[2018] NZSSAA 42

Reference No. SSAA 03/17

**IN THE MATTER** of the Social Security Act 1964

AND

**IN THE MATTER** of an appeal by **XXXX** of XXXX, against a decision of a Benefits Review Committee

## BEFORE THE SOCIAL SECURITY APPEAL AUTHORITY

**Mr G Pearson** - Chairperson

Mr K Williams - Member

Appearances

The Appellant with her agent Ms Carla Woollaston

For Chief Executive of the Ministry of Social Development: Ms J Hume

## DECISION

**G Pearson** (Chairperson)

**Background**

[1] XXXX (the appellant) receives a supported living payment, she is affected by medical conditions limiting her capacity to work. The Ministry's computer system records she suffers from "congenital abnormalities, unspecified bipolar affective disorder and muscular skeletal and connective tissue diseases". As that description makes obvious, the appellant has lifelong challenges due to her physical and mental health. Notwithstanding those severe difficulties, the appellant very successfully reduced her reliance on a benefit. She was an IT technician and then developed specialist skills relating to an artistic product used by the building industry (the art work).

[2] When the appellant first developed her skills with the art work she was heavily reliant on a wheelchair and other devices to facilitate her mobility. Motivated by her desire to maximise opportunities she had with the art work, and with the help of physical therapy, she developed her physical strength. She could then work and live without her wheelchair and other forms of assistance to maintain mobility. By about 2015, she reached the point where she could almost financially support herself without

requiring a benefit. While on a work trip, she was involved in a vehicle accident. She suffered both physical injury and a head injury. Since that time, she has been endeavouring to re-establish her business, though the injuries she suffered in 2015 affect her capacity to do so.

[3] During the years the appellant operated her business, her benefit was adjusted depending on how much the business contributed to her income. The Ministry accepted it should measure her income based on “drawings” from the business. The Ministry’s thinking appeared to be that the amount she would take for her personal living expenses from the business adequately measured her income from that source. The Ministry now says that the correct approach is the higher of:

[3.1] drawings from the business; and

[3.2] the profits earned in the business.

[4] However, the Ministry’s approach to measuring the profits in the business is starkly different from conventional measures of profitability. The Authority is concerned in this appeal with the appellant’s financial results for the year ending 31 March 2016. During that period, Inland Revenue determined the correct amount of net profit was $4,409. The Ministry accepts Inland Revenue had the correct figures, and applied the correct principles for tax purposes. However, by taking a different approach to the costs of generating the income, the Ministry says that for social security purposes the appellant had an income of $19,959, not $4,409.

[5] It is elementary that some receipts are income for social security purposes, and the same receipts are not income for tax purposes. For example, gifts could be income for social security purposes, but not for tax purposes. Other receipts are income for social security purposes when used to meet day-to-day expenditure whereas the application of the receipts would be irrelevant for tax purposes. However, when simply measuring how much a person receives from employment, or a small business, stark differences between the income for tax and social security purposes require scrutiny.

[6] The Ministry routinely uses tax figures to determine income from employment without any adjustments. In those cases, the statutory mechanisms are quite different, but the result is typically similar or identical. That is unsurprising given that Inland Revenue has an overarching statutory duty to measure income from personal exertion on a commercially realistic basis. In this case, the Authority is concerned with a small business with routine characteristics, it is based on personal exertion and is typical of a business potentially available to a person seeking to supplement,

or gain independence from, income support under the Social Security Act 1964 (the Act).

[7] In this case, the discrepancy between Inland Revenue's measurement of the Ministry's approach turns on disallowing a range of expenses. I discuss the details below. However, for illustration purposes the Ministry accepts that the appellant has kept an accurate log book and demonstrated she uses a vehicle 96 per cent of the time for business purposes. However, the Ministry has allowed only 50 per cent of the costs that would be allowed using mileage rates approved by Inland Revenue. It has chosen not to allow the alternative approach of measuring the cost using actual expenses; or the mileage rates applied to actual business use. The Ministry says its departure from how Inland Revenue measures income is justified by court decisions that mandate this result.

[8] If the Ministry is correct, then a person in the appellant's position cannot generally engage in small business activities to supplement their income, and there is no prospect of progressing to independent living through that mechanism. Benefits do no more than provide sufficient means for a person to live with reasonable dignity; it is impossible to use a benefit to supplement business expenses on a significant scale. As an illustration, Inland Revenue says the appellant earned $4,409 net profit in the year ending 31 March 2016, and currently receives an annual benefit entitlement of $13,447. That is a total income of $17,856. From an income of $17,856 the appellant cannot fund the disallowed business expenses of $15,550 and continue to live. Speaking approximately, the Ministry has disallowed about half of the business expenses Inland Revenue allowed.

[9] The figures are not precise as the Ministry did not provide a breakdown of the benefit for the year ending 31 March 2016. However, the appellant's circumstances appear to remain reasonably constant, and the figures are sufficient to demonstrate the outcome the Authority must address.

[10] The human cost of the Ministry's approach is well demonstrated by this appeal. Due to the appellant's lifelong difficulties, it has not been realistic for her to engage in employment. That situation was made more difficult after she suffered from a head injury. Her health does not permit her to work every day and does not permit her to work regular hours. Nonetheless, she is in a position where she does work very successfully over the course of a year.

[11] Until she had her accident in 2015, the appellant was getting close to a position where she would not need a benefit. After re-establishing her business within the confines demanded by her head injury and physical injuries after her accident, the

level of business profit is substantially lower. Nonetheless, from the appellant's point of view, the ability to contribute to society and the therapeutic nature of the work and social engagement has been very important for her wellbeing. I refer, for example, to the fact that when the appellant first commenced her art business she relied heavily on a wheelchair and the work was instrumental in achieving the improved mobility she now enjoys. Furthermore, the appellant has struggled with suicidal ideation and finds it very difficult to contemplate a future where she is excluded from continuing to carry out the business that has been transformative for her life.

[12] It is necessary to discuss some tax issues, not because the Social Security Act 1964 (the Act) uses the definition of "income" used in the Income Tax Act in any respect. It is obvious there is no correspondence between the statutory regime that defines income under the Act and the regime that defines income for income tax. However, there are two factual issues arising from the appellant's tax returns:

[12.1] The Ministry used the tax figures as the base for its own calculations. It adjusted the income by referring to taxation principles. Accordingly, the Authority must identify the foundation for the adjustments, and determine whether the adjustment results in an amount of income that is consistent with measuring income under the Act.

[12.2] Second, as noted, the measurement of income for tax purposes is intended to result in a "commercially realistic" measure of income. In this case there is a gross disparity between the commercially realistic measure, and the income the Ministry attributes to the appellant. The disparity is such that, if correct, it is impossible for the appellant to continue in business. She would have to subsidise business expenses, and could not do so if the Ministry's measure of income is correct. It is necessary to identify whether "income" under the Act does mandate such a departure from commercial realism (a concept the Supreme Court has said applies to measuring income for tax purposes).

[13] The discussion relating to taxation principles is limited to those issues, given the obvious and elementary need to focus on how income is measured for the purpose of the Act, not for tax purposes.

[14] The question before the Authority is to determine the correct amount of income the appellant received during the year ended 31 March 2016 for the purposes of the Act.

**The legislation relating to measuring income under the Act**

[15] The Ministry referred to s 1A of the Act, in particular paragraphs (a)(i) and (c)(i). The section refers to the purpose of the Act being to help people support themselves and their dependents while not in paid employment, and to ensure that persons who are assisted should use the resources available to them before seeking financial support under the Act. Having regard to the background already discussed, it is not immediately obvious what specific significance those provisions have in relation to the issue the Authority must decide; aside from noting that:

[15.1] is the appellant's objective in conducting her business, and

[15.2] she brought this appeal because the Ministry's measure of her income is so distorted from commercial realism that she will have to discontinue her business if the Ministry is correct.

[16] Accordingly, if s 1A is applied to a purposive interpretation of the relevant legislation is supports the appellant, not the Ministry's position. However, the Ministry did say it "needed to determine the income that the business was generating". That does correctly describe the Chief Executive's task, which now falls to this Authority to determine in relation to the appellant's circumstances. Accordingly, the key issue is how the legislation applies to measuring the income the appellant derived from her business.

[17] In terms of determining income, the Ministry's position is that:

> The definition of income for the purposes of the Social Security Act 1964 is distinctly different from, and is wider than, the definition of income contained in the Income Tax Act. In general any money used, or which could be used by a beneficiary for income related purposes, will be considered to be income.

[18] There can be little doubt the Ministry's proposition is generally accurate. However, this appeal is concerned only with a relatively narrow aspect of the definition of income under the Act; namely, how to measure business income. As noted, the Ministry applies the same approach to measuring income as is applied for tax purposes in relation to income from employment.[1] It is not axiomatic that there must be a different outcome from measuring taxable income, despite the wholly different legislation. When dealing with measuring income from personal exertion in employment or self-employment, income tax should be imposed on the true

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[1] If it were otherwise, the Ministry should allow deductions for employment related expenses. There was a substantial body of authority that allowed employment related expenses as deductions until the statutory prohibition in the Income Tax Acts.

economic or commercial result from the activity. The Supreme Court in *Penny and Hooper v Commissioner of Inland Revenue* [2011] NZSC 95 affirmed the tax legislation's anti-avoidance mechanisms ensure that the measure of income from personal exertion must be a commercially realistic income:

> [49] … If the salary is not commercially realistic or, objectively, is not motivated by a legitimate (that is, non-tax driven) reason, it will be open to the Commissioner to assert that it was, or was part of, a tax avoidance arrangement.

[19] Given that the Ministry accepts Inland Revenue has performed its task of evaluating the appellant's income on correct information and with a correct measure for tax purposes, the Authority must examine why the Ministry should derive a result that is far removed from that commercially realistic evaluation of the appellant's income.

[20] The scope of what is "income" turns on the definition of "income" in s 3 of the Act. The fundamental difference in scope of income from taxable income in part comes from the terms of paragraph (b) of the definition. It extends income to include capital receipts, and includes receipts based on how the recipient uses the funds. There is no corresponding dimension to taxable income.

[21] This appeal only raises paragraph (a) of the definition of "income" in the Act, which provides:

> **income**, in relation to any person, —
>
> (a) means any money received or the value in money's worth of any interest acquired, before income tax, by the person which is not capital (except as hereinafter set out); and

[22] This part of the definition includes any receipt of money, or value in money's worth which is not capital.

[23] I note, in general,[2] that the effect of earning income is that benefits are reduced based on the amount of income earned. The mechanism largely turns on the definitions also contained in s 3, in particular "Income Test 1"[3] through "Income Test 4", and "income-tested benefit". How the abatement applies depends on the particular beneficiary's circumstances and the type of benefit they receive. The lowest abatement is 15 cents for every dollar and the highest is 70 cents for every dollar of income before tax. As the amount of abatement is not disputed, it is

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2 After passing a threshold before which any abatement occurs.

3 There are multiple income tests in the legislation.

unnecessary to do more than recognise the principle in this case. The area of contention is the level of the appellant's income.

**The technical issues disputed in the present case**

*Preliminary matters*

[24] To establish the scope of the present dispute, it is important to recognise:

[24.1] The Ministry has taken no issue with the calculation of the appellant's taxable income.

[24.2] It also accepts the correctness of the principles on which that taxable income was determined, for example the extent of business use of a vehicle.

[24.3] In terms of the relevant period of time, the key decision is to determine the amount of the appellant's income from self-employment for the year ending 31 March 2016. The amount the Ministry determined as income in that period was $19,595.

[25] In relation to the period from 8 July 2015 to 5 July 2016, the Ministry considered there was a benefit overpayment of $4,765.29, but has written off the full extent of that overpayment.

[26] The issue is an ongoing one and generally the principles that apply to the year ended 31 March 2016 will apply to other periods; however, I will focus my decision on that period and reserve any further issues that may fall within the scope of the appeal if they cannot be resolved.

*Are deductions from income permitted?*

[27] The Ministry's primary position is that the legislation does not allow for any business expenses to be deducted from business income. However, the Ministry takes the view that notwithstanding the legislation it can deduct business expenses it elects, and this extra-legislative power is supported by previous decisions of the courts. Ms Manhire who was the Chartered Accountant giving evidence for the Ministry said:

> There is no provision for business expenses to be deducted from business income in the definition of income in s 3 of the Social Security Act. It is Ministry practice to allow business expenses that are essential and directly related to earning the income to be deducted. This is supported by case law. However, the Ministry cannot allow for expenses that would be incurred even if there was no business or that are of a private nature.

[28] It is necessary to examine Ms Manhire’s essential proposition that the legislation does not provide for the deduction of business expenses. It is then necessary to examine her claim that she correctly quantified business expenses directly related to earning the income, while producing a gross disparity with the commercially realistic measure of income Inland Revenue was required to determine.

[29] Inland Revenue does not allow for the deduction of private or non-business expenses when determining a commercially realistic income. Accordingly, I must inevitably examine Ms Manhire’s claim in some detail, as the exclusion of private or non-business expenditure is not obviously different whether measuring income for tax purpose or under the Act.

*Are capital expenses and depreciation deductible?*

[30] Generally, capital expenses are not deductible for income tax purposes. However, that is not true of capital assets acquired and consumed for business purposes. None-the-less, generally the deductions are deferred until the value of an asset is consumed in the business. That process is governed by the depreciation regime.

[31] When measuring income under the Act Ms Manhire rejects:

[31.1] Capital deductions of any kind; and

[31.2] Any application of the depreciation regime.

[32] To evaluate Ms Manhire’s view, I observe:

[32.1] The depreciation regime, for tax purposes, defers deductions for the cost of acquiring major plant and equipment until the period where the value is used up in the business.

[32.2] However, depreciation is not applicable to every capital asset (small value items can be deducted immediately whether capital items or not), where value is consumed in the business.

[33] The Ministry’s approach has been to allow for the deduction of inexpensive items which are not brought into the depreciation regime (under $500), even though, in the Ministry’s view, the items are capital in nature. In contrast, the Ministry has disallowed other capital expenditure and not allowed a deduction for depreciation. Accordingly, Ms Manhire’s approach selectively adopts some elements of the income tax depreciation regime. However, she advanced no principled grounds for using the tax regime’s approach to items up to $500, and rejecting its approach for other assets.

[34] It is accordingly necessary to determine the correct approach for each of the items in issue in the appellant's financial statements.

*Is a schedular approach to calculation of income appropriate?*

[35] The Ministry says there is no statutory entitlement to deductions for expenses. However, it inconsistently says it may choose to allow some deductions, and do so using a schedular approach. That is to say each source of income is isolated (schedularised), and the expenses of earning that income are set off against it. If there is a loss, then it is ignored, and the net results for the profitable sources of income are accumulated. The alternative is to accumulate all sources of income, and deduct all expenses.

**What the courts have said**

*Scope of this appeal*

[36] This appeal raises serious implications for the appellant, and the many other people in similar circumstances that flow from the Ministry's approach. The Ministry has departed from what Inland Revenue says is a commercially realistic measure of income, and done so to a striking extent. The Ministry says it is justified by previous court decisions and measures profit using extra-legislative powers to allow some expenditure as a deduction, but disallowing other expenditure required to produce the income. Though the specifics of the Ministry's approach are less than clear. Accordingly, I have undertaken a wide-ranging review of the authorities that apply to measuring income from personal exertion. Some of those authorities have considered other aspects of income, but raise principles that are relevant to the evaluation required in this case.

[37] While many court decisions have addressed aspects of the determination of income under the Act; none of them have directly considered the issue raised in the present case. As discussed below it is clear that in the past the Ministry has not, or not consistently, applied the approach it now seeks to advance in this case.

*Approach to interpretation and the purpose of the definition of "income"*

[38] In *Bramwell v The Director-General of Social Welfare* [2001] NZAR 890, the Court of Appeal considered ACC payments, which are not presently in issue. However, the Court did observe that "income" under the Act is a wide concept. The Court appeared to accept that a purposive interpretation could be applied, but such an approach was not helpful in that case. The Family Court in *McElroy v Director-General of Social Welfare* (1992) 9 FRNZ 366 took a similar view, relying on what is now s 5 of the Interpretation Act 1999. More recently, the High Court has made some significant

observations in *F v Chief Executive of the Ministry of Social Development* [2018] NZHC 1607.[4] Davison J referred to *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 and in particular these observations of Tipping J:[5]

> Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross-checked against purpose in order to observe the dual requirements of s 5. In determining purpose the Court must obviously have regard to both the immediate and the general legislative context. Of relevant too may be the social, commercial or other objective of the enactment.

[39] The Judge found that in accordance with the earlier decision in *Director-General of Social Security v K* HC Wellington AP255/95, 7 February 1997, the purpose of the definition of "income" was to take into account "moneys … [that] truly add to the resources of the person receiving them".[6] In the context of loans, that required taking account of any obligation to repay loans. He accordingly took account of the reality that beneficiaries may be forced through circumstances to borrow for basic needs, and should not be penalised when that was the reality of their circumstances. To do otherwise would locked them into the "multiple deprivations that they face", and was not appropriate.[7]

[40] I must apply the principles in the *K* and *F* cases, which are consistent with each other, and, as the Court observed in the *F* case, consistent with the Court of Appeal's decision in *Bramwell.* In my view, it follows the key principles on which I must measure the appellant's income are to:

[40.1] determine the extent to which the appellant received income that truly added to her resources; and

[40.2] ensure that a distorted measure of income does not lock her into dependence on support under the Act, when she could otherwise gain relative or absolute financial independence through self-employment.

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4 *F v Chief Executive of the Ministry of Social Development* [2018] NZHC 1607 at [55]. It should be noted that the earlier case *Dixon-McIver v The Director-General of Social Welfare* HC Wellington AP 94/98, 20 March 2000 took a similar view to interpreting s 3.

5 *Commerce Commission v Fonterra Co-operative Group Ltd* 2007] NZSC 36, [2007] 3 NZLR 767 at [22].

6 *Director-General of Social Security v K* HC Wellington AP255/95, 7 February 1997 at 7.

7 *F v Chief Executive of the Ministry of Social Development* [2018] NZHC 1607 at [74].

*Losses and a schedular approach to income*

[41] In *Carswell v The Director-General of Social Welfare* HC Christchurch AP 132/98, 14 December 1999, the issue arose of how to address a beneficiary with business activity generating losses. The question was posed as a question of whether the definition of "income" in s 3 of the Act allowed the beneficiary's losses on rental property to be offset against other income.

[42] The appellant in that case contended that in accordance with what he said were fundamental accounting concepts, multiple sources of income should be aggregated to produce an overall profit or loss. In his case, the two sources were:

[42.1] Government superannuation (producing income); and

[42.2] a rental property that produced a loss, as the outgoings exceeded the income.

[43] The Ministry said the definition of "income" meant income from a particular source, and there was no room for negative income.

[44] Chisholm J considered the definition of "income" in s 3 of the Act, and said it did not provide for the subsidisation of unprofitable ventures. However, rather than focusing on the wording of the definition of "income" to answer the question, the Judge relied on the scheme in the Act, which did not contemplate offsetting of losses.[8]

[45] In *Hendrickson v Director-General of Social Welfare* HC Auckland AP25-SW00, 19 June 2000, the High Court again considered taking a schedular approach to income. In that case, the issue arose in relation to whether the appellant met the income test to be a non-qualifying spouse for national superannuation. She received income from interest on deposits, but had losses from a farming operation. She sought to offset the farming loss against the interest income. Gendall J applied the same approach as *Carswell*, and agreed it was the correct outcome. The decision turned more on the principle that the legislation was not intended to have the State subsidise the farming project, rather than the express wording in the definition of "income" in s 3 of the Act. However, the decision also considered what was required to separate income streams, as the appellant contended the funds held on deposit were working capital for the farming operation, and so were an integral part of it. Gendall J took the view that descriptions of the sources of income were not important; rather the

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[8] I note *McElroy v Director-General of Social Welfare* (1992) 9 FRNZ 366 concerned a liable parent whose farming operation was running at a loss. However, the losses were not integral to the reasoning. The key element in the reasoning was that borrowings from arms-length parties was income.

question was whether they were "common to or realistically linked", which was dependent on circumstances and, in that case, a finding of fact.

*Treatment of depreciation*

[46] Depreciation in respect of income tax is a mechanism to allow the cost of enduring assets where their value is consumed progressively, to be deducted from profits progressively. So, for example, if a machine has a life of 10 years, rather than claiming an immediate deduction for the cost of the whole machine the deductions will be spread over the life of the machine. When the machine is disposed of, if the deductions made to date do not cover the difference between the purchase and a lower sale price, a further deduction is allowed. The opposite also applies, and if the deductions have been too high, the excess is recovered on sale. This is a core principle and is now set out in a sophisticated statutory regime for tax purposes in New Zealand.

[47] However, the Act is focused on immediate cash need, rather than correctly allocating the economic or commercial effects over a long period of time. Many people will only receive a benefit for a brief period, though the appellant in this case has enduring difficulties that make independence difficult to achieve. The question in this case arises because the Ministry's approach is to refuse to recognise large elements of her cashflow. Depreciation can never be claimed unless a taxpayer has first purchased the depreciable asset. The Ministry says that under the Act a beneficiary must calculate their income as though they never purchased the business asset. It says, the cost cannot be deducted when the beneficiary purchases the asset, nor can it be deducted in future periods when the asset's value is used up in the business. That approach is not premised on using a cash basis for the calculation of income, it is a selective refusal to allow the deduction of cash expenditure for business purposes. It has support in earlier decisions of this Authority.

[48] In cases such as *Decision No* [2014] NZSSAA 27 this Authority expressed the view that:[9]

> Depreciation is in effect a book entry permitted for taxation purposes to allow a person in business to plan for the replacement of capital items needed to operate the business. If in fact funds are specifically set aside for capital replacement or used for capital replacement, then the Chief Executive may need to consider allowing a deduction for depreciation. Where however the funds deducted for depreciation have been used for income related purposes then the amount of that money must be treated as income for the purposes of the Social Security Act 1964. This approach was approved by the High Court *Hendrickson*.

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9 [2014] NZSSAA 27 at [14].

[49] There are some difficulties with that view. *Hendrickson* did not affirm the Authority's view regarding depreciation. It said that the issue did not arise for determination because the depreciation arose in relation to quantifying a loss. When the Court found the loss was not relevant in relation to support under the Act, there was no significance in how large or small the loss was. The Court said:[10]

> Counsel for the appellant accepted that if there is more than one "income stream" then any question of allowing depreciation does not arise. In other words notional losses or taxation deductions arising in relation to one enterprise could not be offset against income unrelated to that activity. The Authority did not need to consider the issue of depreciation although it did refer to it, obiter, in the context of it being able to be taken into account only when actual money was set aside to recover the replacement of items being depreciated. Otherwise depreciation is a notional concept and is not to be deducted in an accounting process.

[50] As the observations of the High Court are *obiter*, the issue was never explored in depth. There are no references to the decisions of higher authority that identify the true nature of depreciation. It is very clear in those authorities that depreciation is not a "book entry", if that means it is a notional adjustment rather than a deduction giving a proper timing determination for an outgoing of prior expenditure. It appears this Authority has not considered with the assistance of expert evidence that accurately identifies the true nature of depreciation; and there is no reference to the decisions of the higher Courts that have addressed the character of depreciation.

[51] The description of depreciation as a reserve to replace equipment is not correct; indeed, provision for replacement has never been a component of the depreciation regime in the various iterations of the Income Tax Act. The approach of treating depreciation as a reserve fund that can be deducted, if in fact created, is not consistent with any view of depreciation, whether refenced to taxation or financial reporting standards. A reserve fund is a wholly different taxation issue. The general principles relating to reserves is illustrated by *HW Coyle Ltd v Commissioner of Inland Revenue* (1980) 4 NZTC 61,558, where the court considered whether a fund set aside for a threatened claim for damages could be deducted.[11] There are very few instances where a reserve for anticipated expenditure on capital assets is deductible.[12]

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10 *Hendrickson v Director-General of Social Welfare* HC Auckland AP25-SW00, 19 June 2000 at [12].

11 A more recent analysis of the requirements is contained in *Commissioner of Inland Revenue* v *Mitsubishi Motors New Zealand Ltd* (1994) 16 NZTC 11,099.

12 The only exception is aircraft engines acquired before the tax year ending 2018, refer ss DW 5, DW 6, DZ 22 and DZ 23 of the Income Tax Act 2007.

[52] The true nature of depreciation in the income tax regime is set out broadly, but concisely, by the Privy Council in *Peterson v Commissioner of Inland Revenue* (2005) 22 NZTC 19,098:[13]

> Income tax is chargeable on the profits of a trade or business, not on gross earnings, and revenue expenditure incurred in earning those profits, if genuinely incurred, normally falls to be deducted from gross receipts in order to arrive at the taxpayer's taxable profits for the year. Capital expenditure incurred in the course of a trade or business, on the other hand, is not normally deductible in arriving at trading profits. Instead a depreciation allowance may be available to permit the capital cost of an asset with a limited life to be written off against the taxpayer's taxable income over the expected life of the asset: see, for example, s EG 1 of the Income Tax 1994 of New Zealand. Income tax is charged on an accruals basis not on a receipts and payments basis, and expenditure is deductible when it is incurred not when it is paid.

[53] The current regime establishes what is depreciable property in subpart EE of the Income Tax Act 2007, and sets out the methods of calculation. The regime draws no distinction between whether assets are capital or revenue items. It is generally sufficient that an asset might reasonably be expected to decline in value in deriving assessable income,[14] and is not trading stock.[15] Accordingly, short-term assets that are not capital may be depreciable assets. There is also a threshold where an item may be subject to an immediate deduction if it is equal to or less than $500 in value.[16]

[54] It follows that:

[54.1] It is not correct to say that depreciation is concerned with the replacement of capital items; it is concerned with deferred recognition of actual expenditure incurred.

[54.2] The High Court has never determined how to treat outgoings relating to enduring assets with reference to the definition of "income" in s 3 of the Act.

[54.3] It is not correct to say, as the Authority has, that "[w]here however the funds deducted for depreciation have been used for income related purposes then the amount of that money must be treated as income".[17] The deferred recognition of expenditure cannot be income.

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13 *Peterson v Commissioner of Inland Revenue* (2005) 22 NZTC 19,098 at [10].

14 Incomes Tax Act 2007, s EE 6(1).

15 Section EE 7(b).

16 Section EE 38(2)(b).

17 [2014] NZSSAA 27 at [14].

[55] If a beneficiary does set aside a reserve for purchasing new equipment, the Act requires a person to "use the resources available to them before seeking financial support" under the Act. The principle is in s 1A(c)(i) of the Act. A reserve fund may well be a resource a beneficiary should use.

[56] I note that the approach to deprecation taken by the Ministry has not been consistent. In *Carswell*, Chisholm J noted "the Department's manuals allowed for depreciation and for losses on one rental property to be taken into account".[18] That may well explain the absence of authority in court decisions regarding depreciable assets, and how they are treated under the Act when measuring business profits. Ms Manhire's view was that all deductions against income were effectively on a grace and favour basis, not a statutory obligation requiring consistent application.

*Significance of legal personality*

[57] An elementary consideration when dealing with measuring income for tax purposes is that legal personality is material. Accordingly, unless legislation takes a different approach, a company is treated as a separate person from its shareholders and directors. If the principle also applies in the context of the Act, then, if a beneficiary was the sole owner and director of a company, the company and the beneficiary would, regardless, be treated as separate entities. Income the company received would only be attributed to the beneficiary, not the shareholder. Of course, the Act contains principles such as attributing income and property to a beneficiary who deprives themselves of it.

[58] In *Thode v Chief Executive of the Ministry of Social Development* [2015] NZHC 521, Brown J considered benefit entitlement where the appellant worked in an orchard owned by a family trust with which he was associated. The Judge found the correct approach was to ascertain the nature of the transfer of funds between the beneficiary and the trust, and to distinguish loans, capital payments, gifts and income distribution. It appears to follow that the principle of clear identification of legal personality under the Act is applicable.

*Does s 3 of the Act define "income" as a net concept?*

[59] First, it is important to distinguish between:

[59.1] Income as the residue after taxing gross income, and deducting the cost of obtaining it, and

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18 *Carswell v The Director-General of Social Welfare* HC Christchurch AP 132/98, 14 December 1999 at [6].

[59.2] income being net, in the sense of net of income tax.

[60] The definition in s 3 of the Act is clear in referring to income "before income tax". The issue was a matter of debate in *Dixon-McIver v The Director-General of Social Welfare* HC Wellington AP 94/98, 20 March 2000, but only in relation to whether the word "income" in the Ninth Schedule of the Act carried the meaning defined in s 3. The case did not discuss whether the cost of deriving income should be deducted. Perhaps there is some implicit recognition that income is the net amount, as income "before tax" is a figure derived in a business context by taking gross income, and deducting the expenses of deriving the income.

[61] None of the authorities have discussed extensively whether business income is a net concept under the definition of "income" in s 3 of the Act, in the sense that it is gross income with the cost of deriving the income deducted. It is implicit in some of the authorities that is the correct approach. Otherwise, cases such as *McElroy*, *Carswell*, and *Hendrickson* would not have considered how to address losses. There would be no loss to consider, unless it was necessary to consider deductions from gross income.

[62] In *D v The Chief Executive of the Ministry of Social Development* [2014] NZHC 1392, Collins J considered whether a person who was a painting subcontractor and employee received income. The issue arose in in the context of whether there was a relationship in the nature of marriage. If there was such a relationship, then the subcontractor/employee's income was required to be taken into account. In applying the definition of "income" in s 3 of the Act, the Judge noted:[19]

> … the Ministry will generally deduct expenses incurred earning business income where those expenses affect the amount of money a beneficiary can be properly regarded as having received …

[63] The expenses in that case were therefore deductible. The Judge then considered the adequacy of the measurement of the expenses. The Authority had taken a similar approach, in that case. It attempted to measure the net taxable income as the amount of income taken into account under the Act. The Judge observed:[20]

> The Authority also undertook a careful assessment of what business expenses and GST payments should be deducted from the income generated by [the appellant]. Because of the absence of detailed records the Authority made an estimate based upon Inland Revenue Department (IRD) performance benchmarks for self-employed painters and decorators. Using this information as a base, the Authority settled upon

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19 *D v The Chief Executive of the Ministry of Social Development* [2014] NZHC 1392 at [26].

20 At [36].

> a 30 per cent deduction for income to represent Mr M's business expenses during the time he was self-employed. This notional deduction was more advantageous to [the appellant] than the IRD performance benchmark figures.

[64] The Judge agreed with the Authority's approach, and said of his evaluation:[21]

> It is difficult to determine what more [the appellant] could do to accurately determine [the appellant's] actual business expenses during the period in question. However, notwithstanding my sympathy for [the appellant], I am required to determine if the Authority made an error of law. In my assessment, the Authority made factual assessments which were available to it on the evidence when it calculated the deductions that should be attributed to [the appellant's] income.

[65] Unlike the present case, Collins J did not face an argument from the Ministry that business expenses were not deductible under the definition of "income" in s 3. However, it is inescapable that he considered the definition and applied it to allow deductions. Given the perverse outcome of doing otherwise, it is not surprising the issue did not receive extended consideration.

**Discussion**

*Overview of the Ministry's position*

[66] I have extensively reviewed the authorities relating to the measurement of income from businesses. It is evident to me that the approach the Ministry adopted is far removed from a commercial evaluation of the appellant's income. It consistently overstates income, thereby excluding her and others from self-employment. I find no mandate for the approach in the authorities, and it is at odds with the core principle in the Act that the priority for people of working age should be to find and retain work.[22] The contention that the Ministry allows expenditure, or not, on a grace and favour basis, rather than the Act determining the proper treatment of an expense is unsustainable.

*It is necessary to deduct the cost of earning income*

[67] The Chief Executive is bound by the Act just as this Authority is. If the Act does not allow deductions from gross income, the Chief Executive cannot ignore the law. Accordingly, I do not accept Ms Manhire's approach was correct.

[68] Further, I am satisfied the High Court has determined deductions are necessary to determine the amount of income that must be taken into account. As I have observed at [61]–[65], it is implicit in the authorities that a net figure after expenses is the

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21 At [38].

22 Section 1B(b) of the Act.

correct measure of income. I am bound by the approach Collins J took in the *D* case. However, I will expressly reject Ms Manhire's apparently novel approach, given that:

[68.1] it challenges the approach the Courts have taken in earlier cases;

[68.2] the approach was not controversial in those cases; and

[68.3] it produces aberrant results; conflicting with the core principle in the Act[23] that it applies so as to allow people of working age to find and retain work.

[69] I have included a review of the authorities on the approach to interpreting the definition of "income",[24] and treatment of repayable loans are.[25] I have done so because those authorities make it clear that the definition of "income" in s 3 is rather sparse, given the complex range of situations governed by the definition. I compare the brevity of the definition with the volume of provisions used to accurately measure income for taxation purposes. It is clear I must apply a purposive interpretation, and a material principle in doing so is that income is only what "truly [adds] to the resources of the person receiving"[26] the income. The *K* and the *F* cases are authority for that proposition.

[70] Indeed, if it were otherwise, the result would be absurdity. Most, if not all, self-employment would be effectively barred to persons receiving benefits. The appellant and many other people receiving support under the Act can, realistically, only seek independence through self-employment due to their health or other circumstances. There are also sectors of the economy where contract work is more available than employment[27].

[71] I do not disregard the wording of the definition of "income" in s 3, and particularly paragraph (a), which says income "means any money received or the value in money's worth of any interest acquired, before income tax, by the person which is not capital". Given the purposive approach discussed, I have little difficulty recognising the wording as being largely synonymous with basic concepts of income. The other paragraphs of the definition expand the scope beyond that basic concept of income. While "income" is a defined term, there is authority for considering a

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23 Ibid.

24 Above at [38]–[39].

25 Above at [40].

26 *Director-General of Social Security v K* HC Wellington AP255/95, 7 February 1997 at 7.

27 *Bryson v Three Foot Six Ltd* [2005] NZSC 34, and the subsequent Employment Relations (Film Production) Amendment Act 2010.

dictionary definition of a defined term to give context. In *Chief Executive of the New Zealand Customs Service v DB Breweries Ltd* [2017] NZCA 307, the Court considered the effect of a definition of "goods subject to the control of the customs",[28] but nonetheless found it useful to consider the meaning of the word "control".[29] To the extent it is appropriate to consider the essential concept addressed by the phrase in the definition, it is useful to bear in mind income is a net concept.

[72] The *Fundamentals of Income Taxation*[30] contains a review of the fundamental concepts of income, and in a section headed "Income is the Net Gain", states:[31]

> The concept of income is a net sum: a taxpayer's income is the receipts the taxpayer derives, minus the expenses the taxpayer incurs in deriving the receipts and minus any allowances for which the taxpayer qualifies. Income is therefore a difference, and not a particular item of wealth. The fact the income is a difference, which is an elusive concept, is another factor that leads to difficulties in defining income precisely …

[73] Accordingly, in my view, the definition of "income" in s 3 of the Act does contemplate deductions from gross receipts to measure the extent to which the receipts truly add to the resources of the recipient. This is because:

[73.1] That was the approach in the *D* case.

[73.2] It is necessary to apply the purposive interpretation that was applied in the *K* and *F* cases.

[73.3] Given a purposive and contextual interpretation, the definition of "income" in s 3 is consistent with the wording of the definition.

[73.4] Any different result leads to absurdity, locking some persons receiving assistance under the Act into welfare dependency through excluding them from achieving independence using self-employment. Such a result would therefore breach the principles in s 1B of the Act which states that every person exercising or performing a function, duty or power under the Act must have regard to the principles that:

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28 Defined in s 2 of the Customs and Excise Act 1996, with a reference to s 20.

29 *Chief Executive of the New Zealand Customs Service v DB Breweries Ltd* [2017] NZCA 307 at [46].

30 John Prebble, Grant Pearson *Fundamentals of Income Taxation* (Thomson Reuters, Wellington, 2018).

31 At p.47

[73.4.1] work in paid employment offers the best opportunity for people to achieve social and economic well-being; and

[73.4.2] the priority for people of working age should be to find and retain work.

[74] It follows that in my view Ms Manhire's approach to measuring the appellant's business income was wrong; the Ministry cannot apply a "grace and favour" approach to deductions for the cost of deriving income. I do not consider that approach is consistent with the Act. I now turn to measuring the appellant's income, considering the specific principles Ms Manhire applied to reach her measure of the appellant's income.

*Whether drawings are an appropriate measure*

[75] The difficulties for the appellant began when the Ministry moved from measuring income based on drawings to using the higher of drawings and Ms Manhire's measure of income. Accordingly, I first consider whether the Ministry should have continued to use drawings as a preference.

[76] The first point I would make is that the appellant is a sole trader, she does not have her business separated as a trading trust or a company. If that were the case, then I would need to apply the principles of legal personality discussed at [57]–[58]. The principles relating to deprivation of income in the Act may apply in such cases, but otherwise the usual approach would be to examine the amount of income that flowed from the trading entity to the person whose income is in issue.

[77] In this case, any money in the business is the appellant's money. In my view where that is the position, there are only two obvious situations where drawings may be the correct measure:

[77.1] where drawings adequately measure income on the facts of the case; and

[77.2] where drawings bring in income under the wider definition in paragraph (b) or other extensions to the definition of income in s 3 of the Act. In cases with facts such as the *McElroy* case, a business could have losses, but drawings sourced from capital used for day to day expenditure would be income. A "startup" business could well have losses that were anticipated in a business plan, with personal expenses funded from capital. It appears paragraph (b) addresses such cases.

[78] This present case does not involve revenue losses of the kind that routinely arise for start-up businesses, or involve expenses that arise in such cases. Accordingly,

paragraph (b) of the definition of "income" in the Act will not apply here. The appropriate concern that a business operation running at a loss should not be subsidised by entitlements under the Act is evident in *Carswell v The Director-General of Social Welfare* HC Christchurch AP 132/98, 14 December 1999 and *McElroy v Director-General of Social Welfare* (1992) 9 FRNZ 366 remains. The different approach to loans in *F v Chief Executive of the Ministry of Social Development* [2018] NZHC 1607, and *Director-General of Social Security v K* HC Wellington AP255/95, 7 February 1997 do not appear to undermine the approach that the Act does not subsidise business losses. None-the-less, that is not an issue in this case.

[79] In the present case, the Authority is concerned with measuring income in an ordinary business of the kind a person typically uses to seek independence from income support under the Act, it produces profits and has been operating for many years. In my view, drawings are not a satisfactory measure. In a very simple business where there is little or no plant or equipment, and income from personal exertion flows in at irregular intervals, drawings may be a very satisfactory measure; as a question of fact, drawings in those cases measure the cash income. In this case, the Authority has a set of financial statements, which raise issues such as depreciation and mixed private and business use. In my view, there is little difficulty in using the information in the financial statements, subject to any adjustments required to evaluate the appellant's income. That is the methodology Ms Manhire used. I depart from her methodology not in terms of using the financial statements as a starting point, but in the particular adjustments she made. I now discuss each of the adjustments Ms Manhire made to the results in the financial statements.

*Motor vehicle expenses*

[80] The appellant had a motor vehicle. The Ministry accepts that this vehicle was used 96 per cent of the time for business purposes. The appellant has comprehensive records:

[80.1] she kept a log book recording her use of the vehicle; and

[80.2] the financial statements record the actual expenses related to the vehicle.

[81] Two methods[32] are potentially acceptable for calculating the appellant's taxable income:

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[32] Until the 2017 tax year Inland Revenue will allow mileage up to a 5,000 km per year, and otherwise required actual expenses to be calculated. Mileage rates are an

[81.1] The distance travelled and recorded in the log book applied to standard mileage rates published by Inland Revenue.

[81.2] The actual cost of ownership, including depreciation and expenses.

[82] Ms Manhire says neither method is appropriate so she made an adjustment. However, her task was no different from the measurement Inland Revenue applies for tax purposes. Inland Revenue is required to exclude any element of personal or non-business use. Ms Manhire's method was to attribute much of the cost of the vehicle and its operation to the 4 per cent private use. She said that the 4 per cent private use is to bear 100 per cent of the cost of:

[82.1] licensing;

[82.2] warrants of fitness;

[82.3] insurance; and

[82.4] interest and depreciation.

Aside from depreciation, the approach was justified by assuming the appellant would have a vehicle regardless of the business, so she should bear that cost personally. If that logic was correct, it would apply equally for tax purposes. However, I cannot accept Ms Manhier's logic. In this particular case, if that logic had any merit, it would be to attribute 100 per cent of those costs to business expenses as that is the main purpose of having the vehicle. However, I prefer the well-established principle that when dealing with mixed use assets, apportionment produces the most accurate measure. In my view, apportionment based on use at 96 per cent for business and 4 per cent for private purposes produces the most accurate measurement. Using apportionment to measure income is well settled in New Zealand law[33] and commercial practice.

[83] Ms Manhire's methodology can have no place in quantifying the business income intended to produce either:

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approximation to reduce compliance costs, and actual expenses the more accurate measure.

33 The Court of Appeal's decisions in *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485 and *CIR v Banks* [1978] 2 NZLR 472 remain leading authorities on the principles. I apply the principles as a factual question of how to measure business and private use, not with any overlay relating to the Income Tax Act.

[83.1] A commercially realistic measure of income (as Inland Revenue was required to do), or

[83.2] As a measure of how much it added to the appellant's resources (the purpose of measuring income under the Act, as the *K* and *F* cases have determined).

[84] I now consider depreciation in relation to the motor vehicle. As I have observed, depreciation is not a reserve fund, or a notional concept, it is a deduction for actual expenditure. The depreciable asset must be purchased by the beneficiary/taxpayer; but deduction of the cost is limited by spreading it over a first and subsequent periods. That may well mean it needs to be treated differently under the Act from the treatment for tax purposes. There is no justification for adopting tax principles for measuring income under the Act, except as far as there is no difference in outcome, as with the Ministry's treatment of employment income.

[85] When considering depreciation as applied for tax purposes, there is generally a continuity over an extended period. However, that is not always so under the Act. Generally, the Act aims to restore people to independence providing only necessary support under the Act. Accordingly, if a person purchased and paid for an item of plant for a business before needing support, and continues to use that item while receiving support, only disposing of it when support is no longer required, it is difficult to see why any deduction for depreciation should be allowed at all. In that case, there is no cashflow expended while the person is receiving assistance under the Act. There may be other expenses such as interest paid on a loan to purchase the item that do have funding implications within the period of support under the Act. This is a factual evaluation, derived from the premise that the cost should only be allowed when necessary to adequately measure the support required under the Act.

[86] However, the appellant is not in a short-term situation in relation to support under the Act. If I were to look only at cashflow in the period an asset is acquired, there would be a distortion. I would need to allow a deduction of 100 per cent of the cost of the car in the year it is acquired. There may be a loss, which would not be fully taken into account; it would certainly distort the measure of profit I am required to achieve.

[87] In making that observation, I need to deal with Ms Manhire's view that capital expenditure is not deductible when calculating income. I do not accept Ms Manhire's proposition; it appears to be founded on a selective adoption of the taxation principle that capital expenditure is not deductible when calculating income. Section DA 2(1) of the Income Tax Act 2007 contains the capital limitation. However, it is subject to

various exceptions. One of the exceptions is depreciation; s DA 4 of that Act creates this exception. It is a very long-standing principle that to measure income accurately, capital assets, wholly or partly consumed in generating income, are taken into account when measuring income. It is necessary to do so to measure income that adds to the resources of the person receiving the income. The same applies to interest paid for the acquisition of capital equipment; s DB 6(1) of the Income Tax Act 2007 allows a deduction for interest, and s DB6(4) expressly overrides the capital limitation in that regard. The conventional view is that those capital expenses must be deductible to measure income in a commercially realistic way, that is to say measuring the extent to which income contributes to the recipient's resources.

[88] I see no foundation in the definition of income in s 3 of the Act for Ms Manhire's assertion that any expenditure related to capital is not deductible. I do not see any reason to prohibit deduction of any category of the vehicle expenses, which Inland Revenue allowed. Ms Manhire has adopted a taxation principle for measuring income, when there is no mandate for doing so under the Act.

[89] Given I consider that the cost of the appellant's car should be taken into account, and particularly the extent to which its value was consumed in the business during the year ending 31 March 2016, I now turn to consider whether to use:

[89.1] the actual expenses (including depreciation for the period); or

[89.2] the mileage basis.

[90] If the appellant were requiring assistance for only a short term, I would be inclined to use mileage rates. However, in this case I see no reason to apply an adjustment that alters the income tax calculation. The Commissioner of Inland Revenue has a statutory mandate to determine an economic deprecation rate.[34] For tax purposes, the objective is to identify the extent to which a business asset is consumed in a given tax period; that is wholly consistent with measuring income to the extent it truly adds to the resources of the recipient of the income. Factually the figure in the appellant's accounts in my view is the best measure to determine the extent to which her business income adds to her resources.

[91] I accordingly use the vehicle expenses in the appellant's financial statements as her actual outgoing, including the loss of value of depreciable assets, in this case the car.

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[34] Section EE 26 of the Income Tax Act 2007 identifies the provisions that relate to various asset classes.

[92] It follows, I reject Ms Manhire's adjustments to vehicle expenses and adopt the method applied in the financial statements.

*Capital items*

[93] I have already discussed depreciation relating to the appellant's vehicle, and commented on Ms Manhire's view that there is a comprehensive prohibition on deductions of expenses that are related to capital. There are other items besides the motor vehicle where I need to discuss Ms Manhire's approach to depreciation and capital expenses.

[94] Despite rejecting taxation principles for measuring income generally, Ms Manhire inconsistently:

[94.1] adopted the capital limitation rule from tax principles; and

[94.2] rejected exceptions to the capital limitation contained in tax law.

[95] In my view, the result inevitably precludes a principled measure of income, either as commercially realistic (an income tax principle) or as a measure of how much income adds to resources (the objective of measurement under the Act).

[96] Ms Manhire said:

> **Capital Items**
>
> The taxation capital limitation rule prohibits a deduction for any expenditure of loss to the extent to which it is capital in nature. The courts adopt commercial accountancy principles in deciding whether particular items are an allowable deduction. While taxation rules may allow small capital items e.g. tools to be expensed if they cost less than $500 (excluding GST), these are not considered deductible for benefit purposes as these remain a capital item. These small tools are not consumed in the income year, they endure past balance date and are available to be used in the business year after year and provide "an enduring benefit". Any capital loan repayments are also not claimable under this heading as this is the purchase of a capital item. Under accounting concepts capital items are transferred to the balance sheet as a fixed asset and depreciation claimed for tax purposes when the item is used in the business.
>
> Loss or capital gains on sale of fixed assets are also added back to income as these are capital items not incurred in earning the income and are capital in nature. Capital gains generally are not included in the definition of income as this is an accounting difference between the sale price and its cost price and is not actual cash earned during the financial year.

[97] I have already observed that the capital limitation does not apply to depreciation because, if it did, it would be impossible to measure income in a manner reflecting

economic and commercial reality. For the reasons I have expressed, I do not consider a capital limitation can be implied into the definition of “income” in s 3 of the Act.[35] It follows that I do not agree that the purchase of small tools is not a deductible expense; large and small tools to the extent their value is consumed in producing income must be accounted for. The only question is whether the same rules as the depreciation regime should apply; the alternative is the immediate deduction of the cost of tools whether more or less than $500. In my view, the most satisfactory approach is to endeavour to recognise the extent to which the value is expended in the period under consideration. As I have already noted, the depreciation regime does that effectively. In relation to the $500 limit, its primary purpose is to avoid disproportionate compliance costs. Generally, low value items are less durable, and the costs of tracing depreciation is significant. Accordingly, I am satisfied that the same approach as the depreciation regime should apply in this case. However, this is a factual question and the fair and reasonable answer will turn on the evidence in each case.

[98] I agree that repayment of loan principal is not deductible. It is not a cost; the loan repayment is offset by the reduction in loan principal. Accordingly, there is no change in the resources available to the income earner. However, I consider that interest payments on loans used to purchase capital equipment that is used to produce income is deductible.

[99] It is not clear to me whether Ms Manhire considers her observations regarding capital loss or gains are derived from accounting principles, tax law, or her view of income measurement for social security purposes. In my view, the correct principles are:

[99.1] Any surplus or loss on the sale of depreciable assets compared with their written down value should be taken into account when measuring income under the Act. If there is a surplus, there is a cash transaction and the surplus is available; it is not a capital profit, it is only the difference between the written down value and the sale price.[36] The same applies to a loss; it is simply a cash transaction, which quantifies the actual loss expended through consumption of the value of the asset in deriving income. Of course, if there is a better measure of depreciation rates than the Commissioner of Inland Revenue’s rates they may be used, as they are

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35 Above at [86].

36 That is unless the sale price exceeds the acquisition price, in which case that surplus is treated as income only if it comes within paragraph (b) of the definition of “income” in s 3, given the exclusion of capital profit in paragraph (a) of the definition.

not mandated by the Act. I have applied them simply because on the evidence it is the best measure available.

[99.2] Capital profits, in the sense of selling an asset for more than the acquisition and holding costs, are taken into account if they come within paragraph (b) of the definition of "income" under s 3 of the Act, paragraph (a) excludes capital receipts.

[100] It follows I reject all the adjustments Ms Manhire made in respect of capital items. Each of them produces a less accurate measure of the amount of income added to the appellant's resources than the amounts in the appellant's financial statements.

*Is a schedular approach justified?*

[101] Ms Manhire did not use a schedular approach, however the suggestion was made this was a concession. I do not agree. The appellant's business was one primarily based on her personal exertion. It is possible to compartmentalise aspects of her activities, but not in any manner that would make sense in commercial or economic terms. The appellant was the only person providing services; she used some assets for all activities, such as her vehicle, whereas some assets were more specialised. It would make no more sense to separate the appellant's activities than it would for, say, a builder who built and also provided pre-purchase reports on houses. In my view, all the business activity was "common to or realistically linked", the test applied in the *Hendrickson* case. In my view:

[101.1] there is no justification for using a schedular approach in this case; and

[101.2] no evidence the result of doing so would create a loss for part of the business.

*Quantification*

[102] Having found all of the adjustments Ms Manhire made were incorrect, I now turn to the correct quantification of the appellant's weekly income. First, I set out a table showing Ms Manhire's adjustments:

| **Ministry Analysis of Adjustments** | **31/03/2016** |
|---|---|
| Net Profit from Appellant's financial statements | 4,409 |
| Add back taxation adjustments non-deductible | 226 |
| **Net profit before adjustments** | **4,635** |

*Adjustments to profit taxable profit*

| | |
|---|---:|
| Depreciation | 7,898 |
| Depreciation recovered (less) | -280 |
| Entertainment | 49 |
| Home Office | 3,392 |
| Loss on asset sales - capital | 886 |
| Home Phone (later amended to $1167) | 2,289 |
| Vehicle 50% | 1,045 |
| **Adjusted Net Profit** | **19,914** |
| | |
| Add gross interest per tax return | 45 |
| **Total Chargeable Income (original)** | **19,959** |
| | |
| Weekly assessable income | 384 |

[103] I now address each of the items:

[103.1] I do not consider the taxation adjustments of $226 should be added back. Those adjustments are just as relevant to measuring income for the Act as they are for income tax purposes. The purpose of the adjustments is to remove private or non-business expenditure, so the net profit is the net profit for business purposes. Accordingly, my starting point is the taxable profit of $4,409.

[103.2] For the reasons I have discussed, there should be no adjustment to the amount of depreciation or the recovery of depreciation on the sale of depreciable assets. The figure in the financial statements is the best measure available of the extent to which the value of depreciable assets was expended during the year ending 31 March 2016. The whole of the depreciation for that period should be deducted, less the recovery of $280. That is necessary to produce the best measure of the extent to which income added to the appellant's resources, on the evidence before the Authority. This is not a notional figure, it is a principled factual measure of what it cost to do business in the year ended 31 March 2016.

[103.3] Entertainment can only be deductible under the Act where it is expended to produce income. The amount in this case was extremely modest, and the Ministry accepts the taxation figures are accurate, and for tax purposes it is excluded if it is for non-business or private purposes. Accordingly, there is no reason to treat this expenditure as a private or non-business expense on the evidence I have.

[103.4] The appellant's business operated from her home. In such cases, it is usual to apportion the extent to which the home is used for business and non-business purposes. The Ministry has not shown the apportionment methodology the appellant used in her financial statements had any other result. I can discern no reasonable or justifiable grounds to reject the apportionment approach used in the financial statements. It simply separates out private expenditure from business expenditure. That is what this Authority must do to measure income under the Act, I therefore adopt the apportionment in the financial statements.

[103.5] I now consider the loss on capital sales. The description is not particularly accurate. The figure is the sum of three items of depreciable assets that ceased to have any value during the year; they had a value at the start of the year of $886, and had been wholly expended during the course of the year. For the reasons I have discussed, this must be deducted if there is to be an accurate measure of the extent to which to which income added to the appellant's resources.

[103.6] I apply the same analysis to the home phone as that applied to the home office. The apportionment for taxation purposes has not been challenged, and the same should apply. I note that there was an issue of the cost being met to some extent by a benefit, and reserve any issue relating to quantification if the parties cannot agree.

[103.7] I do not agree that the vehicle expenses should be reduced. The Ministry has not challenged the apportionment for tax purposes. It accepts the 96 per cent business is correct; and did not show the financial statements show anything other than an apportionment reflecting that split between business and private use. The Ministry relies on an assertion that some costs should be fully attributed to the 4 per cent use of the vehicle. For the reasons, I have discussed in relation to the home office, the adjustment proposed by the Ministry is not founded on any principle measure of the respective purposes or uses of the asset.

[103.8] I agree that interest should be added to the income.

[103.9] I agree that the weekly income is derived in this case by apportioning it equally to each week of the year.

[104] My view of the correct adjustments is as follows:

**The Authority's Analysis** **31/03/2016**

| | |
|---|---|
| Net Profit from Appellant's financial statements | 4,409 |
| Add back taxation adjustments non-deductible | 0 |
| **Net profit before adjustments** | **4,409** |
| | |
| *Adjustments to profit taxable profit* | |
| | |
| Depreciation | 0 |
| Depreciation recovered (less) | 0 |
| Entertainment | 0 |
| Home Office | 0 |
| Loss on asset sales - capital | 0 |
| Home Phone (later amended to $1167) | 0 |
| Vehicle 50% | 0 |
| **Adjusted Net Profit** | **4,409** |
| | |
| Add gross interest per tax return | 45 |
| **Total Chargeable Income (original)** | **4,454** |
| | |
| Weekly assessable income | 86 |

**Decision**

[105] The appeal is allowed. I determine that the annual income received by the appellant (excluding support under the Act) for the year ended 31 March 2016 was $4,454, which converts to a weekly income of $86.

[106] In the event agreement is not possible based on this decision, leave is reserved for either party to apply to have the Authority:

[106.1] calculate the effect of the decision on the appellant's entitlements under the Act (including quantification and determination of any issues relating to the phone expenditure);

[106.2] decide any issue arising regarding establishing, recovering, and writing off any debt; and

[106.3] to resolve any other issue of quantification within the scope of the appeal that falls outside the period from 1 April 2015 to 31 March 2016.

[107] As the members are equally divided, this decision being the decision of the chairperson shall be the decision of the Authority[37].

**Dated** at **Wellington** this 3rd day of September 2018

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**G Pearson**
Chairperson

[37] Section 12N(2) of the Act.

**K Williams** (Member)

[108] Unfortunately, I respectfully disagree with the majority decision of the Authority where I believe that strong reliance has been based on income measurement by taxation legislation, rather than what I believe the legislation and courts have found under the Act. I outline what I believe the courts have found in the following paragraphs.

**What the courts have said**

[109] The High Court confirmed in *Dixon-McIver v The Director-General of Social Welfare* that the meaning expressly given to "income" by Parliament comports precisely with the ordinary, everyday meaning of the term "income" — money received from any source without deduction.[38] In that case, Hammond J stated that "[g]iven the directness of the Parliamentary language, an extraordinary case would have to be made out before this Court could contemplate reading the words 'before tax' in the statute, as if it reads 'after tax'".[39]

[110] The Court of Appeal in *Bramwell v The Director-General of Social Welfare* stated that s 3 of the Act contains a particularly wide definition of "income":[40]

> We have no doubt that Gendall J in the High Court was right to conclude that the Authority had properly interpreted the relevant provisions. The definition of "income" is, as we have said, particularly wide.

[111] The Family Court in *McElroy v Director-General of Social Welfare* highlighted the purpose for having such a wide definition:[41]

> Bearing in mind that the definition of "income" was obviously designed to catch those who were able to manipulate their financial affairs so as to have no taxable income and might otherwise be entitled to claim state benefits …

[112] In *Carswell v The Director-General of Social Welfare*,[42] Counsel for the Ministry argued that the s 3 definition of "income" primarily meant income from a particular source and that definitions in other legislation, particularly taxation legislation, were irrelevant. The Judge confirmed that proposition:[43]

> As noted by Heron J in *Director-General of Social Security v Kay & Michell* this definition is quite different from the definition of *"income"* used in taxation legislation.

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38 *Dixon-McIver v The Director-General of Social Welfare*, above n 24, at [35].

39 At [36].

40 *Bramwell v The Director-General of Social Welfare*, above n 4, at [12].

41 *McElroy v Director-General of Social Welfare*, above n 5, at 369.

42 *Carswell v The Director-General of Social Welfare*, above n 10, at [7].

43 At [11]–[12].

> I agree with the comment in the decision under appeal that the same or a similar definition would have been used if Parliament had intended the concept of *"income"* to carry the same interpretation for both benefit and taxation purposes. *The different definitions reflect that payment of benefits and the collection of taxation are at opposite ends of the spectrum.* It follows that authorities relating to the definition of "income" for taxation or other purposes are of little assistance in the present context.
>
> The s 3 definition is based on "*money received"* or the value in moneys worth of *"any interest acquired"*. It is not based on notional concepts.
>
> (Citation omitted and emphasis added)

[113] In relation to depreciation and allowance of expense deductions against income, the High Court in *Hendrickson v Director-General of Social Welfare*[44] interpreted "income" under s 3(1) as allowing for income to be streamed with relevant expenses allowed against each stream. By the Court's interpretation, depreciation was only allowed where money to replace items was actually set aside.

[114] Again, in *D v The Chief Executive of the Ministry of Social Development*, the Judge seems to acknowledge that the allowance of expenses against income by the Ministry is a normal practice:[45]

> (1) It is to be noted that payments contingent on the completion of work specified in a contract are expressly included in the definition of "income"
>
> (2) the Ministry will generally deduct expenses incurred earning business income where those expenses affect the amount of MONEY a beneficiary can be properly regarded as having received; and
>
> (3) a one-off sale of personal property will generally be regarded as a one-off capital payment and therefore not within the definition of income.

**Discussion**

[115] The above court decisions appear to confirm overwhelmingly that the definition of "income" is based on a cash concept of gross money received. They also seem to confirm that the definition of income is quite different from that used in taxation legislation. Indeed, in *Carswell* the Judge commented that "[t]he different definitions reflect that payment of benefits and the collection of taxation are at opposite ends of the spectrum".[46]

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44 *Hendrickson v Director-General of Social Welfare*, above n 12, at [9]–[12].

45 *D v The Chief Executive of the Ministry of Social Development*, above n 25, at [26].

46 *Carswell v The Director-General of Social Welfare*, above n 10, at [11].

[116] The gross concept of money received seems to exclude the deduction therefrom of expenses for determining income for benefit purposes, as the majority of the Authority has also pointed out.

[117] However, the practice of the Ministry of allowing cash expenses directly incurred in earning business income appears to have been accepted by the judges in *Hendrickson* and *D* where the Judge in *Hendrickson* confirmed that the Authority was correct to interpret s3(1) of the Act as allowing for income to be streamed with relevant expenses allowed against each stream. That practice has been followed by the Ministry for many years.

[118] The majority decision states that it disagrees with the Authority's decisions in *Decision No* [2004] NZSSAA 126 and *Decision No* [2014] NZSSAA 27. However, I believe that those decisions are supported by the High Court decisions in *Hendrickson* and *D*.

[119] The possibility of depositing actual cash expenditure into a separate bank account, which is equivalent to the depreciation charge being allowed against cash income, seems to reflect the cash concept of income and expenditure in arriving at what is income for benefit purposes. Both *Hendrickson* and *D* appear to support that notion.

[120] Other than a detailed analysis of a beneficiary's business records and bank statements to determine actual cash money received and proper cash business expenses incurred (which would in many cases be a huge and costly task), in the absence of a full cash analysis, the Ministry takes as a reasonable starting point, taxation accounts prepared by the beneficiary or his or her accountant. The Ministry then seeks to add back expenses which they believe have not been truly incurred in earning business income, and also expenses claimed for taxation purposes which do not constitute cash outgoings in the period. It is then open to the beneficiary to question, or otherwise provide, evidence if he or she considers that the Ministry has incorrectly written back an expense, and, if necessary, appeal to higher authorities. By my interpretation of the judgements aforementioned, that practice appears to be an accepted reasonable approach.

[121] In the present appeal, the appellant has appealed a number of adjustments made to her taxation income by the Ministry in arriving at her income for benefit purposes. Her taxation accounts for the year ended 31 March 2016 show a net profit of $4635.

**Adjustments**

*Depreciation and loss on asset sales — capital*

[122] As these are non-cash items and following the judgement in *Hendrickson*, in my opinion the Ministry is justified in writing back these taxation adjustments totalling $8504.

*Home office expenses and rates*

[123] The Ministry added back the proportion of home office expenses and rates which had not been incurred in earning business income. The expenses would have been incurred whether or not the appellant was conducting a business from her home. Both the appellant and her accountants have acknowledged in writing that adding back the total of $4367 is justified.

*Internet and telephone*

[124] An amount of $1167 has been written back by the Ministry which comprises private use of internet costs, home telephone (which had been included in the appellant's disability allowance), and the purchase of an iPhone. The appellant agreed on the private proportion of the internet costs.

*Vehicle expenses*

[125] The total claimed in taxation accounts is $2090. The Ministry has added back 50 per cent of vehicle costs totalling $1045. The appellant confirmed that she had kept a log book of her vehicle for business use purposes, and the costs claimed in her taxation accounts were based on that percentage. In my opinion, the Ministry was not justified in writing back any of the vehicle expenses as the total already reflected an adjustment for private use.

**Conclusion**

[126] I acknowledge that the Ministry does have some latitude in what it determines to be cash business expenses, and these need to be based on accepted norms. However, these may be challenged by a beneficiary and then, if need be, reviewed by higher authorities on appeal.

[127] In my view, the determination of cash business expenditure requires a common-sense approach based on reasoned business norms, and, in this instance, other than the vehicle expenses, I believe this has been achieved.

[128] There is a case for cash expenditure in the period on what is considered to be a capital item (generally referred to as such in taxation legislation) to be treated as being a deductible item against cash income in the period, but the Ministry does not generally recognise such expenditure as being a direct cash business expense. However, given the argument that payment into a depreciation reserve account can be an allowable expense, there is certainly a case for capital expenditure to be considered in the same light. In this instance, it does not appear to be a matter under appeal, but a common-sense approach to such an allowance of cash expenditure may need to be tested in the future. Conversely, it should be noted that the sale of a capital item with this approach could constitute income.

[129] I have enormous sympathy for the appellant's situation, but have endeavoured to set aside any emotional leanings in arriving at a fair decision according to my understanding of existing legislation and case law.

[130] It is for the reasons set out above that I respectfully disagree with the majority decision of this Authority.

**Dated** at **Auckland** this 3rd day of September 2018

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**K Williams**
Member