

Ferdinand & Miranda 1 - Income decreasing, 2007/08 and later years

Ferdinand and Miranda had a joint income of £27,000 in 2010/11 (£13,500 each). Ferdinand loses his job and the couple estimate that their 2011/12 income will only be £16,500. They report this estimated income to HMRC on 1 July 2011, and their tax credits are adjusted accordingly.

From 6 April to 30 June, Ferdinand and Miranda will have been paid tax credits based on a joint income of £27,000 (their 2010/2011 income). From 1 July 2011 to 5 April 2012 Ferdinand and Miranda will receive tax credits based on an income of £16,500 (based on Miranda working for the entire year at a salary of £13,500, and Ferdinand being paid (say) £3,000 for the early part of the year in which he was still in work.) Their tax credits will have increased from 1 July 2011 due to the estimated fall in their income.

However an underpayment will have accrued from 6 April – 30 June of $£27,000 - £16,500 \times 3/12 = £2,625 \times 41\% = £1,076.25$ This will be held back in case an overpayment arises at the end of the year, or if income remains at that low level all year and no overpayment arises the couple will receive the underpayment at the end of the tax year.

Ferdinand & Miranda 2 - Income decreasing then increasing, 2007/08 and later years

Assume that Ferdinand and Miranda (see Ferdinand and Miranda 1) are receiving tax credits based on the estimated 2011/12 income of £16,500, which they provided to HMRC in July 2011.

In November 2011 Ferdinand gets a new job paying much better than his old job. The couple informs HMRC and report to the Tax Credit Office a further revised estimate of £30,500 (made up as follows: Miranda earning £13,500; Ferdinand earning £3,000 from April until June, then (say) £14,000 from November 2011 until March 2012).

As shown above, Ferdinand's losing his job in June brings about an underpayment of £1076.25 related to the period from 6 April to the date he loses his job.

The effect of the couple's income rise in November is that their tax credits for the whole year have to be recalculated on the basis of the new estimate. That causes tax credits paid from July to November on the basis of the low estimate to be clawed back until income again reaches the levels of 2010/11, thus:

	£
Low estimate	16,500
2010/11 income level	<u>27,000</u>
Difference	<u>10,500</u>

The difference of £10,500 is time-apportioned to the four months from July to November as follows:

$$£10,500 \times 4/12 = £3,500$$

- this figure is multiplied by 41% to give the tax credit overpayment of £1,435.

The underpayment that previously existed of £1,076.25 will not now be paid to the couple and they will have an overpayment of £358.75 for that period which will be collected by adjusting their payments downwards for the remainder of the year.

The difference between the 2010/11 income of £27,000 and the higher 2011/12 estimate of £30,500 will be covered by the disregard.

If the rule about holding back the accrued underpayment from April to June had not had effect, and the £1,076.25 had been paid over to the couple, then the overpayment at the end of the year would have been increased by that amount - thus, £1,435 + £1,076.25 = £2,511.25.

Interestingly if Ferdinand and Miranda had chosen not to report their estimated income when Ferdinand lost his job, and continued to receive tax credits on their previous year income, they would have avoided any overpayment and received any underpayment at the end of the year.

However the design of the tax credit system is to ensure that tax credits are responsive to changes in circumstances, and most people find it difficult to manage without the increase in tax credits.

Ferdinand & Miranda 3 – income decreasing then increasing, 2006/07

Ferdinand and Miranda each earned £12,500 in 2005/06 – joint income for tax credits of £25,000.

In July 2006 Ferdinand loses his job and the couple now estimates their joint income for 2006/07 at £15,625. They immediately report this to HMRC and their tax credits are adjusted accordingly for the remainder of the award period. In addition Ferdinand and Miranda receive reimbursement of an underpayment for the early part of the year based on $£25,000 \text{ less } £15,625 \times 3/12 = £2,344 \times 37\% = £867$.

Then, in September 2006, Ferdinand finds a much better job, which pays at the rate of £28,000 a year, and the couple report to the Tax Credit Office a further revised estimate of £29,625 (Miranda's £12,500, plus Ferdinand's $£12,500 \times 3/12 = £15,625$ for April to July 2006, and $£28,000 \times 6/12 = £14,000$ from September 2006 to April 2007).

As shown above, Ferdinand's losing his job in July brings about an underpayment of £867 related to the three months from April to July. The effect of the couple's income rise in September is that their tax credits for the whole year have to be recalculated on the basis of the new estimate. That causes tax credits paid from July to September on the basis of the low estimate to be clawed back, until income again reaches the levels of 2005/06, thus:

	£
Low estimate	15,625
2005/06 income level	<u>25,000</u>
Difference	<u>£9,375</u>

The difference of £9,375 is time-apportioned to the three months from July to September as follows:

$£9,375 \times 3/12 = £2,344$

- this figure is multiplied by 37% to give the tax credit clawback of £867.

The difference between the 2005/06 income of £25,000 and the higher 2006/07 estimate of £29,625 will be covered by the disregard.

The reimbursement of £867 that Ferdinand and Miranda received in the early part of the year, as well as the £867 they have been overpaid from July – September, will become an overpayment.