panel in the case of *LS and RS v Commissioners for Her Majesty's Revenue and Customs* (TC): [2017] UKUT 257 (AAC) : [2018] AACR 2 that a section 16 appeal to the First-tier Tribunal lapses if a section 18 decision is subsequently made. In this situation, a section 16 appeal should be struck out by the First-tier Tribunal. However, if there has been an appeal onwards to the Upper Tribunal, the jurisdiction of the Upper Tribunal remains, because the basis of its jurisdiction (section 11 of the Tribunals, Courts and Enforcement Act 2007) is different from the First-tier Tribunal.

7. In this case, both parties requested that I determine the merits of the appeal, even though the section 16 decision appealed had been deprived of operative effect on 22 January 2019. I consider it appropriate to exercise my jurisdiction to do so for two reasons.

8. First, on the day of the hearing the claimant submitted to HMRC a written application to review the section 18 decision under section 21A of the 2002 Act. HMRC indicated that in the particular circumstances they would accept the application as a late application for review under section 21B. HMRC is therefore tasked with reviewing a section 18 decision made on the same basis and on the same information as the decision under appeal in this case. HMRC indicated at the hearing that it will take into account any decision made in this case when making that decision. Although there was no longer a live, practical issue in relation to the section 16 decision, in the circumstances there remained a live, practical issue in relation to the impending section 18 review decision and whether or not the claimant was entitled to WTC for the tax year 2017/2018. The section 18 review decision was likely to turn on the same point raised in the present appeal of the interpretation and application of the definition of self-employed in the 2002 Regulations.

9. Second, I am satisfied that this is a question of public law, involving a discrete point of statutory construction, where a significant number of similar cases exist or are anticipated so that the issue will most likely need to be resolved in the near future, and the point in issue has wider importance (*R v Secretary of State for the Home Department ex parte Salem* [1999] 1 AC 450). It is for this reason that HMRC requested I hear the case and submitted that guidance would be welcome. HMRC submitted that the issue of self-employment arose in a number of WTC cases. People in self-employment comprised roughly 15 per cent of the labour force. Many self-employed people claim tax credits. They work not only in the arts, but across a range of occupations including taxi driving, building and window cleaning. I accept that the issue of the correct approach to the word "commercial" in the definition of self-employed in the 2002 Regulations is likely to be relevant not only in the section 18 review of the claimant's entitlement to WTC in the tax year 2017/2018, but in a number of other cases. For the reasons in this and the previous paragraph I consider it appropriate I determine this appeal notwithstanding the section 18 decision that has been made.

10. However, the fact that the section 16 decision is no longer operative affects the remedy I am able to grant in this appeal. Below, I have found that the tribunal erred in law. But I do not set aside the decision and remit it to the tribunal, because the First-tier Tribunal would have no jurisdiction, on the analysis in *LS and RS v HMRC* [2018] AACR 2. Rather, I make the finding that there was an error of law by the tribunal, and direct HMRC to have regard to this finding when making its further decision under section 18.

Self-employed: the relevant statutory provisions

11. Entitlement to WTC is contingent on claimants meeting the test in section 10 of the 2002 Act that they are engaged in "qualifying remunerative work". Qualifying remunerative work is defined in the 2002 Regulations. In order to be engaged in qualifying remunerative work, a claimant must satisfy various conditions (Regulation 4(1)). The first condition, read short, is that the claimant is working and is employed or self-employed. "Self-employed" is defined in Regulation 2(1) of the 2002 Regulations and 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 tribunal's findings

12. The tribunal made factual findings about the claimant's business activity as follows. The claimant has for about 10 years been a sole trader in the name Cosmos Original Productions. He has written a number of books and composed and recorded a number of albums of original music (the papers before the tribunal indicate it was 18 books and 16 albums; before the Upper Tribunal the claimant indicated that he had kept working since the tribunal hearing and had now written 20 books and recorded 18 albums). He works irregular hours most days of the week, on average spending 11 hours a day on his business activities. His trade is mostly cash in hand. He writes up a cashbook when he makes sales and records his expenses. He prepares books of account annually. His earnings are below the taxation and national insurance threshold. A sample of his business activity shows earnings of between £30 and £80 a week, and expenses of between £20 and £60 a week. During a

sample 16 week period, the claimant had a trading turnover of £785, with expenses of £650, leaving a profit of only £135 or approximately £8.44 a week. His business activity covers things like having his works available for sale online, contacting traders online, meeting the public for sales, and researching and attending trade fairs. He aims to keep prices low so that they are below high street prices. He spends most of his time in the creation of original artworks and their promotion, making occasional sales and hoping that in time they will be taken up by mainstream publishing and/or performance. The tribunal found that by the date of decision under appeal, the claimant's business activities could not be described as commercially successful. In relation to future mainstream success, the tribunal concluded on the balance of probabilities that it was unlikely.

13. The tribunal found that the claimant satisfied a number of aspects of the definition of self-employed in the 2002 Regulations. It found that the claimant carried on a trade, profession or vocation with a view to the realisation of profits and that the trade, profession or vocation was organised and regular (paragraph 15). But it found the claimant did not fall within the definition of self-employment because:

> "his activities are not commercial in the sense that they are quite unprofitable and have been so for many years".

The tribunal found that earnings of only £8.44 for a working week considerably in excess of 40 hours could not reasonably described as commercial. It found significant that the legislature had changed the definition of self-employment in 2015 and considered that this change was designed to close access to WTC for those who had self-employment similar to that of the claimant. The tribunal considered that there had to be an economic measurement of success when considering qualifying remunerative work. It found that the level of remuneration had to be taken into account in assessing whether the work done was genuine or effective work. It found that:

> "the appellant's earnings from self-employment are so low that the work cannot be described as genuine or effective. In summary, accepting the claimant's earnest description of his self-employment and his hopes for future success, the tribunal concluded that the appellant's activities in creating and promoting his artworks had more of the hallmarks of a hobby than of genuine self-employment as defined in regulations and his appeal fails".

The parties' submissions on the meaning of carrying on a trade, profession or business "on a commercial basis" in the definition of self-employed in the 2002 Regulations

14. The claimant's position, in summary, was that commercial meant producing things to be offered for sale in the marketplace. He quoted from Chapter IV of Adam Smith's '*An Inquiry into the Nature and Causes of the Wealth of Nations',* and in particular a passage about exchanges of the produce of labour. He quoted this sentence "Every man thus lives by exchanging, or becomes in some measure a merchant, and the society itself grows to be what is properly a commercial society". "Commercial" was about exchanges, about people getting things ready for the marketplace, and bringing them to market for others to buy. He submitted that the opposite of "commercial" was "unsaleable". He submitted that he did not produce unsaleable items: he offered 20 books and 18 albums for sale and did make sales, even if they were not as many as he would like. He also submitted it was not a requirement that a business be profitable to be commercial. He produced information showing how little

money Jane Austen made as an author in her lifetime, in support of a submission that there can be a commercial business even if not immediately profitable. And in any event, he submitted that if it was a requirement that a business be profitable, it was relevant that he made a small profit on the sales he made and not a loss.

15. HMRC on the other hand argued that the tribunal's decision was correct. A requirement that a business be operated on a commercial basis introduced a requirement that it have profit rather than artistic or other value as its primary aim. Profitability was relevant to commerciality, and a business that is operated on a commercial basis is a business designed to succeed as a commercial venture and which is worth doing from a financial point of view. There is a need for a viable business worth undertaking; one undertaken with a view to providing income for an individual. It is not sufficient to have a business which is pursued for other reasons, for example as a hobby. The existence of WTC (in providing additional funds which resulted in the activity being able to continue) was not a relevant factor in determining whether a business is run on a commercial basis. HMRC submitted that the tribunal was correct to find that whether a business is run on a commercial basis requires consideration of the profitability of the business.

16. HMRC, having regard to the dicta in *JF v HMRC* (TC) [2017] UKUT 334 (AAC) at paragraph 62, cited three cases from revenue law where judges have commented on the meaning of 'commercial'. The three cases arise in the context of income tax, and in particular whether individuals are entitled to reduce their tax liability by claiming loss reliefs. In *Wannell v Rothwell* [1996] STC 450 Mr Justice Walker said:

> "I was not shown any authority in which the court has considered the expression "on a commercial basis", but it was suggested that the best guide is to view "commercial" as the antithesis of "uncommercial", and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art-gallery or antique-shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante. There will no doubt be many difficult borderline cases for the commissioners to decide; and such borderline cases could as well occur in Bond Street as at a car boot sale".

In two cases from 2017, after the amendment to the 2002 Regulations in issue in this case, it was argued that, where statutory wording in tax statutes about reliefs included both a test of commerciality and a separate profits test (for example on a commercial basis and "with a view to the realisation of profits" or "profits…could reasonably be expected to be realised"), profitability was not relevant to commerciality. Both cases rejected this argument; the Upper Tribunal in *Seven Individuals v Revenue and Customs Commissioners* [2017] UKUT 132 (TCC) followed the apparently obiter comments of the Court of Appeal in *Samarkand Film Partnership v HMRC* [2017] STC 926. The Court of Appeal in *Samarkand*, referring to the dicta set out above from *Wannell v Rothwell*, stated:

> "Robert Walker J himself identified a serious interest in profit as a hallmark of commerciality. That must in my view be correct, but it shows that considerations of profitability cannot be divorced from an assessment of the commerciality of a business. In my judgment it is wrong to regard the profitability and commerciality tests in the legislation as mutually exclusive, and they necessarily overlap to an extent which will vary from case to case…the question of commerciality must…be addressed without reference to the availability or not of loss relief to the individual partners". (paragraphs 90-91).

The Upper Tribunal in *Seven Individuals* stated at paragraph 40:

> "As a matter of ordinary language to run a trade or business "on a commercial basis" suggests running the trade or business in a way that is at any rate designed to succeed as a commercial venture, that is one which is worth doing from a financial point of view. It is true that this means that there is an inevitable overlap between the commercial limb and profits limb, but the alternative would be to empty the commerciality limb of any connection with profit or profitability, when that is a central part of what would normally be understood by a reference to acting commercially".

It went on to say at paragraph 47 that the concept of a trade carried on, on commercial lines has an objective element to it, and cannot be satisfied by proof merely that the trade is well organised and that the trader had a purely subjective hope or desire to make a profit.

17. HMRC's position was that these dicta could be read over to WTC. As profitability was relevant to commerciality, the tribunal had not erred.

Discussion

18. There is no definition of "commercial" in the 2002 Regulations. Commercial is a word which is capable of a range of meanings, as shown by dictionary definitions lodged by parties. The claimant produced the definition in Merriam-Webster of "occupied with or engaged in commerce or work intended for commerce; of or relating to commerce"; and that in the Cambridge Dictionary of "related to buying and selling things". HMRC relied on the fifth definition in the Oxford English Dictionary which is "Viewed as a mere matter of business: looking toward financial profit". Other definitions in that dictionary are "engaged in commerce; trading"; or "pertaining to commerce or trade". Many of these definitions contain no mention of profits or profitability: other definitions do.

19. Given the potential range of the meaning of "on a commercial basis" shown by these dictionary definitions and the judicial dicta set out above, in my opinion the meaning of "on a commercial basis" where it appears in the 2002 Regulations must be ascertained by considering the context in which it appears. As it has been observed, "in law context is everything" (*R (on the application of Daly) v Secretary of State for the Home Department* [2001] UKHL 26 2001] 2 AC 532 paragraph 28). The interpretation of the words "on a commercial basis" in the context of WTC should be that intended by the legislature when enacting the relevant provisions (Bennion, Statutory Interpretation, Fourth Edition, page 405). The context in which the words appear is important to ascertaining intention. The context in this case includes the enabling statute (the 2002 Act) as well as the terms of the

statutory instrument in which the relevant wording appears, and the other statutory provisions surrounding the words "on a commercial basis" in the 2002 Regulations.

20. Turning first to the general statutory context, the 2002 Act and 2002 Regulations aim (among other things and in conjunction with other delegated legislation) to set out a legislative framework for WTC. WTC was introduced in 2002, with a stated purpose of making work pay. WTC aimed to provide an incentive for people to work, and to ensure that those working for a low level of pay received a minimum level of income ("*New Tax Credits: Supporting families, making work pay and tackling poverty*", July 2001, p47, Consultation preceding the introduction of TC). Tax credits were part of a strategy, which included the introduction of a national minimum wage, to tackle poverty and make work pay. Part of the background to the introduction of tax credits was to provide financial incentives for people to work by making work pay more than welfare (page 17); as a result some people would move from benefits into work. The calculation of WTC in a particular case involves (i) calculating "elements" for which a claimant qualifies and adding them together to achieve a "maximum rate" (ii) considering what income the claimant in fact earns (iii) if this is less than a prescribed figure (currently £6420) then the amount of WTC is the maximum rate; if more, then the excess income has the effect of reducing or cancelling out the maximum rate in its entirety (currently the maximum rate is reduced by 41p for every £1 of income above the £6420 threshold) (section 11 of the 2002 Act and Parts II and III of the 2002 Regulations). The important point to notice is that WTC was predicated on a low level of earnings, whether people were employed or self-employed. If a claimant has earnings beyond a certain level, they will not receive an award. But if people work and receive low earnings, then the intention is that those earnings would be topped up by WTC, as an incentive to people to come off welfare and into work.

21. The present definition of "self-employed" in the 2002 Regulations results from an amendment made in 2015. Initially the definition of "self-employed" was a short one of "engaged in the carrying on of a trade, profession or vocation". The Explanatory Notes to the amendment state as the purpose of the amending instrument:

> "This instrument introduces the initiative announced by the Government in the Autumn Statement 2014, to tighten up the eligibility conditions for those claiming working tax credit on the basis of self-employment, with effect from 6 April 2015. The instrument makes changes to the first condition of what constitutes qualifying remunerative work, one of the eligibility criteria to WTC".
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> The Explanatory Notes refer to the Autumn Statement 2014. Paragraph 1.232 of that Statement announced:
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> > "changes that will tighten the eligibility conditions for those claiming tax credits on the basis of self-employment, to prevent abuse of the system. These include a new test to ensure that work being undertaken is genuine and effective, and a requirement that anyone claiming WTC as self-employed registers with HMRC and provides their Unique Tax Reference. This will prevent bogus self-employment and abuse of the tax credits system, while allowing HMRC to continue to support those who are genuinely self-employed".

Paragraph 2.92 announced:

> "Access to benefits. From April 2015, self-employed WTC claimants will need to register their self-employment with HMRC for Self-Assessment purposes and provide a Unique Tax Reference number in order to be able to claim. Those declaring income less than the equivalent of working 24 hours a week at the National Minimum Wage will also be required to provide evidence to HMRC that the work they are undertaking is genuine and effective".

(HMRC's understanding of the changes to the 2002 Regulations is set out in *JF v HMRC* (TC) [2017] UKUT 334 (AAC) paragraph 17, but that understanding is HMRC Guidance and not relevant for ascertaining the legislative intention of the relevant provisions).

22. From the Explanatory Memorandum and the Autumn Statement 2014 referred to in it, the purpose of the amendment was to tighten up eligibility conditions for the self-employed to be entitled to WTC. The concern expressed which motivated these changes was abuse of the system by bogus self-employment. The solution was not to abolish WTC, and so the general purposes of WTC – of making low paid work pay set out above - remain relevant. There is no mention in the Explanatory Memorandum or the Autumn Statement of an intention to pay WTC to self-employed people only if their trade, profession or vocation is profitable. Although there is reference to HMRC investigating a claimant's circumstances when they declare income of less than 24 hours a week at the national minimum wage, it is significant when applying the 2002 Regulations that in fact no minimum income provision was made in the amendments to the 2002 Regulations. It would have been possible to do so, particularly given that there are anti-abuse provisions providing for a minimum income floor in relation to self-employment in regulations 62 and 64 of the Universal Credit Regulations 2013. Instead, there is an express recognition in the Autumn Statement 2014 that HMRC will continue to support those who are genuinely self-employed.

23. Accordingly, the statutory context is one where the general policy intention of WTC is to make work pay. WTC is deliberately designed to top up low earnings. The intention of the amendments in 2015 is to prevent abuse of the system by bogus self-employment.

24. Turning next to the context in which the words "on a commercial basis" appear in the 2002 Regulations, in my opinion other wording within the definition of "self-employed", and the requirements of other provisions in the 2002 Regulations, are relevant to how the words "on a commercial basis" should be interpreted in the context of WTC. Generally speaking, it is to be presumed that the legislature intended all the words it enacted to have meaning and content, otherwise it would not have used them. Other wording and provisions may therefore have an effect on the meaning of a particular term in a particular context. There are three significant matters to notice about the context in which the words "on a commercial basis" appears in the 2002 Regulations:

24.1 Immediately after the words "on a commercial basis" in the 2002 Regulations, the words "and with a view to the realisation of profits" appear. Profits are therefore dealt with expressly, as a separate matter to "commercial basis". There is no requirement of actual profitability. Rather, there must be a view to profits. Taking the ordinary meaning of these words, they potentially cover situations where there is a view to profits in the future, even if there is little or no current profit.

24.2 There are also further requirements in the 2002 Regulations in the definition of "self-employed" (in contrast to some of the tax legislation considered in the income tax cases above). At the end of the definition of "self-employed" there are requirements that the trade, profession or vocation be organised and regular. The word "organised" directs HMRC to look at how the business is organised, for example its accounts, tax returns, sales records and so on. The word "regular" directs HMRC to look at the way the business is conducted, covering matters like opening hours and regularity of business. It is also arguable that the use of the word "regular" allows consideration of irregularities, and so can assist in furthering the intention that claimants should not qualify where there is bogus self-employment.

24.3 Then, beyond the definition of "self-employed", there are other related eligibility conditions in the 2002 Regulations. The second condition is that claimants work a specified number of hours a week, which is a question of fact (in the claimant's case, not less than 30 hours per week). This helps to ensure the claimant is genuinely working and the business is not bogus, although it can be difficult for the authorities to monitor. The fourth condition is that the work is done for payment or in expectation of payment. This condition allows HMRC to look at the economics of the business: work done for free will not qualify. Profitability has been discussed in the context of this fourth condition in the case of *MH v HMRC* [2016] UKUT 79 paragraph 12. It was found that work may be done in expectation of payment even if it is known that no profit will be made for some time but it is expected that the relevant business will become profitable in the future.

25. Drawing all this together, I consider that it is an error of law to find that self-employment is not commercial on the basis it is unprofitable for a number of reasons.

25.1 The 2002 Regulations should not be interpreted in a way which undermines the intention of the principal statute which enabled them. The overall purpose of the WTC provisions in the 2002 Act was to introduce tax credits to help people from welfare to work, by making work pay. They aimed to do so by making it financially worthwhile for people to do low paid work, by topping up income. If "commercial" is read as "profitable", this runs the risk of wrongly excluding a number of low paid people who are genuinely working from WTC and undermining the purpose of the 2002 Act.

25.2 The main mischief that the amendments to the 2002 Regulations sought to address was abuse of the system and bogus self-employment. They were not intended to prevent genuine self-employment from qualifying for WTC.

25.3 There are a number of provisions in the 2002 Regulations which together can be used to prevent bogus self-employment and abuse of the tax credit system, without it being necessary to read the word "commercial" as meaning "profitable". These include that the trade, profession or occupation is carried on with a view to realisation of profits, is organised and regular, and that the claimant works for a set number of hours a week (30 in this case) for payment or in expectation of payment (regulation 4).

25.4 Using profitability as the touchstone of commerciality ignores the core meaning of "commercial". "Commercial" is essentially about commerce, or buying and selling, and in my opinion that should be the focus of the "commercial" part of the definition of "self-employed". Consideration has to be given to whether a business is

truly engaged in buying and selling exchanges, or if there is bogus self-employment abusing the WTC system. Relevant factors are whether the business: generates goods or services by enterprise and effort; makes available and exposes goods or services for sale, for example by advertising, supplying to shops, or listing for sale online; actually makes sales, and the terms on which those sales are made. Also potentially relevant are: the age of the business; business plans for future commerce; and steps being taken to increase income from the work, all bearing in mind the dicta in *JR v HMRC* [2017] UKUT 334 about the extent of documentary support required of modest businesses.

25.5 It is significant that the amendments to the definition of "self-employed" in the 2002 Regulations did not use the word "profitable", nor did they provide that self-employed profits had to achieve a minimum income floor, although both could have been done. If "profitability" is read in as a criterion, it creates obvious practical problems for tribunals and HMRC. It is not in dispute that there was a small level of profit made by the claimant in this case. So just how profitable does a business need to be to qualify, on the tribunal's analysis? It is self evident that taking the approach mentioned in paragraph 2.92 of the Autumn Statement 2014 as a touchstone for when businesses are investigated cannot be the correct approach to whether a business is carried on, on a commercial basis from the point of view of WTC. A 24 hour week at the national minimum wage (£8.21 for persons who are 25 and over for 2019/2020) gives a figure considerably more than the maximum rate threshold mentioned in paragraph 20 above. Yet the legislation clearly envisages that people earning below the threshold should still be entitled to the benefit, because there is provision for them to receive the full maximum rate in that event. So, what then is the figure of acceptable profitability for something to be "commercial"? The legislation is silent. If profitability (or a particular level of profitability) was necessary for a trade, profession or occupation to be carried on, on a commercial basis, in my view this would have been set out by the legislature.

25.6 It is also significant that if "commercial" is defined as "profitable", this may conflict with other parts of the statutory conditions for entitlement, particularly the provisions requiring only that there be "a view to realisation of profits" or work be "for payment or in expectation of payment". As set out above, both of these provisions suggest a legislative intention that there need not be current profitability in order to qualify, as long as future profits or payment are expected.

25.7 I accept that in some circumstances profit can be relevant to whether something is viewed as commercial, but in my opinion there is limited scope, if any, to take into account profitability when deciding if a trade, profession or vocation is carried on "on a commercial basis" under the 2002 Regulations. HMRC or the tribunal will already be considering whether the trade, profession or occupation is being carried on with a view to the realisation of profits, if it is organised and regular, if the claimant is working for a set number of hours a week, and if the work is done for payment or in expectation of payment, as well as "on a commercial basis". These tests properly applied are sufficient to achieve legislative intention without a need to read in profitability. In passing, it seems to me that whether a business is being carried on with a view to the realisation of profits in the 2002 Regulations is unlikely to be a purely subjective concept, and there will need to be some objective basis for the view. However, when considering the objective basis for the view, it is important to bear in mind the overall context. WTC aims to assist the low paid to be in work rather than on

welfare. It is predicated on people on low earnings, but actually working, receiving top ups. Care has to be taken that the concept of "view to realisation of profits" is not used to exclude the people with low earnings WTC was designed to encourage into work.

25.8 It follows that I have come to the view that the dicta quoted above from income tax cases are not directly transferable to WTC. I accept that both tax reliefs and WTC involve public funds, but beyond that I do not consider the contexts sufficiently similar to necessitate the approach in one type of case applying to the other. "Commercial" is a word with a range of different meanings. It is recognised in the *Samarkand* case at paragraph 90 that overlap between profitability and commerciality tests will vary from case to case. It is understandable in an income tax context that "commercial" is read to prevent deliberately loss making businesses qualifying for reliefs to reduce overall tax liabilities. But WTC has a different general legislative purpose from tax reliefs, and different provisions to determine eligibility, which all fall to be considered. WTC exists to help people with low earnings so there is an incentive to get off welfare and into work. An approach equating "commercial" with "profitable", and applied too rigorously, would undermine the general purpose of WTC. It would fail adequately to make provision for businesses which are growing but not yet profitable, or situations of volatile markets, and potentially disincentivise people to take the risks associated with setting up self-employment to get off welfare into work. In my opinion, in WTC cases, HMRC and tribunals should simply apply all of the statutory tests in the 2002 Act and 2002 Regulations. Those tests are sufficient to ensure that the system is not abused by claims involving bogus self-employment, if properly applied.

Genuine and effective

26. As noted above, the tribunal, as well as finding that the claimant's business was not commercial because it was unprofitable, also found the claimant's earnings from self-employment were so low that the work could not be described as genuine or effective. The tribunal used considerations of whether the work was genuine and effective in order to decide whether the claimant was self-employed.

27. I appreciate that the Autumn Statement 2014 says at paragraph 1.232 that the new test (for self-employment) was being included to ensure that work being undertaken is genuine and effective. But those were not words the legislature chose to use in the amendment to the 2002 Regulations. The words "genuine and effective" are words used in other legislative contexts, around which a detailed body of caselaw has built up. If this body of caselaw is read in by the back door, there is potential for an unwarranted additional layer of complexity being added into the tests in the 2002 Regulations. I accept the submission of HMRC that "genuine and effective" is not a concept which assists in the application of the definition of self-employment in the 2002 Regulations. It is legitimate for tribunals to bear in mind that the purpose of the amendment to the 2002 Regulations was to prevent bogus self-employment and abuse of the tax credits system and tighten up the eligibility conditions for those claiming WTC on the basis of self-employment. Genuine might be seen as the opposite of bogus, and to that extent the concept is relevant when the tribunal seeks to give effect to legislative intention. But the tests the tribunal actually has to apply are those set out in the legislation, including the full definition of self-employment and the various conditions in regulation 4 of the 2002 Regulations. "Genuine and effective" is not part of those tests, and in my opinion is best avoided.

Conclusions

28. I find that the tribunal's decision was made in error of law because it wrongly applied tests of profitability and genuine and effective to decide whether the claimant's business was carried on "on a commercial basis". What the tribunal should have done was apply all of the various conditions in the 2002 Regulations in order to decide whether the claimant was eligible for WTC.

29. In particular, when considering the definition of self-employment for the purposes of condition 1 in regulation 4 of the 2002 Regulations, the tribunal should not have applied profitability as the test for whether the business was carried on, on a commercial basis. It should instead have considered the various factors bearing on whether the business was carried on "on a commercial basis" set out in paragraph 25.4 above. The tribunal found that the claimant had written a number of books and composed albums, which from the papers available to it were 18 novels and 16 albums at that time (now 20 and 18 respectively). There was also evidence before the tribunal of the claimant exposing those for sale, through high street shops, book fairs, on the internet, on itunes, spotify, google play, and being registered with Phonographic Performance Limited, a licensing company that pays royalties. There was evidence of sales being made, albeit at a low level. The tribunal did not address the claimant's future plans for sales, which was a relevant factor given the age of the business. Instead, it found that the business had all the hallmarks of a hobby but did not explain why. It is not self-evident that engagement of 11 hours a day in a business (which is potentially far in excess of the 30 hours of work carried out for payment or the expectation of payment necessary to satisfy entitlement conditions 3 and 4 for WTC in regulation 4), and putting in the effort necessary to write 18 books and record 16 albums, equates to a hobby. It should be borne in mind that the fact that a particular trade, profession or vocation is a hobby to some (writing and music are perhaps classic examples), does not preclude that trade, profession or occupation genuinely being carried out on a commercial basis by others for the purposes of WTC, even if profits are low. There was room for matters relating to profit to be considered in the context of whether the claimant's business was carried on with a view to realisation of profits (see paragraph 25.7 above) and whether the work done was for payment or in expectation of payment in condition 4 in regulation 4 (a matter not considered by the tribunal). However, in applying those provisions, the purpose of WTC, and the choice of the legislature not to incorporate minimum income or profitability provisions, must be borne in mind. In giving effect to the relevant provisions in accordance with legislative intention of the 2015 amendments to the 2002 Regulations, it is relevant that there was no finding that the claimant's business was bogus. The Autumn Statement which heralded the amendments to the definition of self-employment in the 2002 Regulations made it clear that HMRC would continue to support those who were genuinely self-employed.

30. It is now for HMRC properly to apply the conditions in the 2002 Act and 2002 Regulations to the claimant's situation for the tax year 2017/2018, in the course of carrying out its review under section 21A of the 2002 Act.