The Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015
Briefing for MPs from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 Although these regulations appear simple, their impact on the majority of tax credit claimants will be devastating. This includes working families, workers without children and those with responsibility for children who do not work.

1.2 We have welcomed the increase to the tax personal allowance and the introduction of the national living wage premium, but those measures will not negate the impact of these tax credit cuts from April 2016. Many tax credit claimants will still be worse off overall.

1.3 We are extremely concerned that many tax credit claimants are not aware of the cuts and will suffer additional hardship from April without any time to adjust budgets or consider their options. The lack of awareness is, we believe, mainly caused by the complexity of the changes to the threshold and taper rate.

1.4 At the time of the Budget announcement, much of the media focused on the April 2017 changes to the tax credits system with little attention been given to the April 2016 cuts. Even those claimants who are aware of the changes to the threshold and taper do not understand the significant impact it will have on their overall award. If these changes are to go ahead, HMRC need to ensure that claimants have adequate warning and information about the changes.

1.5 Originally no impact assessment had been prepared and the explanatory notes suggest that the impact of the changes on business, charities and voluntary bodies is nil. This is astonishing given the severity of the cuts and the large population affected. Since the

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Commons debate, an impact assessment[1] has now been provided at the request of the House of Lords secondary legislation scrutiny committee but there is still no analysis showing how the cuts impact particular groups such as lone parents, people with disabilities, self-employed claimants and those under 25 who do not qualify for the new living wage. Nor is it clear to see how the Government have concluded 8 out of 10 families will be better off by 2017/18.

1.6 In particular, we cannot see that any consideration has been given to the family test which was introduced in October 2014[2] and should be considered for all Government policy. This test requires Government departments to consider the impacts any policies will have on family members.

1.7 We do not agree that there is no impact on businesses, charities and voluntary bodies. A family with income of £18,000 will lose nearly £40 a week from their tax credits. They will likely gain from the increase in personal allowance and may or may not benefit from the living wage premium. However, there are so many factors to consider that most claimants will need individual advice on their overall situation including how other benefits will be affected. The voluntary sector will struggle to deal with this demand at a time of limited funding and no one Government department can give advice across a range of matters.

1.8 Finally, businesses are also likely to see an impact. Claimants will either need to increase their hours to make up for the income they have lost or they may decide to give up work as they can no longer afford their childcare.

2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue &Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not

[1] http://www.parliament.uk/documents/lords-committees/Secondary-Legislation-Scrutiny-Committee/DraftTaxCreditsRegs2015-ImpactAssessment.pdf

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/368894/family-test-guidance.pdf

designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Further detail

3.1 *Impact of the tax credit cuts*

3.1.1 These relatively simple regulations make four changes to the tax credits system:

- Lower the working tax credit (WTC) threshold from £6,420 to £3,850
- Reduce the CTC threshold from £16,105 to £12,125
- Change the WTC taper rate from 41% to 48%
- Reduce the income disregard from £5,000 to £2,500

3.1.2 There are two thresholds in tax credits – the WTC threshold and the CTC threshold. Below these thresholds, claimants receive maximum tax credits (calculated by adding together all of the elements they are entitled to based on their circumstances). Above these thresholds, tax credits are reduced by the taper percentage.

3.1.3 By reducing the WTC threshold and increasing the taper rate, claimants will have their tax credits reduced lower down the income scale and at a much quicker rate.

3.1.4 We have produced the following table which shows the maximum annual loss of tax credits at different levels of income.

	Maximum annual loss £[3]	
Income £	WTC only and WTC/CTC cases	CTC only
2,000	0	0
4,000	72	0
6,000	1,032	0

[3] The income figure is the one used to calculate the tax credits award for 2015/16. We have assumed that income for tax credit purposes and other circumstances will not change for 2016/17. If a claimant's current award is less than the figure in the table, their award will reduce to nil. All figures have been calculated using annual tax credit rates.

8,000	1,344	0
10,000	1,484	0
12,000	1,624	0
14,000	1,764	900
16,000	1,904	1,860
18,000	2,044	2,044
20,000	2,184	2,184
22,000	2,324	2,324
24,000	2,464	2,464
26,000	2,604	2,604
28,000	2,744	2,744
30,000	2,884	2,884
32,000	3,024	3,024
34,000	3,164	3,164
36,000	3,304	3,304
38,000	3,444	3,444
40,000	3,584	3,584

3.1.5 The following example shows how the table works.

Ben is married with one child. He works full-time, and he and his wife have a joint income of £20,000. They expect to have the same income and circumstances in 2016/17. Their tax credits award for 2015/16 is £2,537.

As Ben and his wife are entitled to both WTC and CTC, they need to use the first column from the table. At an income of £20,000 the maximum loss will be £2,184. As Ben currently receives more than this, he can deduct the potential loss from his current award and estimate that his 2016/17 tax credits will be £353. This is a loss of around £42 a week.

3.2 *Interaction of tax credit cuts and other budget measures*

3.2.1 It is impossible to consider the tax credit cuts in isolation from other changes both within and outside tax credits. In considering the impact on a claim the following things need to be considered:

- The increase in the tax personal allowance
- The introduction of the national living wage premium for those aged 25 or over
- Impact of reduced tax credits on other benefits such as housing benefit
- Passported benefits – such as free school meals and help with health costs
- Other tax credit changes such as the reduction in the income disregard and the increase in recovery percentage for households with income of £20,000 or more

3.2.2 We have previously welcomed the increase to the tax personal allowance and the introduction of the living wage premium for those aged 25 or over. However, these two measures alone do not compensate low income workers for the loss of their tax credits from April 2016. It should also be noted that not all tax credit claimants will benefit from these two measures.

3.2.3 The following example illustrates this position:

Trevor and Tanya, both aged 40, work full time (35 hours) for national minimum wage. Their combined gross earnings for 2015/16 are £24,038. They have 2 teenage children.

	2015/16	2016/17
Total EARNINGS	£24,038	£26,208
Total TAX	(£567.60)	(£841.60)
Total NATIONAL INSURANCE	(£950.16)	(£1,185.36)
TAX CREDITS	£3,661.62	£1,194.76
NET HOUSEHOLD INCOME	£26,181.86	£25,375.80

3.2.4 Despite the increase in their earnings and the rise in the personal allowance, this family are still £806 a year worse off in 2016/17. By 2017/18, they will see a further reduction to their tax credits of £1,040. This is because in 2016/17, tax credits are still based on their income of £24,038 due to the income disregard. This means part of the impact is delayed until 2017/18.

3.2.5 Some tax credit claimants will be in receipt of housing benefit. They may see an increase in housing benefit because of the reduction in their tax credits, but this will be offset somewhat by a decrease in housing benefit due to the rise in their income from the other measures. In future years, any increase in the national minimum wage (through the living wage premium) will result in a loss of both tax credits and housing benefit/council tax benefit.

3.2.6 For a number of years, we have pointed out that increasing the personal tax allowance and latterly increasing the NMW via a living wage premium does not help those on the lowest incomes as much as those outside of the benefits system once interactions with benefits are factored in. For example, the personal allowance will rise from £10,600 to £11,000 from April 2016. For basic rate taxpayers, this will lead to a gain of £80 a year. However, benefits such as housing benefit and council tax support are calculated using net income. That means they will lose 85% of the £80 gain, leaving them only £12 better off.

3.2.7 In order to make sure that such measures help those on the lowest incomes, we have suggested that work allowances in UC (and tax credits) need to be increased to offset some of the losses created by both measures in order to protect work incentives.

3.2.8 We would also like to highlight the impact on passported benefits. Some passported benefits have thresholds that historically were set close to the child tax credit threshold (although they have not been uprated). It is not clear whether other departments will amend their thresholds in light of the changes to the CTC threshold. If that was to happen, many people who qualify for free school meals or health costs could lose that support.

3.2.9 There was a previous announcement that from April 2016, claimants with household incomes of £20,000 or more who were repaying tax credit overpayments would see their repayments increase from 25% of their existing award to 50%. Little more is known about this measure and what provisions will exist for hardship cases. However, viewed alongside the cuts that we now know will happen in April 2016, this has the potential to leave low income claimants in severe hardship.

3.2.10 This is particularly the case for those families in receipt of the childcare element. It is possible that some claimants will need to give up work as they can no longer afford their childcare costs when both measures are introduced together.

3.2.11 We would urge the Government to reconsider introducing the overpayment recovery measure in April 2016. If it is to be introduced, protection should be given to the childcare and disability elements to ensure that work incentives are not eroded.

3.3 ***Communication of changes***

3.3.1 If the cuts to tax credits proceed as planned, it is crucial that HMRC develop a communication strategy to ensure claimants are aware of the changes at the earliest opportunity.

3.3.2 From the interaction we have had so far with tax credit claimants, it seems that many are unaware of the changes and the potential impact on their awards from April 2016. In particular, those receiving CTC only believe they are not affected because there was no announcement in the Budget about the CTC threshold. This is because the CTC threshold is set by reference to the WTC threshold and taper, but beyond a small range of tax credit experts and HMRC staff this is not known by the claimant population or many advisers.

3.3.3 As a result some commentators assumed the CTC threshold would remain at £16,105 for 2016/17, leading some claimants to believe they were not affected by the changes or that the impact would be less than it actually is. These regulations are the first time the CTC threshold has been publicly confirmed.

3.3.4 Thought also needs to be given to how and where claimants will be able to access help to understand their overall position in view of the range of factors highlighted in paragraph 3.2.1. Voluntary sector organisations are already struggling due to lack of funding and these changes are likely to create a large increase in demand on already stretched services.

3.3.5 It would be possible to develop a calculator or expand existing calculators to help people understand their position should funding be made available and we suggest this is considered as a priority.

3.4 ***Other tax credit changes***

3.4.1 As well as these regulations, significant changes to child tax credit are currently being debated as part of the Welfare Reform and Work Bill. These regulations needs to be considered in light of those other changes. We are concerned about the potential impact of the two child-limit for child tax credit for those who go on to have more than two children from April 2017, particularly in cases involving rape or other circumstances such as the death of a parent or other care situations. Our views on these changes were set out in a briefing[4] to the Public Bill Committee available on the Parliamentary website.

LITRG
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[4] http://www.publications.parliament.uk/pa/cm201516/cmpublic/welfarereform/memo/wrw34.htm