Bulletin 171
ESHeaD
CTC/1655/2001

DECISION OF THE SOCIAL SECURITY COMMISSIONER

1. The claimant's appeal is allowed. The decision of the Sheffield appeal tribunal dated 1 March 2001 is erroneous in point of law, for the reasons given below, and I set it aside. It is expedient for me to substitute the decision which the appeal tribunal should have made on the claimant's appeal against the decision dated 24 September 2000, on the findings of fact it made (Social Security Act 1998, section 14(8)(a)(i)). My decision is that the claimant is entitled to working families' tax credit for the period from 3 October 2001 to 2 April 2001 at a weekly rate to be calculated by the Board of Inland Revenue on the basis set out in paragraph 23 below. If there is any disagreement on the results of that calculation, the appeal may be returned to me (or, if necessary, another Commissioner) for further decision.

2. This case arises from the claim for working families' tax credit (WFTC) made on 20 September 2000. The conditions of entitlement were satisfied. The amount of WFTC depended on the earnings received by the claimant's partner in the three months immediately before the week beginning 17 September 2000, since he was paid monthly (Family Credit (General) Regulations 1987, regulation 14). Payslips were submitted for salary paid on 15 July 2000, 15 August 2000 and 15 September 2000. On all three payslips the figure for "salary" was £1040.60. On the payslips for July and August an amount of £76 labelled "overpayment" was deducted, so that the amount against the label "gross for tax" in those months was £964.60. The claimant's partner (who I shall call P) had been overpaid by his employer an earlier month, apparently by mistake, and the amount was being recovered over the three months of June, July and August. On the discovery of the mistake, that process was agreed between P and his employer. The deductions for PAYE income tax and national insurance contributions recorded on the payslips were as follows: July, £116.57 and £63.60; August, £116.58 and £63.60; September, £133.31 and £71.20.

3. The decision-maker took the gross pay as £1040.60 for each month and then applied the actual deductions for income tax and national insurance in each month. That produced a figure for average net weekly earnings of £196.68 and an entitlement to WFTC of £72.07 per week from 3 October 2000 to 2 April 2000. The claimant appealed, arguing that only £964.60 should have been taken into account for July and August.

4. The appeal tribunal confirmed the decision under appeal. Full and detailed reasons were given. The direct application of Parsons v Hogg, appendix to R(FIS) 4/85, was rejected on the ground that the deduction of £76 did not represent expenses incurred by the employee in order to secure the earnings. On the argument that taxable earnings should have been counted, it was said that there was an important distinction between taxable earnings and taxed earnings. The deduction did not mean that the P's taxable pay in July and August was not £1040.60:

> "It remained his taxable pay even though tax was actually assessed on a lesser amount because of the previous overpayment. If the adjustment had not been made then an

> inequality would have arisen. The Appellant doubtless paid Income Tax and National Insurance contributions on his overpaid salary when it was originally paid and it would have been inequitable to have done this calculation again because it would have meant he paid double tax and National Insurance contributions. The adjustment was necessary to avoid this."

On the argument that the remuneration actually received in the three months should be counted, the appeal tribunal said this:

> "[P] argues that the amount he actually received must be his earnings and that there is a difference between deduction for National Insurance and Tax which are effectively received by him but then paid out by his employer to a third person and deduction of previously overpaid salary which he never received. I do not see this distinction.
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> The Appellant actually was entitled to receive his gross salary of £1,040.60. By law the employer deducted Income Tax and National Insurance contributions and paid them to the relevant Government Departments. Equally they exercise their right to deduct from the gross amount the amount due to themselves for overpaid salary, which they did. Although the Appellant only received via his pay packet his net pay, he was entitled to receive his gross pay (less National Insurance contributions and Tax). The fact that the employer chose to recover the deduction of salary on that particular pay slip does not affect this position."

5. The claimant now appeals with the leave of the chairman of the appeal tribunal. The written submission on behalf of the Board of Inland Revenue did not support the appeal. The claimant's request for an oral hearing was granted by Mr Commissioner Levenson. The oral hearing took place at Doncaster County Court. The claimant was represented by her partner. The Board of Inland Revenue was represented by Ms Collette Rawnsley of the Inland Revenue Solicitor's Office. I am grateful to both representatives for their careful and detailed submissions. Following the oral hearing I directed further written submissions on the effect of a very recent Commissioner's decision in a child support case, CCS/4378/2001.

6. Before dealing with the legal issues I need to describe the relevant provisions in the Family Credit (General) Regulations 1987 ("the 1987 Regulations"), which have been amended to provide for WFTC. Entitlement and the amount of benefit depends on the amount of a claimant's income when the claim is made (Social Security Contributions and Benefits Act 1992, section 128(1)(a) and (2)). Regulation 13 provides that income is to be calculated on a weekly basis by ascertaining the amount of the claimant's (including a partner's) normal weekly income. Regulation 14(1) provides:

> "(1) Where a claimant's income consists of earnings from employment as an employed earner, except where those earnings arise from employment as a director, his normal weekly earnings shall, subject to paragraphs (3) to (6), be determined by taking account of his earnings from that employment which are received in the assessment period relevant to his case, whether the amount so received was earned in respect of that period

or not, and in accordance with the following provisions of this regulation."

For a person who is normally paid monthly, the assessment period is the three consecutive months immediately preceding the week of claim (paragraph (2)(b)). The rest of regulation 14 is not relevant, except for the provision that earnings are to be calculated in accordance with regulations 19 to 20A of the 1987 Regulations.

7. Regulation 19(1) defines "earnings", for employed earners, as "any remuneration or profit derived from that employment" and lists a number of examples. Regulation 20(1) provides:

> "(1) For the purposes of regulation 14 (normal weekly earnings of employed earners) the earnings of a claimant to be taken into account shall be his average weekly net earnings and where an estimate of earnings has been made in his case, as estimated, and those weekly net earnings shall be determined in accordance with the following paragraphs."

Paragraph (2), on sums to be disregarded, is not relevant in the present case. Paragraph (3) provides:

> "(3) A claimant's net earnings shall, except where paragraph (4) applies, be calculated by taking into account his gross earnings from that employment, less--
> (a) any amount deducted from those earnings by way of--
> (i) income tax;
> (ii) primary Class 1 contributions under the [Social Security Contributions and Benefits Act 1992]; and
> (b) one-half of any sum paid by the claimant in respect of a pay period by way of a contribution towards an occupational or personal pension scheme; and
> (c) [an amount calculated in respect of bonuses and commission]."

Then paragraphs (5) and (6) require average net earnings to be calculated by aggregating net earnings in each pay period within the assessment period (see regulation 14(2)(b), dividing by the number of pay periods in the assessment period and converting the result into a weekly figure. There are fairly crude rules for excluding pay periods where earnings are 20% higher or lower than the average.

8. I start with a subsidiary issue. It was assumed before the appeal tribunal that the actual amounts of income tax and social security contributions deducted in the three months had to be deducted under regulation 20(3)(a). But that exposed the claimant and her partner to a double whammy. Not only was he treated as having gross earnings of £1040.60 in July and August, instead of £964.60, but he was only allowed deductions for income tax and social security contributions on the basis of receiving £964.60 in those months. In a direction before the oral hearing I raised the possibility that under regulation 20(3) the deduction should be of the income tax and social security contributions which would have been payable on the amounts treated as gross earnings.

9. Neither P nor Ms Rawnsley submitted that regulation 20(3) could be interpreted in that way. I agree. Regulation 20(3) does refer to amounts deducted from "those earnings", ie the gross earnings in each pay period. But the ordinary meaning of subparagraph (a) points to whatever amount was actually deducted by the employer in the pay period in question. I accept Ms Rawnsley's submission that those making decisions on WFTC should not be required to undertake speculative and difficult investigations into what income tax or social security contributions might have been payable on particular earnings figures. There are all sorts of reasons, particularly under the cumulative PAYE system, why the amount deducted in a particular pay period may not bear an exact relationship to the earnings in that pay period. The WFTC scheme involves rough and ready calculations, within the control in extreme cases of regulation 20(5) and (6). I conclude that under regulation 20(3)(a) the actual amounts deducted by the employer in the pay periods within the assessment period must be used.

10. The crucial question is therefore what P's gross earnings from his employment were in July and August. It is first necessary to look at the general context created within the 1987 Regulations. The object of the exercise is to fix the amount of the claimant's income as at the date of claim, which will fix the amount of WFTC payable for the next 26 weeks. Regulation 13(1) refers to that being done by ascertaining the claimant's normal weekly income. In the case of earnings from employment, regulation 14 then supplies the fundamental rules. Normal weekly earnings are determined solely by carrying out the averaging process on the earnings received in the assessment period. So far as employees are concerned, there are provisions for bonuses and commissions and for hours being artificially reduced and for the use of forward estimates in the cases of changes in hours worked or new employments. But otherwise, in cases where hours of work are stable, no other test of what normal earnings are can be applied. And earnings received in the assessment period go into the calculation, whether they were earned in respect of the relevant pay periods or not. That is the framework for what I have described above as a rough and ready approach. The general approach for employees is to focus on what is actually received by way of earnings in the assessment period, with no further test of whether that represents what is normal. That allows decision-makers to apply a relatively mechanical test, reducing the scope for messy and time-consuming issues of judgment. Inevitably there will be winners and losers from that rough and ready approach, depending on the chances of how changes in earnings fall.

11. In my view, regulation 20 and the meaning of "gross earnings" must be considered in that context. It is true that regulation 20 has been in essentially the same form since the 1987 Regulations first came into force for family credit purposes, and that there have been amendments, in particular to regulation 14, since. However, it seems to me that the 1987 Regulations must be looked at as one package after their adaptation to the WFTC scheme with effect from 5 October 1999.

12. Ignoring for the moment the existence of Commissioner's decision CCS/4378/2001, I would have rejected Ms Rawnsley's submissions about the application of regulation 20 to the circumstances. She submitted essentially that P was actually paid £1040.60 in July and August and received that amount. It was simply that he spent £76 of those earnings on making repayment to his employer. It was no different from a deduction from earnings for a payment to

a third party or to the employer for something like a sports club or a repayment of a season ticket loan. Such deductions would not be regarded as reducing an employee's gross earnings. It was also submitted that P could have repaid his employer by writing a cheque for £76 each month. That would not have affected his gross earnings in the months in question (although I think that there would have had to be some adjustment, at least at the end of the tax year, for income tax and social security contribution purposes).

13. However, it is necessary to look at what actually did happen, not at other things which might have happened, but did not. When the accidental overpayment to P was discovered, his employer agreed with him to recoup the overpayment over three months. The most natural analysis is that there was a variation of his contract of employment by agreement, so that he was only entitled to receive £964.60 gross in the three months. There was consideration on both sides for the agreement on that effect over the three months. An alternative analysis might be as follows (I do not think that I need to explore whether the employer might also acquire rights under broader restitutionary principles). Monthly paid employees are normally entitled under their contracts of employment to a salary expressed on an annual basis, to be paid monthly. If, by mistake, too much is paid in one or more months, then it could be said that the employee's entitlement to remuneration in the following months would be correspondingly reduced. But that would be subject to a specific agreement about the amount that the employee is to be paid in the following months. The situation is different from the making of deductions from salary for payments to the employer for other purposes, like membership of clubs or the repayment of season ticket loans or advances of pay. The circumstances of an overpayment of contractual remuneration having been made, coupled with an agreement about the precise consequences on future payments of remuneration, alters the content of the employer's obligation under the contract to pay remuneration.

14. I conclude from that analysis that the remuneration or profit derived from P's employment in July and August, and his gross earnings in each month, was £964.60. That conclusion and the analysis is consistent with the context described in paragraph 10 above and with the rough and ready approach of taking into account of amounts actually received. There will in most cases be no difficulty in distinguishing cases where there is an adjustment of pay to take account of an earlier overpayment from cases of deductions for other purposes which do not reduce the amount of gross earnings. The decision in Parsons v Hogg is not directly relevant, because expenditure necessary to secure earnings is not in issue, but it does, as P submitted, suggest that the amount of "gross earnings" in regulation 20(3) can be lower than, in the case of monthly paid employees, one-twelfth of the total annual salary. I also agree with Ms Rawnsley that decisions such as Leeves v Chief Adjudication Officer (R(IS) 5/99), R(IS) 401 and CIS/5479/1997 are not directly relevant because they concern the meaning of "income" in the income support scheme. "Income" is not defined in that scheme and those cases were not concerned with the tight circle of definitions and references which apply to earnings from employment. However, those cases, and R(IS) 4/02, do state a clear preference for taking account of income actually paid to a claimant, which is consistent with the approach I have taken in the present case. The approach to income as a whole cannot be completely disregarded, since for WFTC purposes earnings are one form of income which is to be taken into account under section 128 of the Social Security Contributions and Benefits Act 1992.

15. That conclusion has the additional merit that the amount of gross earnings to be taken into account in July and August is in line with the calculation of the income tax and social security contributions which have to be deducted in those months.

16. I must now consider the effect of Commissioner's decision CCS/4378/2001. There, Mr Commissioner Jacobs was concerned with a case where an absent parent's child support maintenance assessment was based on a particular level of salary from his employment. The absent parent moved to a new job with the same employer, which carried a lower salary, but by mistake the employer continued to pay him at the same rate. When the mistake was discovered, the absent parent's salary was reduced to its proper level and it was arranged (presumably by agreement) that recovery of the overpayment would be made through future salary at £250 per month over five years. The absent parent requested that the deductions be taken into account in calculating his income and reducing the maintenance assessment (presumably through an application for supersession for material change of circumstances).

17. The Commissioner held that the appeal tribunal had been right to refuse to take the deductions into account. In paragraph 8 of the decision he said:

> "8. Earnings and deductions for purposes of the child support formula are governed by Schedule 1 to the Child Support (Maintenance Assessments and Special Cases) Regulations 1992.
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> 8.1 The whole of the absent parent's salary before deductions was `earnings' within paragraph 1(1). It was the `remuneration or profit derived from ... employment'. That is supported by the structure of Part I of the Schedule. It treats salary as earnings even if it never comes into the hands of the parent, for example because it is deducted before payment is made. So, there is no way in which the deduction can be disregarded by treating it as falling outside the basic definition of earnings in paragraph 1(1).
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> 8.2 Some payments are expressly excluded from earnings. They are exhaustively defined in paragraph 1(2) of the Schedule. None covers a deduction to recover an overpayment of salary. The closest is an advance of salary, but that cannot be interpreted to cover the recovery of an overpayment.
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> 8.3 Finally, some deductions are expressly taken into account. These are exhaustively defined in paragraph 1(3) of the Schedule. They cover deductions for income tax, national insurance and pension contributions."

The Commissioner went on to suggest that the solution to the apparent unfairness of that result was that the overpayment did not form part of the absent parent's salary at the time that it was made, as it was not remuneration or profit derived from employment. He directed the new appeal tribunal to investigate whether it had jurisdiction to go back into that period and alter the

amount of the maintenance assessment. He referred in that part of his decision to Leeves.

18. The parties were given the opportunity to comment in writing on the relevance and effect of the decision in CCS/4378/2001 in the present case. Ms Rawnsley submitted that, as the structure and content of the definition of earnings in paragraph 1(1) of Schedule 1 to the Child Support (Maintenance Assessments and Special Cases) Regulations 1992 (the MASC Regulations) is essentially the same as that for WFTC purposes in regulation 19(1) of the 1987 Regulations, the decision was relevant to the present case and supported the submissions on behalf of the Revenue. P submitted that CCS/4378/2001 was wrongly decided in relation to child support and, if not, was not necessarily to be followed in relation to WFTC. He submitted that the MASC Regulations did not have the same context as that of the 1987 Regulations, and in particular did not have the equivalent of the requirement in regulation 14(1) of the 1987 Regulations that earnings received in the assessment period be taken into account (not merely be referred to).

19. There are in my view differences in context between the MASC Regulations and the 1987 Regulations. Apart from that mentioned by P, there are additional provisions in the MASC Regulations for establishing what normal earnings are, in a more sophisticated way than the rough and ready approach for WFTC. That perhaps reflects the fact that a maintenance assessment may remain in force for an indefinite period, in contrast to the limit of 26 weeks on a WFTC award. However, the differences do not seem so great that a child support decision on a particular common issue can be distinguished as irrelevant for WFTC purposes, or vice versa. So I must look at the substance of the decision in CCS/4378/2001.

20. It is apparent from what I have said above that my reasoning is different from that of Mr Commissioner Jacobs. I do not find his somewhat brief reasoning persuasive in the light of the considerations which I have mentioned. There was no oral hearing in CCS/4378/2001 and no submissions were made that the absent parent's contractual entitlements had been varied by agreement or about the double whammy effect of only allowing lower amounts of income tax and social security contributions to be deducted. There is no mention of the absent parent having had the benefit of representation of any kind. I bear in mind that Mr Commissioner Jacobs thought (and I agree) that there would be an unfairness if the overpayment of earnings counted as earnings, while the reduction in earnings to recoup the overpayment was not taken into account. But I have doubts about his solution. I do not see why the overpayment was not derived from employment so as to count as part of gross earnings, at least for any period before the mistake was identified and recovery was required by the employer. The alternative solution which I prefer for other reasons avoids the result which Mr Commissioner Jacobs thought would be unfair.

21. By reason of the combination of the factors just mentioned, I am satisfied that CCS/4378/2001 should not be followed. In my judgment the legal position for WFTC purposes is as set out in paragraphs 12 to 15 above.

22. Accordingly, it must be concluded that the appeal tribunal of 15 March 2001 erred in law, by applying a wrong legal principle to the issue of the identification of P's gross earnings.

Its decision must therefore be set aside. As the primary facts are not in dispute, it is expedient for me to substitute a decision on the facts.

23. The decision is that the claimant is entitled to working families' tax credit for the period of 26 weeks from 3 October 2001 at a weekly rate calculated on the following basis. The gross earnings of the claimant's partner in the assessment period are to be taken as, in July 2000 £964.60, in August 2000 £964.60 and in September 2000 £1040.60. The amounts of income tax and social security contributions recorded as deducted from earnings are to be deducted in calculating net earnings for each pay period. The Board of Inland Revenue is to calculate the claimant's weekly income on that basis and to go on to calculate the amount of the working families' tax credit to which she is entitled. If there is any disagreement as to the result of those calculations, the appeal may be returned to me (or, if necessary, another Commissioner) for further decision.

(Signed) J Mesher
Commissioner

Date: 9 September 2002

Corrected on 26 September 2002