Treasury Select Committee

Household finances: income, saving and debt
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 As tax specialists with an interest in the tax and related welfare issues of the low-paid, and as part of the Chartered Institute of Taxation (CIOT) with a remit to put forward the perspective of unrepresented taxpayers on low incomes, LITRG welcomes this inquiry into income, saving and debt.

1.2 Personal debt and lack of disposable income may prevent many low-income people saving. But the Help to Save scheme is intended to incentivise those who can. Careful consideration of some of the details is still needed to make the scheme workable, accessible and as easy as possible for those eligible to participate in it.

1.3 When it comes to pension saving, auto-enrolment has widened the number of people who are saving into a pension but there are still drawbacks for those on low incomes – for example there is an issue about tax relief for the lowest earners.

1.4 We acknowledge the Department for Work and Pensions' (DWP) recently announced ambitions for auto-enrolment which will undoubtedly benefit many low-income workers. But there is no clear roadmap for incentivising pension saving amongst the self-employed – which the minimum income floor (MIF) rules in universal credit (UC) also serve to discourage.

1.5 We welcome the unification of the currently fragmented pensions and money advice services and their replacement with a single financial advice agency across the UK. However, the successor to the Money Advice Service must appreciate that those on low incomes tend to have more difficulty in accessing websites or recording telephone information, so the provision of face-to-face contact will be an essential element of their proposed service, as will its ability to connect the client seamlessly with appropriate specialist agencies.

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1.6 When it comes to pension freedoms, the interaction with tax and benefits can have major and long-term effects, often unforeseen at the time of the decision, and those without professional representation can be hard-pressed to find the necessary information and knit it together to find the best course to take.

1.7 The same factors that make a flexible labour market can also bring about day-to-day financial uncertainly for many workers. But insecure work can also predispose people to get into unmanageable non-credit debt – in the form of tax and tax credit debt. Tax credit overpayments, for example, are common for those on variable incomes due to the 'pay now, establish entitlement later' annual nature of the tax credits system.

1.8 Without a clear framework of appropriate safeguards, we question whether HM Revenue & Customs (HMRC) always collect such debt in a responsible way and state that more needs to be done to help vulnerable people who find themselves in debt to HMRC.

2 About Us

2.1 The LITRG is an initiative of the 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 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 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 Our approach

3.1 Stemming from our interest in the tax and related welfare position of individuals on low incomes, much of our recently published work concentrates on issues that we consider are relevant to this inquiry.

3.2 The purpose of our submission is therefore to summarise the most pertinent points of some of our recent pieces of work and, as they are already published on the internet, link to them in case the Committee wish to refer to them further.

3.3 We have restricted ourselves to answering questions where we believe can add the most value.

4 What policies could support households in achieving appropriate levels of saving in cash and pensions? Are current policy interventions (e.g. ISAs) well targeted?

4.1 In recent years the ISA regime has been made more generous and flexible. However, it is worth pointing out that people with limited means are often unable to save into an ISA. For those who can, ISA saving offers them little encouragement – interest rates on cash ISAs are low and tax relief is regressive in nature.

4.2 The UK savings landscape is now changing, with the launch of more targeted schemes in the form of the Lifetime ISA since April 2017 and Help to Save from April 2018.[1] These involve a form of direct match saving, which, for lower income households, could have more effect than other forms of incentives.

4.3 These attempts to boost saving are welcome. However, there are issues with both schemes which could undermine their reach. Given LITRG's focus on taxpayers on low incomes, it is the Help to Save policy intervention on which we offer most comments.

4.4 ***Help to save***

4.4.1 Help to Save has been billed as being introduced to help working families on the lowest incomes – claimants of working tax credit (WTC) or UC.[2]

4.4.2 LITRG gave a detailed response to the consultation on implementation of Help to Save, which can be found on our website.[3]

4.4.3 We were disappointed that the Government response to this consultation was very brief and did not cover the range of peripheral issues and detailed points we raised in our submission.[4]

4.4.4 Recent draft regulations[5] address some of the unanswered questions that remained, but not all. For example, we are unclear why it is proposed that Help to Save will only be available to

[1] The two schemes have different objectives – the former helping people to save towards purchase of a first home or retirement, the latter to incentivise those with little or no existing savings to put something aside for a rainy day.

[2] Some people with surprisingly high levels of income might qualify for Help to Save as tax credits can be paid to people with quite high incomes depending on their personal circumstances – including number of children, childcare costs, and /or claiming for children who qualify for the disability element. Note that we do not have a view on whether this is right or wrong, merely that the communications promoting the account will need to take care not to describe it as only being available to those on low incomes per se.

[3] https://www.litrg.org.uk/latest-news/submissions/160712-help-save-%E2%80%93-consultation-implementation

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559099/Help-to-Save-october_final.pdf

[5] https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts

new applicants for five years from launch as there will obviously be a need to encourage and incentivise people to save thereafter. We also:

- Express concern that a single provider model for Help to Save could be a disincentive for some who need or prefer to engage face-to-face.
- Recommend that the Government looks at ways to help scheme participants in making contributions, for example, by allowing them to direct part of their UC or WTC into a Help to Save scheme before they receive it.
- Urge them to look at eligibility: the scheme will be open to those who are in receipt of UC with a household income equivalent to at least 16 hours at the National Living Wage (NLW). Using the NLW as the reference point for UC claimants, rather than the age-appropriate National Minimum Wage (NMW) creates some unfairness for those under 25 as they may need to work more hours than other claimants to meet this threshold.
- Advise that savings in Help to Save accounts should be disregarded from the assessment of capital for means tested benefits purposes, so as not to disincentivise saving.[1]
- Suggest that JobCentre Plus should play a significant role in encouraging take up of Help to Save by advertising the scheme using posters and flyers and helping people to open accounts online.
- Call for clear guidance on Help to Save to illustrate the difference as compared to pensions. Those eligible for Help to Save are unlikely to have much, if any, surplus income. There is therefore bound to be a tension, if not a clash, between Help to Save and auto-enrolment. People need to understand that saving into a pension might produce a better overall return if employer contributions and tax relief are added, as well as the saver possibly being able to claim extra tax credits or UC.[2]

4.5 ***Auto-enrolment***

4.5.1 Auto-enrolment is widely regarded as a savings policy success. However, there are drawbacks for employees on low incomes.

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[1] The assessment of tariff income in UC for example, begins when a claimant has capital of £6k or more (unless that capital is otherwise disregarded). While even the maximum saved into Help to Save plus bonuses would not exceed this amount, a specific disregard would mean that the Government could promote the scheme as not being counted for restriction of means tested benefits – a selling point that could encourage maximum take up. The upper limit is 16k so anyone with savings (capital) over 16k cannot get UC.

[2] The latter is obtained because, in the calculation of tax credit and UC income, employees may deduct 100% of pension contributions. This means that a higher tax credit or UC award might result from the deduction of employee pension contributions from assessable income. For example, UC's 'taper rate' of 63p in the pound means that a £100 pension contribution could result in a £63 increase in the individual's UC award.

4.5.2 There are current gaps in the coverage of the policy – the self-employed, young workers and part-time workers for example. We acknowledge the DWP's recently announced ambition to remove the lower earnings limit so that every saver makes pension contributions from their first pound of earnings, and to lower the age limit from 22 to 18. However, these changes are a long way off[1] and, under current rules, it could take a very long time for a low-paid worker who has been auto-enrolled to accrue anything like adequate retirement provision, especially with such low contribution levels.

4.5.3 Normally, the relevant percentage of a worker's 'qualifying earnings' has to be put into their pension each pay day. Qualifying earnings start at £113 per week, £226 per fortnight or £490 per month. The rationale for having a lower earnings band limit like this is that it maintains *'… a de minimis gap that produces contributions in pounds not pennies…'.*[2] Currently, the gap between the current entry point and the lower limit of the qualifying earnings band is £4,124 giving minimum annual contributions for people with regular earnings of around £10,000 per annum of about £82.50 (2%). Although this is set to rise to £206.20 in April 2018 and £329.92 in April 2019 – these still are not huge amounts.[3] Further, if a worker's income fluctuates, this may mean that in some pay periods they could earn enough for there to be pension contributions, and in other pay periods they will fall short and there will be none.

4.5.4 In addition, it is not guaranteed that their pension pot will be boosted by tax relief – this depends on how much they earn and whether their employer is operating a net pay arrangement or relief at source. This issue affects those who earn over the £10,000 needed to trigger auto-enrolment, but below (or not very much above) the £11,500 income tax threshold, who are enrolled in a net-pay pension scheme rather than a relief at source scheme.

4.5.5 Under relief at source arrangements, members of pension schemes who do not pay income tax are nonetheless permitted the basic rate tax relief (20%) on pension contributions up to £2,880 a year. In practice this means that HMRC will top up a net contribution of £2,880 to a gross £3,600. The government-backed pension provider, NEST, uses a relief at source scheme, as do various other auto-enrolment scheme providers.

4.5.6 However, this tax relief is not available to non-taxpayers for schemes that operate net pay arrangements, like NOW: Pensions, and the vast majority of occupational and trust based

[1] The report states that it is the government's ambition to implement the proposed changes to the framework in the *mid-2020s:* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.PDF

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388546/automatic-enrolment-earnings-thresholds-2015-2016-response.pdf

[3] This assumes no changes in the earnings thresholds. From April 2018, the overall contribution figure will be 5% and from April 2019 the figure will be 8%.

schemes. It is such a thorny issue that some pension providers are topping up non-taxpayers' pension pots out of their own pockets to offset the shortfall.[1]

4.5.7 In the recent DWP review of auto-enrolment[2] it was stated: '*The government recognises the different impacts on pension contributions for workers earning below the personal allowance. To date, it has not been possible to identify any straightforward or proportionate means to align the effects of the net pay and relief at source mechanisms more closely for this population.'* We do not think this is acceptable.

4.5.8 There was also no clear roadmap set out to increase pension savings amongst the self-employed although the DWP said: '*We will test targeted interventions with the aim of establishing what works to increase pension saving for the self-employed. We will use the evaluation of these to inform implementation options and will consult on specific proposals prior to any changes to legislation.'*

4.5.9 When establishing what works to increase pension saving for the self-employed such as extending a form of auto-enrolment to them, it should be remembered that the self-employed would not benefit as much from pension savings for the obvious reason that there is no employer contribution. Also they would need to take extreme care in assessing the UC position when making pension contributions due to the MIF for 'gainfully self-employed' claimants.

4.5.10 If the MIF is applied and the individual's income from self-employment falls below the set level (in general, this is 35 hours x NLW less notional tax and National Insurance contributions (NICs)), they are deemed to have earnings equal to the MIF in the UC calculation. Unlike tax and NICs, pension contributions are not deductible when calculating the MIF. So, if a claimant's income is already near or below that minimum, the pension contribution may have little or no positive effect on their award.

4.5.11 We explain more about this in our report on self-employment and UC on our website.[3]

5 What actions can government take to improve levels of financial awareness and education, and what lessons can be learned in designing the successor to the Money Advice Service?

5.1 Awareness of financial matters, including taxation and associated matters, must begin with education in schools and lifelong learning must continue as people's circumstances change and they need to meet new obligations.

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[1] https://www.nowpensions.com/press-release/now-pensions-top-non-taxpayers-pension-pots-offset-net-pay-income-tax-relief-shortfall-second-year/

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.PDF

[3] https://www.litrg.org.uk/sites/default/files/Self%20Employment%20report%20FINAL%20for%20release.pdf

5.2 A relevant cross-reference here is to the work of the APPG on Financial Education for Young People. LITRG has contributed to their work in the past and we have stressed the need to include tax as part of young people's financial education.[1]

5.3 In terms of the successor to the Money Advice Service, we think it is a great opportunity to create a service that better helps those on low incomes.

5.4 In our submissions on the topic (for example our 22 January 2017 response to the HM Treasury and DWP's consultation 'Single Public Financial Guidance Body'[2]) we have put forward various ideas for the new body, such as that it should cover the accumulation stage of pensions, e.g. auto-enrolment, as well as the decumulation stage.

5.5 In our view, tax debt is an area in which the public are not currently well served in terms of getting free and easy access to expert advice to help deal with the debt. There are currently only two tax charities[3] which give direct advice to the public and they cannot deal with all the enquiries they receive on their limited resources. Understanding how to manage the debt is one thing, but, unlike most areas of general debt, a specialist investigation is often needed to establish whether it is correctly due in the first instance. All too often when advisers from the tax charities challenge HMRC on behalf of clients, the supposed debt turns out to be wrong or non-existent.

5.6 Therefore, we think the new body should certainly maintain a central website as a starting point for enquirers, helping to paint a broad picture and explaining different interactions, but that each segment should link clearly to relevant expert advice service and specialist websites.

5.7 In designing the successor to the Money Advice Service, the Government must not underestimate the substantial proportion of the population who have difficulties in their dealings with the rest of the world digitally or by telephone, whether through lack of access or confidence, mental or physical disability, inability to afford broadband or landline, shortcomings of literacy or numeracy, or inadequate broadband. Additional obstacles include geographical remoteness, absence of public transport, or caring responsibilities. Delivery of public financial guidance must concentrate on reaching out to these disadvantaged groups.

[1] http://www.litrg.org.uk/latest-news/news/160122-press-release-campaigners-urge-higher-priority-school-lessons-about-money

[2] http://www.litrg.org.uk/sites/default/files/files/170127-LITRG-response-single-public-financial-guidance-body-FINAL.pdf

[3] Tax Aid (www.taxaid.org.uk) and Tax Help for Older People (www.taxvol.org.uk)

6 Are retiring households receiving adequate and appropriate financial advice following the implementation of pension freedoms?

6.1 Following the changes to legislation that took effect from 6 April 2015 allowing greater choice over how an individual might access their pension savings, we have heard of many drawdown disasters.

6.2 Apart from guidance provided by individual pension schemes (where available), the main sources of guidance for pensioners on low incomes will either be financial advisers, or other professionals charging fees, or Pension Wise. While the people using Pension Wise seem to rate their guidance highly, it is concerning that Pension Wise does not require its advisers to be qualified in tax. It is also concerning that Pension Wise may not be advising on the potential impacts of a pension withdrawal on the individual's, or their family's, rights to state benefits both in the short and the longer term.

6.3 The consequences of not fully understanding the implications of your actions can be seen in the real-life case study of Bill.

6.4 Bill is a man of limited means but had worked hard to build up a pension pot of £40,000. Upon his retirement, he withdrew his entire pension pot. Bill brought a new car for £20k (which he admits he does not really need) and put the remaining £20k in an ISA which he plans to drawdown in his remaining years.

6.5 Although Bill received some pension freedoms guidance from the Citizens Advice Bureau (who help Pension Wise deliver face-to-face guidance), his hasty decision has cost him heavily in the form of an unnecessary tax charge and the withdrawal of his Council Tax benefit. All the while his savings were in his pension, they were not reckoned as capital for means-tested benefits (the £20k in his ISA now is) and 75% of Bill's £40,000 withdrawal is taxable as income on him – if he had taken it in stages, spread over a number of tax years he could have avoided paying so much tax.

6.6 The key point that has tripped Bill up is the difference between 'advice' and 'guidance'. The current Pension Wise service is limited because it offers only general guidance which is given by staff who may not be qualified financial advisers. However, individuals really need to have access to *advice* that is based on their individual circumstances and is given by fully qualified professionals.

6.7 We look further at the availability of advice in our response to the Work and Pensions Committee on pension freedoms.[1]

[1] https://www.litrg.org.uk/sites/default/files/files/171019-LITRG-response-WandP-commitee-pensions-freedom-FINAL.pdf

7 What is the scale of and trend in problematic debt and over-indebted households? To what extent is unmanageable debt being manifest in non-credit defaults (e.g. on utilities bills or council tax)?

Have household incomes become more variable as a result of more flexible labour markets and the "gig economy", and does this raise the need for new credit products?

7.1 We think it would be useful to conflate elements of these two questions and look at non-credit debt and the relationship with non-standard work, such as low-paid self-employment, agency and zero hours contract work – given its seemingly upward trend as opposed to full-time, permanent, work.

7.2 All these types of work can come with day-to-day financial uncertainty for workers. But we also think that such work predisposes people to get into unmanageable non-credit debt – in the form of tax and tax credit debt.

7.3 For example, people who are in agency work or have two or more jobs risk an under-deduction of PAYE due to difficulties with the 'starter checklist'.[1]

7.4 Often people do not fully appreciate how important it is that they tick the correct box of the starter checklist. This can lead to people just ticking box A and being given another tax-free personal allowance to set against their second or subsequent job. We have tried to help people better understand and manage their taxes when they have multiple jobs by issuing a factsheet, 'Having more than one job'.[2]

7.5 Irregular working patterns can also cause significant issues with payments of tax credits that are initially based on the income of the previous year, for example a 2017/18 claim is initially based on the income of 2016/17. After the end of the tax year, the claim is finalised based on either the previous year's income or the current year's income depending on changes in income levels. There is an income rise disregard of £2,500 (£5,000 before 6 April 2016) and an income fall disregard of £2,500.[3]

7.6 The disregard system provides some cushioning for tax credits purposes to those in non-standard work. Larger fluctuations in income might mean that tax credits are significantly underpaid in a year, causing financial hardship. Or tax credits might be overpaid, possibly pushing the worker and their family into debt as they attempt to repay that sum in a later year. Despite this, a claimant is not required to notify changes in income levels during the tax year and although changes *can* be reported in year those in non-standard work can find it hard to estimate their earnings.

[1] https://www.gov.uk/government/publications/paye-starter-checklist

[2] http://www.litrg.org.uk/sites/default/files/files/Multiple%20jobholding%202017-18.pdf

[3] http://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/understanding-the-disregard/

7.7 UC is currently being rolled out across the UK gradually[1] and will eventually replace WTC.[2] UC is calculated on a monthly assessment period basis and takes account of net income levels gleaned from HMRC's Real Time information (RTI) system – this system marks the individual's record as being a UC claimant and automatically passes the Pay As You Earn (PAYE) data supplied by any employer in relation to that individual to DWP**.**

7.1 UC is designed to be responsive to changes in earnings, so if a person's wages go up or down their UC payment should automatically change on the next payment date to reflect the change in their earnings. This is welcome and should help cut down on debt in time. However for some people UC is a less generous system than the legacy benefits it is replacing, mainly due to cuts introduced to UC (but reversed for tax credits[3]) and this is a worry for household finances and resilience in the longer term.

8 What are financial regulators doing to monitor the issues of problematic debt? Has the UK financial services market been effective in providing suitable credit products for low income households? What interventions can the Government make, including "breathing space" schemes?

8.1 As we have set out above, not all debt is owed to the private sector.

8.2 Getting into tax or tax credit debt can be a worrying time for many families – particularly at a time when because of other economic factors many are finding it hard to make ends meet. We see many instances where a debt has arisen through no fault of the individual concerned, but we also see many examples where HMRC's handling of the situation often differs little, if at all, to their actions in pursuing the intentionally non-compliant.

8.3 In terms of Government interventions, theoretically, for those who are struggling with tax debt and tax credit debt, HMRC can put a 'Time to Pay' (TTP) arrangement in place, which enables them to pay the debt in affordable instalments over a period of time. These arrangements are entered into on a case-by-case basis and are tailored to the ability of the customer to pay, taking into account their particular circumstances. HMRC also provide a Needs Enhanced Support (NES) service for those with specific, additional requirements – this can involve face-to-face help with debt from a specially trained HMRC adviser.

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[1] You can check whether you live in a UC postcode area by entering your full postcode in the tool developed by LITRG, in conjunction with LASA: http://universalcreditinfo.net/

[2] And income-based Jobseeker's Allowance (JSA), income-based Employment and Support Allowance, Income Support, Child Tax Credit and Housing Benefit.

[3] While some changes to UC were announced in the budget, we do not think these go far enough as per our press release: https://www.tax.org.uk/media-centre/press-releases/litrg-press-release-changes-universal-credit-announced-%E2%80%93-do-they-go-far

8.4 However, we have heard conflicting accounts of HMRC’s willingness to enter into TTP arrangements and while the NES service is very worthwhile, the public access point to it is still the usual helplines and relies on an HMRC adviser recognising a ‘driver of need’. Thus, things like the telephone voice recognition software and being met with ‘computer says no’ responses often erect barriers to people contacting the tax authority for early support.

8.5 Therefore as well as ‘breathing space’ schemes, we think the Government should ensure HMRC and other Government departments have good support systems in place for those who are struggling to repay their debts and that they are implemented in all the appropriate circumstances. In particular we would urge HMRC to follow best practice guidelines for helping vulnerable consumers in debt who have mental health conditions[1] and at the very least, ensure that the debt management team are working to HMRC's own internal guidelines on vulnerable customers.[2]

LITRG
11 January 2018

[1] The Money Advice Liaison Group have mental health and debt guidelines. http://malg.org.uk/resources/malg-mental-health-and-debt-guidelines/)

[2] E.g. https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm585180).