

ORD

Calculation of self-employed earnings

92/94
★

MJG/MB/2

Commissioner's File: CFC/041/1993

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

Name: Eileen Wakefield (Mrs)

Social Security Appeal Tribunal: Norwich

Case No: 2:10/9154

1. I allow the claimant's appeal against the decision of the social security appeal tribunal dated 10 March 1993 as that decision is erroneous in law and I set it aside. My decision is that, in the ascertainment of the claimant's entitlement to Family Credit as claimed by her on 4 March 1992, her self-employed "earnings" shall be calculated according to the following rules:-

- (a) Against the figure for sales of stock (£19,570) there shall be set off the figure of £16,880 under the head "cost of sales" in the claimant's trading and profit loss account for the year ended 30 April 1991;
- (b) The sum of £10,182 introduced into the business is to be disregarded;
- (c) No sum shall be taken into account for the net proceeds of sale (£7,500) of a motor van belonging to the business.

The adjudication officer shall forthwith recalculate the claimant's entitlement to Family Credit for the relevant period. Any problem or difficulty that arises from that calculation can be referred to me or to another Commissioner for Direction or

Supplemental Decision: Social Security Administration Act 1992, section 23.

2. This is an appeal to the Commissioner by the claimant, a married woman born on 7 October 1950. The appeal is against the unanimous decision of a social security appeal tribunal dated 10 March 1993, which was dealing with the claimant's appeal from her entitlement to Family Credit as claimed by her on 4 March 1992. The tribunal's decision on the various points in issue in the case is contained in their findings of fact and decision (boxes 2 and 3 of form AT3) as follows,

"Appellant claims Family Credit on 4 March 1992. The sum of £10,182 capital introduced should not have been included as relevant income. The correct figure for the relevant income should be £27,070 and not £37,252. The sum of £7,500 from the sale of the business assets was properly included. No adjustment can be made for opening and closing stock. The formula makes no provision for stock purchased in an earlier period and carried forward to the period and consideration for stock unused at the end of the period under consideration. Appeal disallowed in that the entitlement to Family Credit should be calculated on the basis that the total income for consideration is £27,070."

3. So far as concerns the tribunal's decision that the sum of £10,182 introduced should not have been included, that is clearly correct in view of the consent decision to that effect by the Court of Appeal in another case on 21 August 1992. So far as concerns the net sum of £7,500 for the sale of a motor van, it is submitted by the adjudication officer now concerned, in paragraph 5 of a written submission dated 22 April 1994, that that sum should also be disregarded, in view of the decision of another Commissioner on file CFC/3/92. I accept that submission. Consequently the sum of £7,500 should not be taken into account as "earnings".

4. That leaves the main issue which was involved in this case, namely whether or not, in calculating the earnings of the claimant attributed to her from her husband's business, the relevant Family Credit regulations (see below) permit the use of the normal accounting convention (here used in the claimant's husband's trading and profit and loss account for the year ending 30 April 1991), by which against the actual sales in the accounting year of goods there is set off a 'notional' figure for the 'cost of sales'. That figure was itemised in the trading and profit loss account as follows:

"Cost of sales:

Opening stock -	£19,905
Purchases -	£2,886
Packaging -	£144
Total:	£22,935
Less closing stock -	<u>£6,055</u>
Net total -	<u>£16,880.</u> "

5. The appeal was the subject of an oral hearing before me on 21 July 1994, at which the claimant attended and was represented by Mr. D.J. Ford, a Chartered Accountant. The adjudication officer was represented by Miss N. Mallick of the Office of the Solicitor to the Departments of Health and Social Security. I am indebted to all those persons for their assistance to me at the hearing.

6. On the principal issue on which the appeal was brought, I found in favour of the claimant as indicated in paragraph 1(a) of my decision. I have therefore acceded to the arguments of Mr. Ford to that effect and rejected Miss Mallick's contrary contentions. I would commend the moderate and carefully reasoned way in which both Mr. Ford and Miss Mallick put forward their arguments.

7. This particular problem has been the subject of a number of Commissioners' decisions and is also the subject of a decision of the Chief Commissioner in Northern Ireland on file C2/89(FC). So far as the decisions of the English Commissioners are concerned, attention was principally concentrated on two starred decisions namely the decision against allowing deduction for cost of stock of Commissioner Rowland on files CFC/010/011/93 and the decision the other way of Mr. Commissioner Rice on file CFC/019/1993. As far as I know, neither of those starred decisions have been designated by the Chief Commissioner for reporting.

8. Miss Mallick frankly said that she did not altogether rely on Commissioner Rowland's decision on file CFC/010/011/93, in view of certain phraseology in it, but equally she submitted strongly that Commissioner Rice's decision on file CFC/019/1993 was erroneous in law, in that it concentrated too much on accountancy principles and did not necessarily address all the relevant provisions of regulation 22 of the Family Credit (General) Regulations 1987. As a result I acceded to both parties' request to hear all the legal arguments relating to this problem de novo. I have ultimately concluded that Commissioner Rice was correct in his decision on file CFC/019/93 when to quote his starring note he decided that,

".. in calculating the net profit of a business for the purpose of determining a claimant's earnings, and hence his or her entitlement to Family Credit, it is necessary to take into account both the opening and closing stock of the relevant year."

9. I should say that I have also given careful consideration to the above-cited decision of the Chief Commissioner in Northern Ireland since of course such a decision is of considerable persuasive authority. I have ultimately decided however that the arguments that prevailed with Commissioner Rice and those of Mr. Ford before me tipped the scales. I must therefore refuse to follow the decision of the Northern Irish Chief Commissioner, as indeed Commissioner Rice refused to do, in CFC/019/1993.

10. The relevant regulations are regulations 15 and 22 of the Family Credit (General) Regulations 1987 S.I. 1987 No.1973, as amended by S.I. 1988 No.1970. I deal with each in turn. The relevant provisions of regulation 15 are as follows:

"Normal weekly earnings of self employed earners

"15(1) ... 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 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.

(1A) In paragraph (1)(b) -

- (a) 'balance sheet' means a statement of the financial position of the employment disclosing its assets, liabilities and capital at the end of the period in question;
- (b) 'profit and loss account' means a financial statement showing the net profit or loss of the employment for the period in question; and

- (c) 'trading account' means a financial statement showing the revenue from sales, the cost of those sales and the gross profit arising during the period in question."

It should be noted at this point that the definition in regulation 15(1A)(c) of "trading account" refers to "the revenue from sales" and "the cost of those sales" (my underlining). It should also be noted that sub-paragraphs 15(1)(b) and (1A) were introduced by amendment regulations, S.I. 1988 No. 1970, as from 5 December 1988.

11. Regulation 22, so far as is relevant, provides as follows:

"Calculation of net profit of self-employed earners

"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) in the case of a self-employed earner who is engaged in employment on his own account [i.e. the claimant's husband in this case], the net profit derived from that employment;

(b) [not relevant]

(2) [not relevant]

(3) For the purposes of paragraph 1(a) the net profit of the employment shall, except where paragraph (3A) .. applies, be calculated by taking into account the earnings of the employment received in the assessment period, less

- (a) subject to paragraphs (5) to (7), any expenses wholly and exclusively defrayed in that period for the purposes of that employment;

(b) and (c) [not relevant]

(3A) For the purposes of paragraph (1)(a), in a case where the assessment period is determined under regulation 15(1)(b), the net profit of the employment shall ... be calculated by taking into account the earnings of the employment relevant to that period (whether or not received in that period), less -

- (a) 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;

(b) - (c) [Not relevant]

(4) [Not relevant]

- (5) Subject to paragraph (6) no deduction shall be made under paragraphs (3)(a), (3A)(a), .. 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.
- (7) A deduction shall be made under paragraphs (3)(a), (3A)(a), .. 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), .., 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." (my underlining).

12. I should note at this point that amendments were made to regulation 22 by the same amendment regulations, namely S.I. 1988 No. 1970. Of particular significance in this case, regulation 22(3A) was introduced. It should also be noted that the phrase in regulation 22(3) "received in the assessment period" was substituted by the 1988 regulations for the previous expression which was simply "the earnings of the employment of the assessment period". A contrast is thus made with the insistence of the new paragraph (3A) that, where accounts have been supplied under regulation 15(1)(b), the relevant period is "the earnings of the employment relevant to that period (whether or not received in that period)". Moreover, the provision of para.(3A) dealing with expenses is "any expenses relevant to that period (whether or not defrayed in that period)"(para.(3A)(a)).

13. In my view, the use of the phrase "whether or not defrayed in that period" is fatal to any objection that the cost of purchase of goods does not happen to have been incurred during

the accounting period in question. It is sufficient that under the normal accounting procedures there is taken into account the cost of opening stock less closing stock since that was that sum that was needed to buy the goods sold at a profit. I cannot see anything contrary to the normal rules of the family credit scheme in this. As I can see, it would appear that the new paragraph (3A) was introduced for this very purpose, hence the contrast with cases where accounts are not supplied where now of course a strictly cash basis is to be used (reg.22(3)). Only expenses "defrayed in that period" i.e. the period taken into account under regulation 15(1)(a) or (c), can be deducted. Moreover it seems to me that the definition of "trading account" in regulation 15(1)(c) which refers to "the cost of those sales", (my underlining) tends to the same conclusion.

14. In so holding, I should say that I have not overlooked the detailed submissions of Miss Mallick relying on what she contended was the artificiality of accounting conventions. She also stressed that there are exemptions in regulation 22(6) from the prohibition of certain deductions in regulation 22(5) but those exemptions do not include a deduction for the difference between opening and closing stock. However, that does not seem to me necessarily to be conclusive, since most of regulation 22(5) is dealing with sums which clearly ought not to be allowed as losses or expenses. From such a list one would not necessarily expect to find an exemption for deduction of the cost of sold stock.

15. I also note that it is open to the adjudication officer under regulation 15(1) not necessarily to accept a claimant's accounts but to insist on proceeding under regulation 15(1)(c) which provides that "in any particular case" another period of weeks other than the period in the accounts can be taken where it would "enable [the claimant's] normal weekly earnings to be determined more accurately." Consequently, in my view, in the normal case where the accounts are accepted the figure in those accounts for net profit (see regulation 22(1)(a)) should be accepted. Clearly it is in the interests of proper administration of the family credit scheme that adjudication officers should be able to accept proper accounts at their face value and not be required to indulge in any more dissection of them than is strictly authorised by regulation 22.

16. Lastly I should mention that towards the end of the hearing Miss Mallick mentioned a question as to the receipt by the claimant or her husband of a £5,000 repayment of tax. There may be some question as to whether or not that £5,000 ought to be taken into account. However, that matter was not pursued any further before me but the adjudication officer may need to look into it.

(Signed) M.J. Goodman
Commissioner

(Date) 12 September 1994