

Calculation of income - treatment of P.A.G.  
of capital receipts; valuation of livestock  
and other assets. 10/19/94

MR/SH/2

Commissioner's File:

CFC/010/1993

CFC/011/1993

FAMILY CREDIT (GENERAL) REGULATIONS 1987

SOCIAL SECURITY ADMINISTRATION ACT 1992

APPEAL FROM DECISION OF SOCIAL SECURITY APPEAL TRIBUNAL ON A  
QUESTION OF LAW

DECISION OF THE SOCIAL SECURITY COMMISSIONER

{ORAL HEARING}

1. These appeals are unsuccessful.
2. On 5 February 1992 the Department of Social Security received two claims for family credit from the claimant. They have been treated as a claim in respect of the 26 weeks from 4 June 1991 and a claim in respect of the 26 weeks from 3 December 1991. The adjudication officer accepted that there was good cause for the delay in claiming but decided that the claimant was not entitled to family credit on either claim because her husband's income (which, under section 22(5) of the Social Security Act 1986, was treated as hers) was too high. The claimant appealed but on 12 October 1992 the Leicester social security appeal tribunal dismissed the appeals. She now appeals against the tribunal's decisions with the leave of the tribunal chairman.
3. At the hearing of the appeals the claimant was represented by Ms Ingrid Simler of counsel, instructed by Messrs Bramleys, solicitors of Nottingham, and the adjudication officer was Mr Neil Hewitt. I am grateful to both Ms Simler and Mr Hewitt for their helpful submissions.
4. The claimant's husband is a farmer who, at the material time, was in partnership with his mother and brother. His income was calculated by reference to a trading and profit and loss account and a balance sheet for the year ended 5 April 1991.

5. It is common ground that the tribunal erred in law in treating as part of the partnership's receipts a sum of capital introduced into the business by his mother and used to reduce the substantial bank overdraft. The tribunal relied on CFC/004/91 and were plainly unaware that that decision had been set aside by consent in the Court of Appeal (Kostanczuk v. Chief Adjudication Officer). The Court of Appeal's order states that:-

"..... THE COURT DIRECTS

that capital receipts not generated by a claimant's business do not form part of the gross receipts of employment for the purpose of regulation 21 of the Family Credit (General) Regulations 1987 (SI 1987 No. 1973)."

6. However, another point arises. It was submitted by Mr Hewitt that, in any event, the claimant's husband's income was too high. Although the profit and loss account shows an overall loss, Mr Hewitt submitted that, for family credit purposes, it is not possible to include in the "cost of sales" any amount in respect of a reduction in the value of livestock and other assets. As the reduction in valuation was £74,969, the partnership's loss would have been converted into a respectable profit if it had not been taken into account. Ms Simler accepted that, if Mr Hewitt were right, the claimant would not be entitled to family credit on either of the two claims.

7. The following provisions of the Family Credit (General) Regulations 1987 are relevant to this appeal:-

" 15. (1) Subject to regulation 17 (periods to be disregarded), where a claimant's income consists of earnings from employment as a self-employed earner, his normal weekly earnings shall be determined, subject to paragraph (2), by reference to his weekly earnings from that employment -

(a) except where sub-paragraph (b) applies, over a period of 26 weeks immediately preceding the week in which the date of claim falls; or

(b) where the claimant provides in respect of the employment a profit and loss account and, where appropriate, a trading account or a balance sheet or both, and the profit and loss account is in respect of a period of at least 6 months but not exceeding 15 months and that period terminates within the 12 months preceding the date of claim, over that period; or

(c) over such other period of weeks preceding the week in which the date of claim falls as may, in any particular case, enable his normal weekly earnings to be determined more accurately.

....

21. (1) Subject to paragraph (2), 'earnings', in the case of employment as a self-employed earner, means the gross receipts of the employment .....

....

22. (1) For the purposes of regulation 15 (normal weekly earnings of self-employed earners), the earnings of a claimant to be taken into account shall be -

(a) ....;

(b) in the case of a self-employed earner whose employment is carried on in partnership or is that of a share fisherman within the meaning of the Social Security (Mariners' Benefits) Regulations 1975, his share of the net profit derived from that employment less -

(i) an amount in respect of income tax and social security contributions payable under the Social Security Act calculated in accordance with regulation 23 (deduction of tax and contributions for self-employed earners); and

(ii) one-half of any qualifying premium payable.

....

(4) For the purposes of paragraph (1)(b) the net profit of the employment shall, except where paragraph (4A), (9) or (10) applies, be calculated by taking into account the earnings of the employment received in the assessment period less, subject to paragraphs (5) to (7), any expenses wholly and exclusively defrayed in that period for the purposes of that employment.

(4A) For the purposes of paragraph (1)(b), in a case where the assessment period is determined under regulation 15(1)(b), the net profit of the employment shall, except where paragraph (9)

applies, be calculated by taking into account the earnings of the employment relevant to that period (whether or not received in that period) less, subject to paragraphs (5) to (7), any expenses relevant to that period (whether or not defrayed in that period) and which were wholly and exclusively incurred for the purposes of that employment.

(5) Subject to paragraph (6), no deduction shall be made under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, in respect of -

- (a) any capital expenditure;
- (b) the depreciation of any capital asset;
- (c) any sum employed, or intended to be employed, in the setting up or expansion of the employment;
- (d) any loss incurred before the beginning of the assessment period;
- (e) the repayment of capital on any loan taken out for the purposes of the employment;
- (f) any expenses incurred in providing business entertainment.

(6) .... A deduction shall be made under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, in respect of the repayment of capital on any loan used for -

- (a) the replacement in the course of business of equipment or machinery; and
- (b) the repair of an existing business asset except to the extent that any sum is payable under an insurance policy for its repair,

(7) An adjudication officer shall refuse to make a deduction in respect of any expenses under paragraphs (3)(a), (3A)(a), (4) or (4A), as the case may be, where he is not satisfied that the expense has been defrayed or given the nature and the amount of the expense that it has been reasonably incurred.

...."

8. By virtue of regulation 22(4)(b), when calculating the "net profit" of a business for family credit purposes, it is not permissible to take account of any reduction in the value of capital assets. In the present case, the issue is whether it is permissible to take account of any reduction in stock valuation.

9. In his written submission, the adjudication officer relied on C2/89 (FC), a decision of the Chief Commissioner in Northern Ireland, in which he said at paragraph 7:-

".... regulation 21(1) provides that 'earnings' means 'gross receipts' and under regulation 22 the net profit of Mr Jeffers' employment shall be his earnings (i.e. gross receipts) less the specified deductions. Those deductions do not in my view include any allowance in respect of a reduction in stock values which, for family credit purposes, cannot be taken into account."

The Family Credit (General) Regulations (Northern Ireland) 1987 are not distinguishable from the regulations I must consider. Ms Simler submitted that C2/89 (FC) was wrongly decided. She argued that regulation 22(4A) does permit the deduction of an allowance in respect of a reduction in stock valuation because such a reduction is part of the costs of the business and is wholly and exclusively incurred for the purposes of the employment.

10. The reason that a decrease of increase in valuation of stock is shown in accounts and taken into account for tax purposes is that the accounts then more fairly show the profit (or loss) of the business in the relevant period. If regulation 22(4A) could be read by itself, it might well be appropriate to take account of any reduction in the valuation of stock, either as a reduction of earnings or as an expense. However, regulation 22(4A) cannot be read without regard to regulations 21(1) and 22(7) and it seems to me to be clear from those provisions that only earnings actually received and expenses actually defrayed may be taken into account.

11. Ms Simler referred me to paragraph 30 of CFC/25/1989 (now reported as R(FC) 1/91) for the proposition that the calculation of net profit under regulation 22(4A) is made on an "earnings basis" in contrast to the "cash basis" used when regulation 22(4) applies. However, the distinction between paragraphs (4) and (4A) is merely that, where the former applies, the earnings must be received, or the expenses defrayed, during the relevant period, whereas, where the latter applies, the receipt or defrayal need not necessarily be within the relevant period as long as the earnings or expenses are relevant to that period. There is nothing in the Commissioner's decision to suggest that actual receipt of earnings, or actual defrayal of expenses, is not required.

12. Ms Simler further argued that it was necessary to take account of the variation in stock valuation in order to give effect to the obvious purpose lying behind the 1987 Regulations which are intended to assist those who are working but have low incomes. However, quite apart from the fact that I cannot ignore the language of the legislation, I do not accept that taking account of variation in stock valuation would necessarily advance its purpose. A variation may be upwards as well as downwards. Bringing into account stock valuation affects the year in which advantages and liabilities may arise as the result of commercial transactions. For tax purposes there are clearly strong arguments for taking a long-term view and making the notional adjustments to income and expenditure involved in taking account of stock valuation. However, for social security purposes, there are equally strong arguments for taking a short-term view of a claimant's needs. It seems to me to be consistent with a social security scheme that only money actually received or actually expended should be taken into account and that notional adjustments should be excluded - however sensible they may be in other contexts. I accept that there is already an element of artificiality where the relevant accounting period is some considerable time before the date in respect of which benefit is claimed, but if trading and profit and loss accounts and balance sheets are to be used that is inevitable.

13. In the present case the claimant's husband had very little money at the time in respect of which the claims were made because the partnership had reduced its indebtedness to the bank. However, regulation 22(5) prevents the payment to the bank being taken into account in calculating his income, except in so far as the payment was in respect of interest and charges (for which allowance has duly been made).

14. I therefore accept Mr Hewitt's submissions and reject those of Ms Simler. Because the tribunal erred in law on the ground explained in paragraph 5 above, I must set aside their decision. However, there is no dispute about the accuracy of the accounts in this case and I can clearly give the decision the tribunal should have given which is to exactly the same effect as their original decision. The claimant is not entitled to family credit on either of the two claims she made on 5 February 1992.

(Signed) M. Rowland  
Commissioner

(Date) 26 April 1994