

Tax credits overpayments

How they arise, how they are recovered, and how to challenge them

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1.0 Introduction

Of the many differences between traditional social security benefits and tax credits, one of the most fundamental is that, in tax credits, overpayments are an integral and often unavoidable part of the system.

While a benefit claimant's entitlement is generally ascertainable at the time of payment, entitlement to tax credits for a tax year cannot be established until after the year-end. Payment during the year is based on income of a previous year, or an estimate of income for the current year; but it is not until after the year-end that the actual current year income can be ascertained and final entitlement assessed. If it then transpires that the claimant's entitlement exceeds what they have been paid, there is an underpayment; if it is less, an overpayment arises.

This provisional structure gives rise to three fundamental differences in the nature of overpayments as between the tax credits and social security regimes:

1. Under the social security system, overpayments are recoverable by the Secretary of State only if the statute so prescribes. In tax credits, overpayments are part of the system and all are recoverable by statute if HM Revenue and Customs (HMRC) decide to recover them (which they nearly always will).
2. In social security there is a right of appeal by which the recoverability of an overpayment can be judicially tested. There is, however, no right of appeal against an HMRC decision to recover a tax credit overpayment.
3. In most social security benefits, overpayments are only recoverable if they arise through misrepresentation or failure to disclose on the part of the claimant, 'whether fraudulently or otherwise' (Social Security Administration Act 1992, s 71). Housing benefit and council tax benefit overpayments are also recoverable if they arise from official error, and the claimant can reasonably be expected to have known that they were being overpaid; if they cannot reasonably have known that, the overpayment is not recoverable (*Housing Benefit Regulations 2006/213, reg 100(2)*; *Council Tax Benefit Regulations 2006/215, reg 83(2)*). In tax credits, by contrast, there is no distinction between recoverable and non-recoverable overpayments – they are all recoverable at the discretion of HMRC, which can (and generally do) recover even a tax credit overpaid by reason of their own error.

We shall examine those propositions further below. But first let us look in greater detail at how the tax credit system is structured, as it is necessary to understand that in order to grasp how tax credit overpayments arise.

2.0 The annual nature of the tax credit system

The cycle of award and entitlement

The reason why overpayments are endemic in the tax credit system is that the system works on the basis of pay now, establish entitlement later. Unlike any other welfare benefits, entitlement to tax credits is based on the tax year, 6 April to the following 5 April, but it is not until after the end of the tax year in which payment is made that entitlement is finally ascertained. This 'cycle' of award followed by entitlement works like this.

An initial award is made at the start of the year, or when a claim is received, based on the claimants' current circumstances, and their income for the previous tax year (for 2003-04 the 'previous tax year' was deemed to be 2001-02 to enable claims to be made in advance).

As the year progresses the claimant has the opportunity to notify changes in circumstances and income so as to keep their award updated, and is obliged to report certain changes such as alterations in the composition of the adult members of the household, in the children or young persons for whom a claimant is responsible, and in normal weekly working hours. The first of those groups includes single claimants entering a relationship, couples splitting up, or one member of a couple dying or going abroad for a prolonged period. The second might include children leaving the household and going into care, young people over 16 dropping out of further education or training, or a child dying. The third group involves reporting to HMRC if 'normal' weekly working hours drop from 16 or more hours a week to below 16, or from 30 or more hours a week to less than 30.

Assessing entitlement for 'current year'

After the year end, HMRC send a stack of renewal papers, the purpose of which is to ascertain the claimants' actual entitlement for the year just gone, and if appropriate act as a claim for the year ahead. Changes in entitlement will arise from changes in personal circumstances and changes in income. For income the final entitlement is based on the following formula:

- If current year income (CYI) is less than previous year income (PYI), the final award is based on the lower CYI and there may be an underpayment;
- If CYI is equal to PYI, or greater than PYI by no more than a certain amount (known as the income disregard (see 2.1)), the final award is based on PYI;
- If CYI is greater than PYI by more than the income disregard, the final award is based on CYI less the income disregard, and an overpayment may arise.

Establishing initial award for following year

The same information is also used to establish the claimants' initial award for the

following tax year although in that case the full CY income is used. The income disregarded for the current year, CY, can only be used to compare CY income with preceding year income; it cannot be carried forward to the following tax year.

2.1 The income disregard and its implications

The income disregard in each year from 2003-04 to 2005-06 inclusive was £2,500. Its purpose was to provide a 'buffer zone' in which a family's income could increase during the course of a year without affecting their tax credit entitlement. Though considered generous at the time it was introduced, the £2,500 buffer zone proved in the event insufficient to prevent hardship to families whose income increased above that amount. Therefore in 2006-07, in a bid to reduce the volume of overpayments arising from increases in income, the income disregard was increased quite dramatically to £25,000. See *Tax Credits (Income Thresholds and Determination of Rates) Regulations 2002/2008, reg 5*.

That was probably the most significant of the changes announced in the pre-Budget Report on 5 December 2005 ('PBR 2005'), and the latest round of overpayment figures (relating to 2006-2007 tax year) shows a significant fall in both the number and amount of overpayments. HMRC have attributed this largely to the increased disregard.

The effect of the increase has been to bring greater certainty for claimants in a system where a major problem had been the sheer unpredictability of what families could expect to receive. Yet, the tax credit system retains some flexibility for those whose income goes down in a year to claim a higher entitlement, subject to one important new restriction discussed at point 3 below.

However, there are some traps.

1. Cross-year overpayments originating before 2006-07

The £25,000 disregard applies only to income rises in 2006-07 and subsequent years – overpayments being recovered now from final awards for 2005-06 and earlier years will still be calculated by reference to the £2,500 disregard applying in those years. See [Doing the sums](#) for more details and an example.

2. Reporting income increases to HMRC

Secondly, it might at first seem that any income rises of £25,000 or less, because they have no effect on the current year's award, need not be reported to HMRC until the renewal process gets underway at the start of the following tax year. But in fact it is sound advice to report such changes during the current tax year, even if they have no effect on the current year's entitlement, in order to avoid overpayment of provisional payments in the early part of the following tax year. Again, see [Doing the sums](#) for examples of how this works.

To guard against overpayments generated by provisional payments that reflect outdated income figures, the Government announced two specific measures in PBR 2005.

- At the end of the tax year 2006-07, in early calendar year 2007, HMRC would contact 'key groups of claimants' to 'obtain more up-to-date income information on which to base the next year's payments while the finalisation process is completed'.
- From 2008-09, where claimants have not provided up-to-date information about their income and circumstances, the income figure used to calculate provisional payments will be uprated by average earnings.

3. Income decreasing then increasing in-year

The £25,000 disregard covers any increase in income over and above the level of the previous year's income. Where income falls below the level of the previous year, then rises again, the subsequent increase is not covered by the disregard until it reaches the same level as the previous year's income.

Therefore, there is a risk of a recoverable overpayment accruing if income falls, and the claimant, in order to secure extra tax credits, submits a revised income estimate which is based on the lower figure. If income rises again in the same year, that initial estimate may turn out to be too low, and tax credits paid on the basis of the low estimate may turn out to have been overpaid.

This is a point that needs to be borne in mind particularly in periods of maternity leave, sick leave and similar periods of temporary absence from work when income levels fall but might rise again later in the year if the claimant returns to work.

There are more details with worked examples at [Doing the sums](#).

The problem is partly alleviated from 2007-08 by a PBR 2005 measure under which claimants reporting a fall in income will have the rest of their payments for the year adjusted accordingly, but will not be paid the accrued entitlement from the earlier part of the year. At the end of the year, when final income is known, any remaining underpayment will be paid over. According to the PBR announcement:

... this approach will provide a buffer against any overpayment accumulated by the family during the year, especially where their estimate of income proves to have been too low.

This measure will help those whose incomes fall during the year then rise again in that any ensuing overpayment will be kept within limits. However, it will be of less assistance to those whose income falls and stays low in that they will not get the underpayment that will have accrued up to that point until the end of the year. The measure has been criticised by bodies such as the Child Poverty Action Group on

those grounds. Nevertheless, tax credit entitlement for the remainder of the award period will be adjusted from the point at which the claimant reports the fall in income.

Again, there are numerical examples at [Doing the sums](#).

2.2 Accrual of tax credits income during the tax year

As shown at the beginning of this article, a tax credit overpayment generally arises by operation of the system, irrespective of any claimant misrepresentation or non-disclosure.

One of the features of the annual basis of assessment for tax credits is that income, as assessed for tax credits purposes, is deemed to accrue evenly day by day throughout the year. Therefore, in tax years when the income disregard was only £2,500, claimants reporting an increase in income would notice that an overpayment had accrued for the period before they reported the increase, as well as after, even if they reported the increase promptly. A simplified example will illustrate how this worked.

Example

Fergus and Deirdre made a joint claim for tax credits in 2005-06. In the first six months of 2005-06, only Fergus was working. Their joint income for 2004-05 was £12,000 a year, Fergus's annual salary. Therefore, for the first six months of 2005-06 their tax credit award was based on joint income of £6,000 (half of Fergus's earnings).

Fergus continued on the same salary level in 2005-06. Half way through the tax year Deirdre started working, also earning £12,000 a year, so their annual income in a full tax year doubled to £24,000 and their joint income for the second half of the year to £12,000.

Fergus and Deirdre reported this change to The Tax Credit Office straight away, who processed it promptly. The Tax Credit Office recomputed their income ignoring the first £2,500 of the increase, and recalculated their tax credits accordingly.

Now because of the way the regulations spread income over the whole tax year, when Fergus's and Deirdre's income for the whole of 2005-06 is recalculated, it is spread evenly over both six-month periods. Thus, because their annual income is now £18,000 (£12,000 for Fergus and £6,000 for Deirdre), for the first six months their joint income is recomputed as £9,000, not £6,000. Even with the £2,500 disregard, this is bound to make a difference to their entitlement for those six months and could mean that an overpayment will have arisen in that period.

This 'washback' effect of income-based overpayments is hardly noticeable now that

the disregard has been raised to £25,000. But in earlier years, the fact that overpayments could arise even if claimants reported everything promptly, and did all that they were supposed to do, was barely acknowledged in HMRC literature and guidance. Hence, a lack of claimant understanding – not helped by incomplete or misleading guidance from HMRC – merely compounded the problem of overpayments in the early years.

3.0 How do overpayments arise?

Apart from income rises, other ways in which overpayments can arise include:

- through claimant error;
- through official error (see below);
- through claimant delay in notifying changes of circumstances or income;
- through official delay in processing changes of circumstances or income (see below);
- through adjustment of an award following an in-year examination or an end-of-year enquiry;
- through not completing renewal forms;
- because provisional payments in the first few weeks of a new tax year pending completion of the renewal formalities are too generous. This is often because they are based on income or circumstances which are out of date, whether because the claimant has failed to keep HMRC updated on changes, or because HMRC has failed to register them.

Also, while WTC was being paid to employees through the payroll, an employer was allowed up to 42 days to process a change in an employee's WTC paid in that way. An overpayment would tend to accrue during that waiting period. No new overpayments can arise in this way as the system of Payment Via Employer (PVE) came to an end in February 2006.

4.0 Recovery of overpayments – Revenue discretion

Note the text of TCA 2002, s 28(1):

'Where the amount of a tax credit paid for a tax year to a person or persons exceeds the amount of the tax credit to which he is entitled, or they are jointly entitled, for the tax year . . . the Board may decide that the excess, or any part of it, is to be repaid to the Board.' (italics supplied).

Section 28(1) should be read in conjunction with s 28(5), which gives HMRC power to adjust an award in-year if they detect that an overpayment is likely to arise at the end of it:

‘Where it appears to the Board that there is likely to be an overpayment of a tax credit for a tax year under an award made to a person or persons, the Board may, with a view to reducing or eliminating the overpayment, amend the award or any other award of any tax credit made to the person or persons . . .’

When questioned about this during the passage of the Tax Credits Bill through Parliament, the responsible minister Paul Boateng MP said that he expected the then Inland Revenue to use their discretion ‘sensibly and fairly’ (*Hansard, Standing Committee A, 22 January 2002, col 185*). So how in fact does HMRC exercise this discretion given them by statute, and is their exercise of it fair and sensible? This is the question on which much of the controversy regarding tax credits has focused in the first five years of the system’s operation.

Under TCA 2002, s 29(3) to (5), HMRC may recover overpayments in one of three ways:

- by deduction from any tax credit award made to the claimants; or
- by direct recovery; or
- through PAYE coding.

HMRC have set out their practice on recovery in COP 26. This has been modified a number of times, and the [current version](#) dates from March 2008.

- *Recovery by deduction from continuing award*

This is HMRC’s preferred method of recovery. Under the current version of COP26, there are certain limits on the amount by which payments of tax credits can be reduced in order to recover an overpayment which arose in the previous year (cross-year overpayment). Those limits, which depend upon a claimant’s income, are as follows:

- 10% of the award payment for claimants on maximum tax credits;
- 100% for claimants receiving only the family element of child tax credit; and
- 25% for all other claimants.

Sometimes HMRC will adjust an award during the award period in order to try to prevent an overpayment from accruing. In such cases the limits set out above apply to restrict recovery.

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HMRC will reduce, or even stop, payment of tax credits where the claimant reports a change in circumstances or income that results in a lower entitlement, or entitlement ceasing altogether.

Potential overpayments that are identified during the award period in this way are loosely termed in-year overpayments.

In certain circumstances, HMRC will agree to reduce the recovery percentages further, or collect an overpayment over a longer period, or write off an overpayment altogether if the claimant is experiencing particular hardship (see 5.1).

- *Former recovery practices*

Recovery practices were not always so simple. Historically, the above limits applied only to cross-year overpayments. In-year overpayments were recovered differently. HMRC's computer would automatically adjust the award to ensure that tax credit was paid at 'the right amount' for the whole year. If this caused hardship, claimants could ask for additional payments, which might prevent them from falling into poverty but prolonged the recovery of the overpayment debt into later years. Also, the initial hardship caused by the automatic 100% in-year recovery was only alleviated if the claimant asked, and knew that it was possible to ask, for additional payments.

The additional payments, where made, brought payments back up to a certain percentage of what they were before the recovery began, that percentage depending on the circumstances of the claimant. Up to and including March 2006 those percentages were:

- 10% for those on income support or jobseeker's allowance whose child tax credit payments had fallen below 90% of what they would have received if they had not been overpaid;
- 25% for those on maximum working tax credit or child tax credit, or in receipt of a disability element in either tax credit;
- 50% for other claimants whose payments had dropped below that percentage of what they would have received if they had not been overpaid.

Additional payments were not made to those receiving only the family element of child tax credit, or to those whose award was reduced because the Revenue found that 'something was wrong' with their claim. In addition, where an overpayment had arisen from an increase in income of more than £2,500, no additional payments were made. That latter restriction was removed with effect from 13 February 2006.

After March 2006 the percentage rates of in-year recovery were brought into line with the more generous rates applied to cross-year overpayment recovery – ie the 10%, 100% and 25% rates set out above. This was announced in a statement made by

the Paymaster General to the House of Commons Treasury Sub-Committee dated 1 February 2006.

In an earlier statement made at the same time as the pre-Budget Report on 5 December 2005, the Paymaster General announced that from November 2006 in-year overpayment recovery would be subject to automatic limits set at those 10%, 25% and 100% rates. In other words, in-year overpayments would no longer be subject to 100% automatic recovery, and there would no longer be any difference between the rates of recovery of in-year and cross-year overpayments.

Both these announcements were in response to specific lobbying by LITRG and other tax and welfare rights bodies.

Then, in a further statement on 6 December 2006, the Paymaster General announced that it had not been possible for the technology to achieve the automatic limits on recovery promised for in-year overpayments from November 2006. Instead, the automatic limits would apply from April 2007; the limits would be applied manually in appropriate cases, without the claimants having to ask, from January 2007; and meanwhile HMRC remained open to requests for top-up payments from those eligible.

The fully automated limits were finally implemented during a system upgrade over the weekend of 30 June/1 July 2007.

- *Recovery of cross-year overpayments from additional payments*

For 2004-05 and 2005-06, where a cross-year overpayment was being collected at the 10%, 25% or 100% rate (see above), it was recovered at the same percentage from any additional payments made. Thus, if additional payments were being made at the 90% rate, and a cross-year overpayment was still being collected at 10%, the effective rate of additional payment was 81%, i.e. 90% less 10% of 90%. It is understood that this double recovery has not applied since April 2006.

The Appendix shows a table that traces the developments in the history of HMRC's tax credit overpayment recovery since just before and after the 2005 pre-Budget report.

- *Direct recovery*

HMRC generally recover tax credit overpayments directly like any other tax debt in two situations:

- where there is no continuing award; or
- where the claim in which the overpayment occurred has ended. For example, there has been a change of household which has ended the previous household's claim, and the overpayment being collected arose under the claim made by that previous household.

Where such payments are demanded by HMRC sending a 'notice to pay', they are strictly due within 30 days, but claimants can immediately ask to repay the overpayment over 12 months. If necessary, a 'time to pay' arrangement can be made to pay back the money over a longer period based on the claimants' circumstances usually determined by way of an income/expenditure form.

Direct recovery is administered by the debt collection arm of HMRC, known as Debt Management and Banking (DMB). It was renamed in 2005 having previously been known as Receivables Management Service (RMS). Most probably still prefer to think of it as HM Collector of Taxes.

- *Recovery through PAYE coding*

While provision is made in the *Tax Credit Act 2002, s 29(5)* for tax credit overpayments to be collected through the PAYE system, HMRC have never implemented collection this way. However, HMRC will shortly begin pilots offering this facility to certain groups of claimants who have smaller overpayments, with a view to possibly extending it at a later date.

4.1 Stopping awards where no entitlement

COP 26 states:

'If you tell us about a change of circumstances and we find you are not entitled to tax credits at all, we will stop paying you tax credits for the rest of the year.'

4.2 'Fairly and sensibly'?

In operating these systems, are HMRC recovering tax credit overpayments 'fairly and sensibly', as Paul Boateng MP hoped when introducing the Tax Credits Bill in January 2002 (see above)?

Having devised a welfare system that aimed to be responsive to changes in income and circumstances, for the Government then to create a regime where overpayments could be corrected with the minimum hardship to claimants was always going to be a tough challenge. But the solutions initially decided upon (practically without consultation) resulted in HMRC facing accusations of maladministration, as the implementation of policy all too often plunged claimants back into the very poverty from which it was the purpose of the system to relieve them.

During the summer of 2005, a succession of reports such as those by One Parent Families, the Adjudicator, the Parliamentary Ombudsman and Citizens Advice drew attention to the hard cases and injustices created by the prevailing regime. Meanwhile, the tax professional and welfare rights bodies involved in tax credits work were agitating for specific changes, urging HMRC and Government:

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- to cease automatic 100% in-year recoveries, and consider freezing all in-year recoveries;
- to take greater care in setting provisional payments so as not to set them too high;
- to consider applying the percentage recovery rates to the cumulative total of overpayments, without distinguishing between in-year and previous year overpayments, while enabling those who wish to pay early to do so;
- to introduce a 'pause' before recovery began, so that those facing overpayments had a chance to budget.

The first and third points were dealt with by the Paymaster General's announcement that automatic in-year recovery would reflect the percentage rates applicable to cross-year recoveries, and that from April 2006 those same rates would be applied to additional payments made to claimants put in hardship because of in-year recovery. Regarding the second point, after 2004-05 HMRC ceased the practice of automatically deducting the £2,500 disregard when setting the levels of provisional payments at the start of a new tax year, so that fewer claimants were paid too much in the early part of the year.

Perhaps the most important objection to the present regime is to the way in which HMRC deal with claimants who are overpaid owing to official error, but who are still expected to repay. It is to that difficulty that we now turn.

5.0 When will HMRC not seek recovery?

There are two sets of circumstances in which, according to COP26, HMRC will not seek recovery of an overpayment. These are:

- where recovery would cause the claimants hardship, and
- following a successful dispute, in cases where the overpayment has resulted from a failure of HMRC to meet their responsibilities as set out in COP 26.

It is worth noting at this point the difficulty which exists for claimants (and sometimes HMRC) in knowing the difference between an appeal and dispute. Anyone can *dispute* a matter with HMRC, but an *appeal* lies against a decision by HMRC to an independent tribunal. As noted earlier in this text, there is no such appeal against the recovery of an overpayment. A right of appeal exists only against decisions on entitlement, which may if revised reduce or eliminate an overpayment.

Recovery of an overpayment can only be challenged using the dispute procedure as set out in COP 26 and discussed below. We have seen several examples where claimants have mistakenly 'appealed' to HMRC against a decision on recovery, or

‘disputed’ a decision on entitlement when they should have lodged an appeal. HMRC have assured representative bodies that they would forward challenges to the correct channel, however there remain concerns as to whether this always happens in practice.

5.1 Hardship

In its March 2008 version, COP26 states that in exceptional circumstances an overpayment may be written off if the claimant is suffering financial hardship and cannot meet your essential living expenses.

COP26 then lists the factors which HMRC will take into account if they are considering allowing payment at a lower rate, or writing off the overpayment, on hardship grounds. These are, briefly:

- family circumstances, in particular young children, and anyone chronically ill or disabled;
- present and future income;
- living expenses (such as rent, gas or electricity bills);
- savings, investments and other assets;
- other debts (such as mortgage repayments);
- how long it will take to pay back the overpayment;
- whether the claimant is paying back an earlier overpayment or has recently repaid one.

In practice, HMRC are reluctant to write off overpayments altogether on grounds of hardship, preferring to give the claimant time to pay by spreading repayments over a longer period or deferring payment whilst carrying out frequent reviews. The question of hardship does arise, however, when there is no ongoing award and overpayments are recovered directly. In such cases, Debt Management and Banking applies the same criteria as for other forms of tax debt, and in appropriate cases this can involve writing off the overpayment.

Internal HMRC procedures in hardship cases are described in the [Tax Credit Office Manual](#).

5.2 HMRC or other official error

As stated above, HMRC will write off an overpayment where they have failed to meet their responsibilities (as set out in COP 26). This responsibilities test came into practice on 31st January 2008 with the publication of a new COP 26.

Prior to 31st January 2008, claimants faced the much criticised ‘reasonableness test’. This test had long been criticised by representative bodies, and following a succession of reports in 2007 by the Adjudicator, The Parliamentary Ombudsman and Citizens Advice, HMRC decided to revise the test.

The following paragraphs contain information about the operation of the reasonableness test. Whilst the test is not applicable to new cases, we have been informed by HMRC that the test will still be used where a claimant asks HMRC to review a previous dispute decision that was made under the old test. Any disputes outstanding as of 31st January 2008 should be dealt with under the new test.

COP26 (April 2007 version) stated:

‘For us to write off an overpayment you must be able to show that the overpayment happened because:

- we made a mistake, and
- it was reasonable for you to think your payments were right.’

Both tests had to be satisfied before HMRC would write off an overpayment.

5.2.1 The reasonableness test

Of the two tests described above – that HMRC must have made a mistake, and that it must be reasonable for the claimant to have thought their award was right – it was the second of the two, commonly known as ‘the reasonableness test’, that provoked the most controversy.

The April 2007 version of COP26 put the section *Disagreeing with recovery of an overpayment* very near the front of the document. It tended to adopt a ‘tick box’ approach to satisfying the reasonableness test, the general thrust being that if the claimant had done all they could be expected to do, and HMRC had not, then it was likely that HMRC would agree to write off the overpayment.

What was the claimant expected to do? Specifically, the claimant was required to check their award notice promptly on receiving it. As a minimum, the claimant was expected to check the following details.

- Whether the award was for an individual or for a couple. If the award was made out to a single claimant, and the claimant was a couple and in receipt of a joint award, any resulting overpayment was unlikely to be written off if the claimant did not spot and report the error.
- The hours the claimant worked. The award notice should have showed that information, and if it recorded it incorrectly, the claimant should have spotted and reported it. Simple enough in straightforward situations, though where working hours fluctuated because the claimant worked for an agency, for instance, or did shift work, this test could be more difficult to satisfy. The

- difficulty could be exacerbated by the absence of any clear guidance from HMRC as to how an agency or shift worker should compute their 'normal' working hours.
- Whether the claimant received income support or income-based jobseeker's allowance. If they did, then they should also have received maximum tax credits. Again, this should have been an easy check to make in most situations, though where people were unfamiliar with the benefits system they may have been unsure of the difference between the income-based and contribution-based variants of jobseeker's allowance (JSA). To add to their confusion, DWP payment slips did not always make it clear which variant the claimant was being paid. It was not uncommon for tax credit overpayments to arise because claimants in receipt of contribution-based JSA had been paid maximum tax credits appropriate to income-based JSA, and because of their unfamiliarity with the systems they had not spotted or reported the error. Unfamiliarity with systems (in the case of a migrant claimant) has been held to satisfy the equivalent reasonableness test in housing benefit (see *CH/858/2006*).
- Whether the claimant, or anyone in the claimant's household, had a disability element. Again, confusion often arose when people were paid severe disability element (SDE) when they were only entitled to the standard disability element. It was rare for an overpayment so generated to be written off, and we have even seen a case where (initially at least) the TCO refused to write off an overpayment where a local tax office had themselves wrongly advised the claimant that she was entitled to SDE.
- The number and age of any children in the claimant's household.
- Childcare costs. The difficulties in correctly calculating the average where there are fluctuating childcare costs need hardly be elaborated here. The important thing was to check that the figure reported to the TCO was the one that was shown on the award notice.
- Total household income for the period shown on the award notice. Again, this should reflect what the claimant reported to the TCO.

In addition, the claimant was required to check that the amounts going into their bank account matched what was shown on the award notice. This was easier said than done in cases where the payments matched in total, but individual bank account entries did not tally with the individual payments listed on the award notice.

HMRC expected the claimant to report any incorrect information on their award notice on the day that the notice was issued. If there was a change in their circumstances or income, they were obliged again to report that to HMRC.

Given the legendary complexity and opacity of the tax credit award notice, there was surprisingly little sympathy for people who misunderstood it. They were simply

expected to ask for advice, or get someone to do so on their behalf. This betrayed a complete lack of understanding of the predicament of people with a disability that made deciphering, or understanding, such material problematic, and was arguably in breach of HMRC's own [disability equality scheme](#).

A claimant could have been excused for failing to make these checks in exceptional circumstances – bereavement of a close relative or a serious illness were given as examples.

5.3 – The responsibilities test

The old versions of COP 26 were most noticeably silent on what claimants could expect from HMRC. Whilst HMRC internal guidance gave some indication of what claimants could expect, the reasonableness test centred around the claimant and put the emphasis on them to check HMRC's work. There seemed little responsibility for HMRC and this led to large overpayments being recovered in situations where the claimant did not spot an error which HMRC had made.

In designing the new test, HMRC attempted to move away from the one-sided list of responsibilities, replacing a test which imposed all of the responsibility on the claimant to one which set out responsibilities for both parties.

HMRC's responsibilities are set out below, taken from the March 2008 version of COP 26:

- **When you contact us for information we should** give you the correct advice based on the information you give us. We'll offer you support, for example, if you want us to explain your award notice to you, we'll talk you through it in detail.
- **When you make or renew your claim we should** accurately record and use the information you give us to work out your tax credits and pay you the correct amount.
- **When we send you an award notice we should** include information you've given us about your family and your income. If you tell us that there is a mistake or something missing on your award notice, we'll put it right and send you a corrected award notice.
- **When you contact us to tell us about a change of circumstance we should** accurately record what you've told us and send you a new award notice within 30 days. The 30 days doesn't start until we get all of the information we need from you to make the change. It is therefore important that you give us all of the information when you tell us about a change.

The claimant's responsibilities, as set out in March 2008 COP 26 are:

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• **When you make or renew your claim you should** give us accurate, complete and up-to-date information.

• **You should tell us about any change of circumstance throughout the year** so we have accurate and up-to-date information. The law says you must tell us about certain changes **within one month** of them happening – you should use the checklist we sent with your award notice to check what the changes are, a copy of the checklist is included with this leaflet.

To reduce the chance of getting an overpayment, we recommend that you tell us about any changes in income as soon as possible.

• **Each time you get an award notice you should** use the checklist we sent with it, a copy of the checklist is included with this leaflet. You should check all the items listed and tell us if anything is wrong, missing or incomplete.

You must tell us about some changes **within one month** of them happening - these are listed on the back of the checklist.

The main details we expect you to check are:

- whether the award is for you as an individual or as part of a couple
- the hours you work
- whether you get Income Support or income-based Jobseeker’s Allowance or Pension Credit
- whether you, or anyone in your household, has a disability element
- the number and age of any children in your household
- childcare costs
- your total household income for the period shown on the award notice.

We’ll send you a corrected award notice when you tell us if anything is wrong, missing or incomplete. **If you don’t get an award notice within one month of telling us about a change in circumstance please phone our Helpline as soon as possible.**

• **After you get any award notice you should** check that the payments you get from us every week or every four weeks match the amount we said you should get on the award notice. We expect you to tell us if you got any payments that didn’t match what was shown on the award notices during the period an overpayment arose.

• **If you spot a mistake on your award notice you should** tell us **within one month** of getting your award notice. Please make a note of when you got your award notice and when you told us about the mistake. We may ask you for this information to show that you acted **within one month**.

5.3.1 The responsibilities test in practice

Under the new COP 26 there are four possible outcomes after applying the responsibilities test. The idea of this is that more certainty will be created for claimants and more consistent decisions will be seen. The following table sets out the possible outcomes:

<i>Outcome</i>	<i>Overpayment written off?</i>	<i>Explanation</i>
1. Both HMRC and the claimant have met their responsibilities.	NO	If both sides have met their responsibilities, the overpayment is likely to be a naturally occurring overpayment which is built into the system, or is caused because HMRC have 30 days to action a change.
2. HMRC have met their responsibilities but the claimant has failed to meet theirs.	NO	The overpayment is not written off because of the failure of the claimant to meet their responsibilities. This may be overridden if there are exceptional circumstances.
3. HMRC have failed to meet their responsibilities but the claimant has met theirs.	YES	The overpayment is written off in full because HMRC failed to meet their responsibilities.
4. Both HMRC and the claimant have failed to meet their responsibilities	PARTIALLY	The part of the overpayment attributable to HMRC's failure will be written off, the part attributable to claimant error will remain recoverable unless exceptional circumstances are present.

There is an extremely useful document within HMRC's own guidance detailing the steps that dispute advisers should follow in determining disputes under the new test. This document can be found [here](#).

The third step of the process for TCO advisers requires consideration of whether any 'exceptional circumstances' were present which prevented the claimant from meeting their responsibilities (see 2 and 4 in the summary table above).

According to the guidance exceptional circumstances do not need to be rare, and the words can simply mean 'strong reasons'. Examples given of exceptional circumstances are the death of a close relative, serious illness, and flooding of the claimant's home.

If exceptional circumstances are found then the overpayment that resulted from the claimants' failure to meet their responsibilities due to exceptional circumstances should be written off.

Both HMRC and the claimant have failed to meet their responsibilities

Under point 4 in the summary table above, where both parties have failed in their responsibilities there will be a partial write off calculated by apportioning the part of the overpayment that is attributable to HMRC's failure.

The guidance directs dispute staff to go on and consider four additional questions in this situation:

- Did the claimant for overpayments in 2008-2009 onwards, report any error on their award notice within one month of receiving it?
- Did the claimant, for overpayments prior to 2008-2009 report any award notice error promptly?
- Did HMRC delay in processing a change of circumstances for more than 30 days?
- Did HMRC incorrectly process a change of circumstances?

In the first two cases, if the claimant informed HMRC within one month (or promptly for overpayments arising earlier than 2008-2009) the overpayment relating to the error on the award notice should be written off. If notification is made outside of these time limits, it would seem that the overpayment will only be written off from the date that HMRC were actually informed of the error.

In the last two cases, the part of the overpayment relating to HMRC's error in not processing a change of circumstances within 30 days or processing a change incorrectly should be written off.

Any remaining overpayment would appear to be recoverable.

5.3.2 The responsibilities test – an improvement?

Overall we have welcomed the departure from the old reasonableness test, and remain optimistic that the new test will provide better decisions for claimants. Particularly welcome is the clarity on what HMRC expects from claimants and more importantly what claimants can expect from HMRC.

However, there are parts of the new test that we still have concerns about which still seem to create an unfair balance in favour of HMRC:

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- We strongly oppose the 30 days that HMRC have allowed themselves to implement changes of circumstances reported by claimants. However promptly claimants make their report, if HMRC do not process the changes until the end of the 30 day period, any overpayment accrued in the meantime will remain recoverable. We feel that there is no justification for this practice which will hit worst those on the lowest incomes.
- We are concerned that the new test is based around establishing whether HMRC and the claimant have met responsibilities and what evidence HMRC will use to determine this. In light of the missing telephone recordings (as detailed below) and the repeated frustration of advisers reporting post going missing in the HMRC post room, we remain concerned about how HMRC will establish whether the claimant has met their responsibilities.

The positive aspects and improvements brought about by this new COP 26 will ultimately rely on the processes in place to make sure the guidance is applied in the way intended.

Claimants also need clear explanations of how overpayments arose in order to invoke COP 26 effectively, and HMRC need to show claimants that COP 26 has been applied by issuing full and detailed explanations of decisions. This does not always happen and we believe that this is fundamental if the new test is to work effectively for claimants.

5.4 Records of telephone calls

HMRC say that they may check that the claimant made appropriate contact with TCO by referring to their records of calls. However, these are not complete. In a number of cases in 2003 and 2004, calls to the helpline that were diverted to a private supplier were not always recorded. The scale of the problem was revealed in the answer to a Parliamentary question by David Laws MP on 20 February 2007 (see *col 612W in Hansard* for that date). The response from Benefits and Credits was:

‘The private sector advisers dealt mainly with generic, non-claimant specific enquiries. They received the same training as the HMRC staff to enable them to do this.’

However, it would have been very difficult to filter accurately the generic from the claimant-specific, particularly where the same call contained elements of both.

Following a campaign by LITRG and others, tax credit officials have agreed that where an issue arises as to whether a claimant telephoned the helpline at that time to report a change in circumstances or a mistake in their payments, in the absence of any tape recording of the call the claimant will usually be given the benefit of the doubt, with any ensuing overpayment being written off.

See our [evidence](#) to the Treasury Sub-Committee in March 2007 for more details on this.

5.5 The mechanics of disputing

If a claimant feels that they should not be required to repay an overpayment on the grounds that it was generated by official error, the first step is to contact the Tax Credit Office. They will despatch a [form TC846](#) for the claimant to complete (award notices give a time limit of three months, but nowhere else is a time limit given) and a copy of COP26. The claimant is not obliged to use TC846, but must state – in writing – why they believe that they met their responsibilities and HMRC did not.

As soon as the claimant disputes an overpayment, whether on form TC846 or in some other written format, HMRC must suspend recovery while the matter is investigated. Recovery should not recommence unless and until the dispute is resolved against the claimant and in HMRC's favour. Thereafter, HMRC's policy is that suspension can only be reactivated if the claimant submits a new dispute with new evidence to HMRC which requires further investigation.

This is a harsh policy, particularly in light of the often poor explanations of overpayments that we see. Under current policy there is no suspension of recovery whilst seeking an explanation for the overpayment, nor is there suspension whilst pursuing a complaint via HMRC's own procedures or escalating to the Adjudicator. Whilst this is the official HMRC policy, it is still worth speaking with DMB to request a suspension as sometimes they will defer recovery whilst you take further action.

5.6 Remedies

While there are rights of appeal against awards and other decisions on tax credit entitlement, there is no statutory right of appeal against the exercise by HMRC of their discretion in relation to an overpayment recovery. That is not to say there is no legal or other remedy. If HMRC refuse a request to write off an overpayment resulting from their error, the following steps may be taken.

Make a formal complaint under HMRC's complaint procedures. These are described in the factsheet [Complaints and putting things right](#) which supplanted Code of Practice (COP) I in April 2007.

If the internal complaints route produces a result that is unsatisfactory to the claimant, refer the matter to the [Adjudicator](#). The Adjudicator acts as a 'fair and unbiased referee investigating complaints about [HMRC and certain other departments] after their own efforts to resolve matters have failed'. It is important to note that the Adjudicator cannot rewrite HMRC policy and procedure, she can only determine whether the existing policies and practices of the Department have been applied fairly.

If the claimant is dissatisfied with the Adjudicator's decision, the claimant's MP can refer the matter to the [Parliamentary Ombudsman](#) whose brief is to investigate cases of maladministration by Government departments or other public bodies resulting in injustice.

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Although there is no statutory right of appeal against HMRC's exercise of their discretion, there is one judicial remedy – that of judicial review, exercisable by the High Court. One advantage of this method is that the initial threat of proceedings, or failing that an application for permission, can concentrate the mind of the defendant. Another advantage is that the procedure can be expedited so that it can work much faster than other remedies. The drawback is that if the Department does not back down in the preliminary stages, going ahead with the procedure can be expensive for the claimant, even if CLS funding is obtained. It is also a specialist area where expert legal representation is required. There is a very useful basic guide to judicial review procedure on the website of the [Public Law Project](#).

If some kind of administrative review jurisdiction could be exercised at a lower level within the judicial structure – e.g. by a specialist tribunal more accessible to those on low incomes – access to justice in this important area would be greatly enhanced. The Tribunals, Courts and Enforcement Act 2007, when it enters into force on 1 April 2009, will empower the upper Tribunal to exercise judicial review as well as the High Court. Whether this will be effective in increasing access to judicial review remains to be seen. A better solution, from the point of view of the low-income claimant, might be an appellate body similar to the Internal Review Service which reviews DWP decisions on access to the Social Fund.

6.0 Couples

Under TCA 2002, s 28(4), joint claimants are jointly and severally liable to repay overpayments. This means that the Revenue can pursue either or both of them for the whole debt.

Where a couple has broken up and owes an overpayment which arose before the break-up, HMRC cannot recover the overpayment from any ongoing award of either partner. They must recover it directly from the former joint claimants who incurred it.

The March 2008 version of COP 26 sets out HMRC's policy on collection in cases where a joint claim has ended but an overpayment remains. It states that HMRC will usually ask both parties to pay 50% of the amount, or the parties themselves can agree to pay different proportions. Whilst this may seem to be a fair solution, if HMRC cannot contact both parties, they reserve the right to come back to one party for the full amount.

Concern is expressed by advisers that it is often the female partner, who usually takes on care of the children, who bears the brunt of HMRC's efforts to recover the money owed to them, particularly if the male partner cannot easily be found.

This is despite the statement in COP26 that:

' We will only ask you to pay the whole amount after making every possible attempt to contact your ex-partner and failing to do so'

It is considered that where this is policy is not followed, with the result that the partner with care of the children is forced to pay back the lion's share of the overpayment – or indeed all of it – HMRC are undermining the very policy behind child tax credit which is to alleviate child poverty. Furthermore, it may even be a contravention of the gender equality legislation.

**APPENDIX
CHANGES IN TAX CREDIT OVERPAYMENT RECOVERY ANNOUNCED
SINCE NOVEMBER 2005**

With effect from/for	Change	Source
November 2005 onwards	Manual suspension of collection of disputed overpayments introduced	PMG statement to Treasury Sub-Committee, 26 October 2005
13 February 2006 onwards	Top-up payments offered to people whose income rises by more than £2,500 wef 13 February	PMG statement to Treasury Sub-Committee 1 February 2006
2006-07 and subsequent years	Annual income disregard rises from £2,500 to £25,000	Pre-Budget report December 2005
April 2006 onwards	Rates of top-up payments reflect rates at which year-end overpayments are recovered from ongoing payments of award	PMG statement to Treasury Sub-Committee 1 February 2006
January 2007	Manual process to enable rates of recovery of in-year overpayments to be aligned with those of cross-year overpayments	Pre-Budget December 2006
July 2007	Rates of recovery of in-year overpayments aligned automatically with those of cross-year overpayments	Pre-Budget December 2005 as modified by pre-Budget December 2006