



## Department for Education Consultation

### Eligibility for free early years entitlement for two-year-olds under Universal Credit Response from the Low Incomes Tax Reform Group (LITRG)

#### 1 Executive Summary

- 1.1 We welcome the opportunity to respond to this consultation. This response makes many of the same points as our response to the eligibility for free school meals consultation that closed recently, although the level of the threshold proposed is different.
- 1.2 The consultation document lacks sufficient detail about how the net annual income threshold will work in practice against a monthly-assessed benefit. In this response we raise a number of related points that need further consideration including the definition of 'earned' income for the threshold, how self-employed claimants subject to the Minimum Income Floor (MIF) will be treated for free early years education and similarly how, from April 2018, those with surplus earnings will have their income assessed.
- 1.3 If the proposed threshold is only based on earned income, this may lead to unfairness between families with similar household incomes but with different sources of that income.

#### 2 Introduction

- 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 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.
- 2.4 We welcome this opportunity to respond to this consultation document on free early years entitlement for two-year-olds under Universal Credit (UC). As noted in the consultation, this is very important as evidence shows that children from low income families are far less likely to access formal early education than children from more affluent backgrounds.
- 2.5 We have, for many years, been concerned with the complexity for claimants caused by the various qualifying criteria for passported benefits and the impact of their withdrawal on work incentives.
- 2.5.1 In the Government's response to the Social Security Advisory Committee's 2012 report<sup>1</sup> on passported benefits it was noted that the introduction of UC presents not only a challenge for Departments with responsibility for passported benefits, but also a unique opportunity to consider more fundamental reform to simplify and streamline some passported benefits in the future. It is disappointing that the opportunity has not been taken to consider other options and address some of the issues related to having a single fixed threshold as the cut-off point. At the same time as consulting on this threshold, the Department are consulting on a threshold for free school meals set at a much lower figure of £7,400. Other passported benefits, such as help with health costs, have introduced other earnings thresholds leading to a confused picture for claimants and a series of cliff edges.
- 2.5.2 In our response<sup>2</sup> to the SSAC review of passported benefits we identified transparency as one of the three key principles that should drive reform of passported benefits. Some complexity is inevitable, but the burden of dealing with this should fall on those responsible for delivering the benefit, rather than those receiving it. It is also important to ensure that the public should understand not only the passported benefit itself, but also how that passported benefit entitlement is linked to income and the impact that changes will have on the person's overall financial situation.

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<sup>1</sup> <https://www.gov.uk/government/publications/universal-credit-the-impact-on-passported-benefits>

<sup>2</sup> <https://www.litrg.org.uk/latest-news/submissions/110722-passported-benefits>

- 2.5.3 As well as being clear and easily understood, the scheme should be as easy and straightforward as possible to access in order to ensure take-up by eligible claimants is as high as possible.
- 2.5.4 The second principle we highlighted in our 2011 response to SSAC was that the impact of passported benefits must be included in any calculation or presentation of marginal deduction rates under UC – both in general terms and to claimants. The loss of passported benefits as income rises should not come as a shock.

### **3 Specific comments on the proposals**

#### **3.1 Use of an annual earnings threshold**

- 3.1.1 Page 8 of the consultation document states ‘Our suggested net earnings threshold is £15,400 per annum’. However, the glossary of terms on Page 12 says:

**‘Earnings threshold for households receiving universal credit**

A maximum monthly net earned income level for households in receipt of Universal Credit that qualifies an individual or a family to receive additional support.’

- 3.1.2 UC is a monthly assessed benefit and therefore it is not easily compatible with a true annual threshold. It seems that the intention is to either have a monthly threshold against which the UC monthly income is compared or the UC monthly income is being used as a ‘proxy’ for the annual income and multiplied by 12 to give an annual figure which is then compared to the annual threshold.
- 3.1.3 It is important that this distinction is considered further, not least from a communication perspective. For example, consider a family who are outside of the UC system and have earnings of £18,000 from April to August and then the main wage earner loses their job and they claim UC in September. If there was a true annual threshold – this family would not qualify because their actual annual earnings are above £15,400 – whereas we think what is actually intended is that their earnings in September will be used a proxy for annual earnings and compared to the threshold. The position is far from clear.

*The amount of the threshold*

- 3.1.4 The proposed threshold of £15,400 is higher than the threshold proposed for free school meals which, according to the consultation document, is intentional in order to widen entitlement compared to free school meals. Setting the threshold at this amount will mean around 8,000 more children would take up entitlement by the time UC is full rolled out, compared to the number receiving entitlement at present. We welcome the fact that more children will benefit from the free offer.
- 3.1.5 The consultation document introduces an earnings threshold and on Page 13 it is made clear that this only considers income from employment and self-employment – in other words unearned income is excluded.

- 3.1.6 This means that a family with a significant proportion of their income coming from unearned income could have a much higher income than a family with the majority of their income from earnings yet the former may qualify for free early years education whereas the latter may not. This is due simply to the source of their income.

*Definition issues*

- 3.1.7 Page 13 of the consultation document states that 'net earned income' means:

*'Earnings from employment or self-employment after deductions. The three common deductions are income tax, national insurance and pension contributions'*

- 3.1.8 It is helpful that this definition confirms that pension contributions are taken into account when calculating net income. This was not covered in the consultation on free school meals.
- 3.1.9 There are other definition issues that need consideration. The UC definition of earned income includes a tax refund in some circumstances. It would seem unfair if a tax refund in a particular month could block entitlement to free early years education given that parents have no control in some cases over when they receive the refund.
- 3.1.10 Self-employed UC claimants may be affected by the MIF. After the first 12 months of trading, if they are in the all-work requirements group, their UC will be calculated using either their actual income or if that is lower than their MIF amount, the MIF figure will be used in place of their actual income.
- 3.1.11 The MIF is very harsh for self-employed claimants who have fluctuating income and expenditure patterns and it does not take account of pension contributions (whereas employed UC claimants have their award calculated after the deduction of all pension contributions).
- 3.1.12 There is no detail in the consultation document about whether it will be the self-employed UC claimant's actual income that will be assessed against the new earnings threshold or whether it will be the MIF amount. Given the level of the proposed threshold, this is likely to be an issue for any couples where both are self-employed with low earnings.
- 3.1.13 In addition, from April 2018, new surplus earnings and loss rules will be introduced into UC that could add further distortions to income figures used to calculate UC awards and therefore will have a knock-on effect onto entitlement to passported benefits.