Low Incomes Tax Reform Group
A voice for the unrepresented

Inquiry into the impact of welfare policy in Scotland
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to respond to the inquiry examining the impact of UK welfare policies in Scotland, launched by the Scottish Affairs Committee.

1.2 Although Universal Credit is reserved to the UK Parliament, inevitably there are interactions between Universal Credit and the income tax system, which is partly devolved to the Scottish Parliament. We think there may be risks specific to Scotland if Universal Credit policy is made without giving consideration to the differences between the income tax systems in Scotland and the rest of the UK.

1.3 Due to devolution, Scottish claimants of Universal Credit may be confused about which government department to contact in relation to their social security benefits. Although Universal Credit is not devolved and continues to be administered by the Department for Work and Pensions (DWP), this does not mean that claimants may not mistakenly contact Social Security Scotland, or indeed the Scottish Government, if they have a query. It is essential that all government organisations that might be contacted by claimants have procedures in place to ensure that a claimant is passed to the appropriate contact in the correct organisation.

1.4 We understand that there are a number of arrangements in place to try to ensure effective co-operation between the UK and Scottish Governments on the devolution of welfare powers to Scotland, including the Joint Ministerial Working Group on Welfare. In addition, the memorandum of understanding on social security and employment services in Scotland requires the appointment of single points of contact by the Scottish Government and DWP.

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Our experience from the development of the Carer's Allowance Supplement and the need for legislative changes at the UK level was that once the Scottish Government were aware of the necessary changes and had made the relevant parties in the UK administration aware, these amendments were made, and that this was a relatively trouble-free process.

1.5 We note that the Scottish Government and DWP have put in place agency agreements and service level agreements. These are helpful in managing challenges, as it means there are frameworks for DWP and Scottish Government to refer to when interacting with one another. All these documents need to be published on GOV.UK and the Scottish Government's website, with proper links to ensure that they can be found easily by stakeholders.

1.6 Ideally, a welfare system would be designed holistically, to ensure that there are no gaps, and in addition, it would take account of the income tax system (as the income tax system would take account of the welfare system). With both the welfare and tax systems being partially devolved and partially reserved in Scotland, there is the risk of significant complexity. This may mean that where there is a choice of benefits, a Scottish claimant cannot easily determine which benefit (or group of benefits) is most likely to be suitable for their circumstances.

1.7 Complexity may arise as a result of the need to honour the fiscal framework. This may mean that benefits require 'special' treatment, or treatment that diverges from that in the rest of the UK. So, for example, a Scottish tax credit claimant in receipt of Carer's Allowance and Carer's Allowance Supplement must include their Carer's Allowance as income, but not their Carer's Allowance Supplement.

2 About Us

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

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

3.1 We welcome the opportunity to respond to the inquiry examining the impact of UK welfare policies in Scotland, launched by the Scottish Affairs Committee. We have only responded to those questions where we believe we can add value, as we do not have the first-hand evidence and experience that would enable us to comment in respect of some of the questions.

3.2 In 2018, we responded to an inquiry into social security and in-work poverty published by the Social Security Committee of the Scottish Parliament. Our response, which is available on our website, may be of interest to the Scottish Affairs Committee.[1]

4 Are there issues with Universal Credit that are specific to Scotland compared to the rest of the UK?

4.1 Although Universal Credit is reserved to the UK Parliament, inevitably there are interactions between Universal Credit and the income tax system, which is partly devolved to the Scottish Parliament. We think there may be risks specific to Scotland if Universal Credit policy is made without giving consideration to the differences between the income tax systems in Scotland and the rest of the UK.[2]

4.2 The Scottish Parliament has the power to set rates and bands for income tax on the non-savings and non-dividend income of Scottish taxpayers.[3] For those Universal Credit claimants in Scotland who currently pay income tax, any increase in take-home income arising from a decrease in their tax liability, whether because of an increase in the personal allowance (set by the UK Parliament), or a change to the rates and bands in Scotland (set by the Scottish Parliament),[4] will not be as great as that seen by taxpayers who either do not claim any welfare benefits at all, or who claim tax credits.[5] This is because the basic position for

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[1] https://www.litrg.org.uk/latest-news/submissions/180817-social-security-committee-scottish-parliament-%E2%80%93-inquiry-social

[2] Although Wales has control of rates of income tax for non-savings non-dividend income of Welsh taxpayers with effect from 6 April 2019, currently there are no changes in overall income tax rates for Welsh taxpayers.

[3] Non-savings and non-dividend income consists of employment income, self-employment profits, pension income and rental profits.

[4] There are currently (tax year 2019/20) five bands of income tax for the non-savings and non-dividend income of Scottish taxpayers. The lowest rate is 19% on the first £2,049 of income above the personal allowance (£12,500 in 2019/20).

[5] The issue does not arise for tax credits as these depend on gross income – so the issue for Universal Credit is a new one in respect of an in-work benefit.

Universal Credit is that entitlement depends on net earned income, that is, after tax income. A decrease in tax liability results in an increase in net earned income, and a subsequent reduction in entitlement to Universal Credit. The current taper rate applicable to earned income is 63%, meaning a Universal Credit claimant only sees 37% of any change to their net earned income.[6]

4.3 As an aside, it should be noted that the rules for passported benefits available to Universal Credit claimants are not the same in Scotland as those in the UK. Moreover the guidance on passported benefits is poorly organised and requires consolidation, so as to be of more practical assistance to claimants.[7]

4.4 Due to devolution, Scottish claimants of Universal Credit may also be confused about which government department to contact in relation to their social security benefits. Although Universal Credit is not devolved and continues to be administered by DWP, this does not mean that claimants may not mistakenly contact Social Security Scotland, or indeed the Scottish Government, if they have a query. We are aware, from meetings with Revenue Scotland and the Scottish Government, that Scottish taxpayers have contacted them about Scottish income tax, even though this is administered by HMRC. It is essential that all government organisations that might be contacted by claimants have procedures in place to ensure that a claimant is passed to the appropriate contact in the correct organisation. Often claimants are vulnerable, and it is not enough for an organisation to simply indicate that they are unable to assist because the claimant has contacted the wrong organisation.[8]

4.5 As an organisation, our focus in relation to Universal Credit has been the effect on those in self-employment.[9] According to the Office of National Statistics, 10.8% of the labour force in Scotland was self-employed in 2016. This is at the lower end of the spectrum for the UK's regions.[10] It is also possible to look at the split of the workforce (employed and self-

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[6] Unearned income, such as pensions, is taken into account on a gross basis and therefore reduces the entitlement to Universal Credit £ for £, that is, a taper rate of 100%.

[7] Paragraphs 6.3 ff. of our response to the Social Security Committee of the Scottish Parliament: https://www.litrg.org.uk/sites/default/files/180817-LITRG-response-SSC-inwork-poverty-FINAL.pdf

[8] There is comparable evidence in relation to the transition from tax credits to Universal Credit, as referred to in the Adjudicator's annual report for 2019. Page 11 ff., *Annual Report 2019* – Adjudicator's Office (June 2019): http://www.adjudicatorsoffice.gov.uk/pdf/AO.pdf

[9] *Self-employed claimants of universal credit – lifting the burdens* – Low Incomes Tax Reform Group (October 2017): https://www.litrg.org.uk/latest-news/reports/171030-self-employed-claimants-universal-credit-%E2%80%93-lifting-burdens

[10] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/trendsinselfemploymentintheuk/2018-02-07

employed) by type of industry.[11] This analysis suggests that, when compared with the UK workforce as a whole, there is a higher proportion of the Scottish workforce engaged in industries where the work is more likely to be seasonal or subject to irregular income flows, such as 'agriculture, forestry and fishing' (1.5% in Scotland compared to 1.0% in the whole of the UK) and 'accommodation and food service activities' (7.5% compared to 6.8%). Scottish claimants of Universal Credit may therefore be more likely to be affected by some of the issues raised in our 2017 report, particularly in relation to measurement of income and the Minimum Income Floor.

4.6 We also note that there are currently a number of issues arising for Universal Credit claimants in relation to the interaction between Universal Credit and Real Time Information (RTI). In particular, problems arise when employed claimants receive two salary payments in one Universal Credit assessment period,[12] or when there is a clash of assessment periods and pay frequencies.[13] These situations mean that the Universal Credit award is affected.[14] These problems are not specific to Scotland, but it is important that they are taken into account and not exacerbated by diverging policies, and that when a solution is devised, it works in Scotland as well as in the rest of the UK.

5 How effective has cooperation been between the UK and Scottish Governments on the devolution of new welfare powers to Scotland?

5.1 We understand that there are a number of arrangements in place to try to ensure effective co-operation between the UK and Scottish Governments on the devolution of welfare powers to Scotland. These include the Joint Ministerial Working Group on Welfare, whose minutes are published on GOV.UK. This group does not seem to meet according to a strict timetable, but it facilitates discussion at the top level of government.[15]

5.2 The memorandum of understanding on social security and employment services in Scotland requires the appointment of single points of contact by the Scottish Government and DWP. Those appointed to these roles are responsible not only for day-to-day management, but

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[11] https://www.nomisweb.co.uk/reports/lmp/gor/2013265931/report.aspx

[12] This has arisen when a regular payment date has fallen on a non-banking day and has therefore been paid early, meaning that two separate monthly wages are treated as earnings in the same assessment period.

[13] This may arise when a claimant is paid on a weekly, two-weekly or four-weekly basis.

[14] See https://www.litrg.org.uk/latest-news/news/190710-uc-two-payments-one-assessment-period-problem-–-what-next and http://www.cpag.org.uk/content/universal-credit-assessment-period-inflexibility

[15] https://www.gov.uk/government/publications/minutes-of-the-joint-ministerial-working-group-on-welfare-12th-meeting

must also act as the first point of escalation and dispute resolution, and ensure that all information requests are dealt with in accordance with the memorandum.[16]

5.3 We would refer you to the report published by the Scottish Parliament's Information Centre in respect of some of the difficulties that have been encountered.[17]

5.4 One of our interests in the devolution of new welfare powers to Scotland related to the Carer's Allowance Supplement, which is a transitional benefit that provides a top-up to the reserved welfare benefit Carer's Allowance until the Scottish Government has put in place its own Carer's Assistance. The Scottish Government will be able to determine whether or not Carer's Assistance is taxable or not, but because Carer's Allowance Supplement tops up an existing benefit, it has to follow that benefit's tax treatment. So, because Carer's Allowance is taxable, Carer's Allowance Supplement also has to be taxable. However, to follow the provisions of the fiscal framework, it is important that receipt of Carer's Allowance Supplement does not mean a recipient's entitlement or award in respect of other benefits is affected.

5.5 We assisted the Scottish Government in identifying the required legislative amendments to ensure that Carer's Allowance Supplement would not be taken into account as income for determining tax credits as well as other benefits. Our experience was that once Scottish Government were aware of the necessary changes and had made the relevant parties in the UK administration aware, these amendments were made, and that this was a relatively trouble-free process.[18] This has similarly been the case for consequential amendments required in respect of Scottish income tax.

6 What challenges are posed by the DWP administrating benefits on behalf of the Scottish Government? How can these challenges best be managed?

6.1 We note that the Scottish Government and DWP have put in place agency agreements and service level agreements, for example in respect of Carer's Allowance and Carer's Allowance

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[16] https://www.gov.uk/government/publications/memorandum-of-understanding-social-security-and-employment-support-services-in-scotland

[17] Page 19 ff. *Devolved social security powers: progress and plans* (SB 19-27) - Scottish Parliament Information Centre (10 May 2019): https://digitalpublications.parliament.scot/ResearchBriefings/Report/2019/5/10/Devolved-social-security-powers--progress-and-plans

[18] http://www.legislation.gov.uk/uksi/2018/365/contents/made and http://www.legislation.gov.uk/uksi/2018/872/contents/made

Supplement, and Fair Start Scotland.[19] In addition there is a memorandum of understanding on social security and employment services in Scotland. These are helpful in managing challenges, as it means there are frameworks for DWP and Scottish Government to refer to when interacting with one another.

6.2 These agreements are often published on GOV.UK, although we note that those in relation to Carer's Allowance do not show up under links from the Scottish Government.[20] All these documents need to be linked properly to both the Scottish Government and DWP to ensure that they can be found easily by stakeholders. We understand that agency agreements are also in place for healthy start vouchers and other devolved social security powers, but these are not available on GOV.UK. We think that it is important for transparency that all the agency agreements and service level agreements are published on GOV.UK and the Scottish Government's website.[21]

6.3 In terms of keeping track of costs, it is helpful that DWP have now agreed a memorandum of understanding with the Scottish Fiscal Commission, which has responsibility for producing independent forecasts of and evaluating the Scottish Government's devolved social security expenditure.[22]

7 What impact could diverging welfare policies in Scotland and the rest of the UK have on welfare claimants in Scotland?

7.1 While we recognise that one of the reasons for devolution is to allow for diverging policies, which may better suit the needs of a local population, significant divergence could create problems for welfare claimants in Scotland. Ideally, a welfare system should be designed holistically, to ensure that there are no gaps, and in addition, it should take account of the income tax system (as the income tax system should take account of the welfare system). It should be noted however, that, because the criteria for being a Scottish taxpayer differ from those for being resident in Scotland for welfare benefits purposes, there will be some individuals who are Scottish taxpayers but fall entirely within the reserved UK welfare

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[19] https://www.gov.uk/government/publications/carers-allowance-in-scotland-agency-agreement-and-service-level-agreement and https://www.gov.uk/government/publications/finding-a-job-and-starting-work-in-scotland-fair-start-scotland-service-level-agreement

[20] Items published on GOV.UK indicate which government organisations they arise 'from'. If they are linked correctly to an organisation, they should be accessible from that organisation's homepage on GOV.UK. This is not the case for the Carer's Allowance agreements referred to.

[21] We have been able to locate the agreement in relation to Fair Start Scotland on the Scottish Government website (https://www.gov.scot/), but none of the other agreements.

[22] https://www.gov.uk/government/publications/memorandum-of-understanding-between-the-scottish-fiscal-commission-and-dwp

benefit system and also some who fall within the Scottish system for welfare benefits while remaining UK taxpayers.

7.2 With both the welfare and tax systems being partially devolved and partially reserved in Scotland, there is the risk of significant complexity. This may mean that where there is a choice of benefits, a Scottish claimant cannot easily determine which benefit (or group of benefits) is most likely to be suitable for their circumstances. There is currently a comparable situation (though not Scotland-specific) in relation to childcare choices. These include employer-supported childcare, tax credits childcare support, Universal Credit childcare support, free childcare places, other childcare support and tax-free childcare. As we point out in our website guidance, in some cases it is possible to use a combination of the schemes, but in others, only one scheme can be used. The best option can depend not only on current circumstances, but known future changes, and applying for help through one scheme can sometimes mean that help through another scheme automatically stops.[23]

7.3 In addition, benefits may require 'special' treatment in order to honour the fiscal framework. This may mean that claimants face unexpected rules when, for example, declaring income to determine eligibility. This has already occurred with the Carer's Allowance Supplement. This is a taxable benefit, and as such, one might normally expect it to count as income for determining eligibility for tax credits. Due to the fiscal framework, it has been necessary to ensure that this is not the case. So, a tax credit claimant in receipt of Carer's Allowance and Carer's Allowance Supplement must include their Carer's Allowance as income, but not their Carer's Allowance Supplement.

7.4 As noted above, one of the difficulties faced by welfare claimants in Scotland is that there are more agencies dealing with welfare benefits – currently, HMRC (tax credits and child benefits), DWP (most benefits including Universal Credit), Social Security Scotland (Carer's Allowance Supplement for example) and local councils (Council Tax Reduction, for example). This can create confusion as to which organisation a claimant should contact;[24] this is exacerbated when policy decisions are made in Scotland, but the benefit is delivered by DWP. There is also a danger in relation to the transition from tax credits to Universal Credit that claimants will fall between the cracks if handover does not occur correctly between HMRC and DWP.

7.5 One option for minimising or alleviating confusion, and for ensuring people do not fall between departments, could be to set up one-stop shops in principal locations around Scotland. These could be staffed jointly by Social Security Scotland, DWP, HMRC and local authority staff. Not only would this mean claimants could access staff with the appropriate

[23] https://www.litrg.org.uk/tax-guides/childcare

[24] This situation is likely to be exacerbated in the case of an individual who is resident in Scotland for tax purposes but not for welfare benefits or vice versa, as discussed in paragraph 7.1.

experience and knowledge, it would provide the staff with the opportunity to learn from one another.

7.6 As welfare policies diverge, there may well be basic principles that apply across both UK and Scottish systems or that are common to both the welfare system and the tax regime, for example how income is calculated, timing of applications or reporting changes. Where variance in the policies allows, it would reduce the complexity for claimants if common basic principles could be adopted.

LITRG

30 July 2019