Interact:

benefits, tax credits and moving into work

community links 30 years

LOW INCOMES TAX REFORM GROUP

THE CHARTERED INSTITUTE OF TAXATION

CHILD POVERTY ACTION GROUP

Research report • December 2007

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About the partner organisations

Community Links

Community Links is an innovative charity running community-based projects in east London. Founded in 1977, we now help over 53,000 vulnerable children, young people and adults every year, with most of our work delivered in Newham, one of the poorest boroughs in Europe.

Community Links pioneers new ideas and new ways of working locally and shares the learning nationally through **linksUK**, which provides practitioner-led consultancy and training, research and policy development, and a programme of publications.

For further information about Community Links and linksUK, see www.community-links.org or contact: uk@community-links.org

Low Incomes Tax Reform Group (LITRG)

The LITRG was set up in spring 1998 by the Chartered Institute of Taxation to give a voice to the unrepresented in the tax system. It aims to help those on low incomes cope with the tax system, by challenging the Government to simplify the rules and by encouraging Her Majesty's Revenue and Customs to make its processes and services friendlier to the needs of people on low incomes. Its reports and recommendations are available at www.litrg.org.uk, along with practical help for those on low incomes.

Child Poverty Action Group (CPAG)

CPAG promotes action for the prevention and relief of poverty among children and families with children. To achieve this, CPAG aims to raise awareness of the causes, extent, nature and impact of poverty, and strategies for its eradication and prevention; bring about positive policy changes for families with children in poverty; and enable those eligible for income maintenance to have access to their full entitlement. If you are not already supporting us, please consider making a donation, or ask for details of our membership schemes and publications.

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sied

Further information on the SIED partnership can be found at:
http://sied.acbba.org.uk

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Executive summary

The Government's twin goals of eradicating child poverty and achieving full employment go hand in hand. A series of fiscal policies, most notably tax credits, have been introduced in recent years to support the achievement of these goals. These measures have enjoyed some success, helping bring about an increase in the employment rate to 74.4 per cent (ONS, 2007) and lifting 600,000 children out of poverty since 1999 (DWP, 2007a).

Child tax credit (CTC), introduced in 2003, is paid to a child's main carer and helps meet the costs of raising children. CTC exemplifies New Labour's concept of 'progressive universalism', paying most to those on the lowest incomes, so that families with incomes of up to £70,000 a year may be eligible for the family element. Working tax credit (WTC), payable to those in low-paid employment, with or without children, is intended to supplement low wages to 'make work pay'.

Despite the Government's achievements in reducing child poverty and increasing employment, especially lone parent employment, on current rates of progress, neither the child poverty target nor the lone parent employment target look likely to be met. The adequacy of the level of benefits and tax credits and the availability of the support needed to move those most disadvantaged in the labour market into work and to dismantle the barriers that obstruct their progress are areas of criticism. Alongside these, considerable attention continues to be focused on structural deficiencies in the design of the fiscal measures intended to end child poverty and make work pay. The rate at which benefits are withdrawn when claimants move into or increase their hours of work, the loss of passported benefits, and the complexity of the system have been highlighted as inhibiting the progress the Government desires.

This report by Community Links, Low Incomes Tax Reform Group and Child Poverty Action Group follows a technical and qualitative study of the tax, tax credit and social security systems and barriers to employment. It has improved our understanding of the way both fiscal and non-fiscal barriers interact together to impact on government policies regarding child poverty and making work pay. Our research included interviews with a number of individuals in receipt of tax credits and social security benefits in, out of and contemplating work.

The claimants' experiences show the following.

- Social security benefits and tax credits are intrinsically complex and complex in their interactions with each other.
- This double layer of complexity leads to confusion among claimants about their entitlements and the impact of changes on their personal circumstances.
- Tax credit claimants can be affected negatively when the granting of one benefit leads to the withdrawal or curtailment of another, making them worse off.
- The advent of tax credits has introduced a system of financial support that is constantly changing as claimants' circumstances alter. This makes it hard for people to make informed decisions about moving into paid employment or increasing their hours of work.
- The quality of delivery of benefits and, in particular, tax credits is patchy.

There is appreciation of the extra financial help offered by tax credits and in-work benefits, but little understanding of the way the system works. Individuals face a range of interactions with the benefit, tax and tax credit systems as they move into, out of or towards paid work. These interactions coincide with a range of structural and individual barriers and circumstances, which mean that consequences are not always predictable or in line with policy intent. The system is experienced by individuals as complex, and work disincentives can result. Individuals often expressed a sense that remaining on benefits would in reality mean they would be better off (though this did not always mean that individuals chose not to work).

There is, moreover, a lack of overall strategic ownership of the systems of delivery to support achievement of the policy goals. Processes are not designed from a customer-focused perspective, and there is no central oversight or responsibility to identify and eliminate inconsistencies and contradictions, or remove work disincentives which arise from cross-system interactions and rules.

From our study we conclude that while the Government has taken significant steps to reduce child poverty and make work pay, there is still much to be done to achieve its stated targets. The recommendations we make suggest improvements that will be vital if the Government's twin objectives of ending child poverty and achieving full employment are to be met.

Our recommendations are as follows.

Strategy and governance

- The Government should clarify its objectives for the tax, tax credit and benefit systems. These should be clearly designed to achieve the goal of eradicating child poverty and support the ambition of securing full employment.

- A coherent and holistic strategy is needed across government to bring about those objectives. That strategy must be supported by a set of outcome targets, and/or incorporated into appropriate public service agreements in the next comprehensive spending review, which should be 'proofed' against these aims.

- One government department should be given the overall responsibility for these aims and should be measured by reference to the achievement of them. That department should be responsible for the ownership of the 'total customer experience'.

- Any proposed change to a benefit, tax credit or tax rule should be checked or 'proofed' for possible interactions with other existing systems, which might detract from the delivery of its policy objective. The expertise of the Social Security Advisory Committee should be harnessed to provide such an overview.

- Policy and practice must be aligned in each of the systems to secure achievement of the child poverty and full employment goals. Benefits and tax credits must be set at a level that lifts families out of poverty in and out of work. Financial disincentives to taking or increasing hours of paid work should be eliminated.

- The tax, tax credit and benefit systems should be designed from the perspective of the experience of the individual claimant and in the light of lessons learned from the Wallsend pilot.

- Systems should be designed around individuals' life events, not around technology or departmental needs.

- A 'sounding board' or 'claimant advisory panel' should be set up to facilitate design and delivery.

- The Work and Pensions and Treasury select committees should jointly oversee the activities of the relevant government departments, holding joint inquiries from the perspective of the overarching policy goals.

- The National Audit Office should consider conducting an inquiry into 'value for money' of the interactions as presented in this report.

Systems and processes

- Better education and information are needed to ensure greater understanding of entitlements. These include localised take-up campaigns and improved explanations of awards and recoveries.

- Staff training and awareness of the fiscal instruments managed by other departments must be improved.

- Better-off calculations must take full account of the loss of passported benefits and the wider costs of moving into/increasing hours of work, including tax and national insurance contributions.

- The system should be smoothed so that different payment and award periods (eg, weekly, four-weekly, annually) are aligned to claimants' needs.

- Passported entitlements (eg, to free school meals and subsidised health costs) should be extended on a universal basis to reduce the disincentives that loss of passported benefits create.

- A review of the tax and benefit systems (including tax and national insurance rates and allowances, and taper rates and disregards for benefits and tax credits) should be undertaken. This should aim to reduce or eliminate the financial disincentives from taking or increasing hours of paid work and ensure the systems complement each other in their mutual interactions.

- Adequate access to independent advice, including more face-to-face advice, should be available to claimants, to take account of the complexity of the system and the variety of individual needs.

Introduction

The twin goals of ending child poverty and increasing employment lie at the heart of New Labour's social policy: work is seen as the route out of poverty for most families, and efforts to achieve ministers' aspirations for full employment – expressed as an 80 per cent employment rate (DWP, 2005) – have concentrated on increasing parental employment, and particularly lone parent employment.

Making work pay and the provision of a seamless system of financial support for families with children, whether parents are in or out of work, are fundamental to achieving the strategy. The predominant policy instrument that has been used to do so are the new tax credits, introduced in 2003 and replacing their predecessors, working families' tax credit and disabled person's tax credit, introduced in October 1999. Child tax credit, received by the majority of families with children and made up of family and child elements, is paid to the main carer of a child to help meet the costs of raising children, and continues to be paid as parents move in and out of work. It exemplifies New Labour's concept of 'progressive universalism', paying most to those on the lowest incomes, but with reduced levels of payments stretching far up the income scale, so that families with incomes of up to £70,000 a year may be eligible for the family element (some £545 per year). Working tax credit, payable to those in low-paid employment, with or without children, is intended to supplement low wages to 'make work pay'.

There is no doubt that the strategy has enjoyed some success. The number of children living in poverty has fallen by 600,000 since 1999 (DWP, 2007a). The employment rate for people of working age is 74.4 per cent (ONS, 2007) and lone parent employment, for which the Government set itself a target of 70 per cent by 2010, has increased substantially from 44 per cent in 1997 to 56 per cent today (DWP, 2007c).

But significant criticisms have been made of the implementation of the policies intended to achieve the strategy and on current rates of progress, neither the lone parent employment target nor the child poverty target look likely to be met. Both the adequacy of the level of benefits and tax credits and the availability of the support needed to move those most disadvantaged in the labour market into work and to dismantle the barriers which obstruct their progress are areas of criticism. Alongside these, considerable attention continues to be focused on structural deficiencies in the design of the fiscal measures intended to end child poverty and make work pay. The following factors have all been highlighted as inhibiting the progress the Government desires.

- The rate at which benefits are withdrawn as recipients move into or increase their hours of work.
- The cliff edges that recipients face when transitional payments are removed.
- The loss of passported benefits when claimants' income rises.
- The complexity of the systems claimants need to navigate.

In undertaking this research project, Community Links, Low Incomes Tax Reform Group and Child Poverty Action Group wanted to gain a better understanding of the way both fiscal and non-fiscal barriers affect the achievement of the Government's ambitions, and to do so by learning more about the attitudes and experience of individuals at whom the policies are aimed. In thinking about the barriers, we quickly became aware that the vast variety of individual circumstances, and the multiplicity of relationships with state and other actors faced by those on low incomes, would affect individuals' experiences and outcomes.

'Status' factors, such as whether a recipient:

- is a lone parent or in a couple,
- is a disabled adult,
- has a disabled child, or
- cares for another family member,

intersect with issues of:

- the availability of suitable employment,
- the social networks individuals are a part of and the environment they inhabit,
- individual attitudes and values, and
- the intricacies of the administration of the tax credits and benefits systems.

These all gave rise to a range of outcomes that were not always predictable or in line with policy intent.

Our analysis has, therefore, sought to understand the impact of this complexity on individuals in the light of the Government's anti-poverty and full employment goals. We have noted the way in which individuals' circumstances, aspirations and experiences result in a range of responses from the social security and tax credit systems, and also what results from these responses and from different forms of family and employment support. We observed the impact this complexity has on individuals' attitudes and aspirations, and on the way in which the design and delivery of the system reflects and reinforces the complexity rather than reduces or minimises its effect. Reflecting the overlapping and multiple factors we encountered, and the range of responses and interventions experienced by individuals, we named the project 'Interact'.

Structure of this report

The first part of this report outlines the main features of in-work and out-of-work financial support for families and the relevant fiscal instruments that impact on recipients of social security benefits and tax credits as they move towards, into and out of employment. We provide a brief description of the key features of the social security, tax and tax credit systems, covering in outline:

- social security benefits: income support, jobseeker's allowance, housing benefit and council tax benefit;
- child tax credit and working tax credit;
- tax and national insurance, including PAYE.

In the second part of the report we bring together the learning from what we have called the 'technical phase' of the project with the experiences of tax credit and benefit recipients, gained from interviews.

The technical phase of the work (details of which are provided in full in the Appendices) draws on the longstanding experience of the three partner organisations in the provision of social security benefits and tax credits advice, and our knowledge of likely problem areas. In this phase, we modelled the financial implications for individuals of a number of scenarios as individual circumstances change, centring on income support, jobseeker's allowance, carer's allowance, and the tax and tax credit systems. These interactions were considered in the light of whether tax credit and social security policy and design supports the goal of ensuring that work offers a route out of poverty for most families.

In parallel with the technical phase, we interviewed tax credit and benefit recipients, and identified and analysed the links between the interview findings and the technical study. Interviews were conducted to get a snapshot of people's experiences of the tax credit and benefit systems, how the systems contributed to their financial situation, and whether or not people perceived that fiscal measures make work pay. In this section we include the analysis of the interviews and examine:

- the financial contribution of the tax credits system to individual and/or family income, and the importance people attach to this;
- the interaction with non-financial factors, such as childcare, type of employment, housing arrangements and educational attainment;
- the impact on aspirations, attitudes, behaviour and choices.

Finally, we draw together some conclusions and recommendations for policy change, and for further research.

The benefit, tax credit and tax systems: a brief outline

Benefits and tax credits

Administration

The government department responsible for the overall administration of and policy in relation to most social security benefits is the Department for Work and Pensions (DWP). Housing benefit (HB), and council tax benefit (CTB) are administered by local authorities. Tax credits, child benefit and guardian's allowance are dealt with by Her Majesty's Revenue and Customs (HMRC).

An executive agency of the DWP, Jobcentre Plus, administers most social security benefits, including the social fund, for people under 60. The Pensions Service delivers benefits and pensions and the Disability and Carers Service is responsible for disability benefits and carer's allowance. The Child Support Agency (to be replaced in July 2008 by the new Child Maintenance and Enforcement Commission) administers the child support system. An executive agency of the Ministry of Justice, the Tribunals Service, is responsible for administering benefits and tax credits appeals.

Main types of benefit and tax credit

Some working-age benefits are paid only if a person has limited income and capital – these are known as means-tested benefits. Currently these are income support (IS), income-based jobseeker's allowance (JSA), HB, CTB, child tax credit (CTC) and working tax credit (WTC).

Some means-tested benefits are restricted to those not in full-time employment, but some, such as HB and CTB, are available for people both in and out of work.

Some benefits, known as passported benefits (eg, free school meals and social fund payments) are payable if a person qualifies for particular means-tested benefits or tax credits. Some passported benefits are administered by different government departments and access depends on information given to these by the DWP and HMRC.

Some benefits are discretionary, even if the means test is satisfied.

Non-means-tested benefits, by contrast, do not involve a detailed investigation of means. A person qualifies if certain basic conditions are satisfied, such as being available for work, disabled or bereaved. JSA is both a means-tested and a non-means-tested benefit: income-based JSA is means-tested, whereas contribution-based JSA is based on the amount of national insurance contributions paid.

Some benefits are earnings-replacement benefits; they compensate a person for her/his inability to work (eg, because of sickness, unemployment or pregnancy). These include carer's allowance, maternity allowance and contribution-based JSA. Others exist to meet particular needs (eg, a disability or having children) irrespective of a person's ability to work. These include child benefit and disability living allowance.

Tax credits

Tax credits are means-tested payments.

WTC is paid to people in work, irrespective of whether they have children. CTC is paid to people with responsibility for a child(ren), irrespective of whether they are in work.

The main qualification for WTC is that a person must be in qualifying remunerative work. That is, s/he must satisfy four conditions.

- S/he must be working on the date of the claim, or have accepted an offer of work that is expected to begin within seven days of making the claim.

- S/he must fulfil certain age qualifications and be working for a minimum number of hours a week.

- The work must be expected to continue for at least four weeks.

- The work must be done 'for payment or in expectation of payment'.

The minimum age requirement for a person who has responsibility for a child or who is disabled is 16; otherwise it is 25. If a claimant has responsibility for a child, is disabled, or is over 50 years of age and returning to the job market after at least six months on benefits s/he must work at least 16 hours a week; otherwise s/he must work at least 30 hours a week.

WTC also contains a childcare element, payable to couples both of whom are in work, or to lone parents in work, who use registered or approved childcare for children under the age of 15 (or 16 if the child is disabled).

To qualify for CTC it is necessary to have 'responsibility for' a child(ren) or a young person between the ages of 16 and 20 if s/he is still in full-time education.

Both WTC and CTC are divided into components, or 'elements', which are payable in particular circumstances. For example, there is a disability element of WTC paid to workers with a disability that inhibits their ability to get a job. Other elements of WTC are payable to couples, lone parents, people who work 30 or more hours a week, the over-50s returning to work after a period on benefits, and to workers with a disability. In CTC, there is an element for each individual child in the household, with increments for children with a disability, higher still for children with a severe disability. The 'bedrock' element of CTC, the family element, is £545 a year, paid in whole or in part to nearly every claimant.

Entitlement is initially assessed on the basis of the previous tax year's income and current circumstances. At the end of the award period, the claimant's entitlement is ascertained by comparing income in the current tax year with that in the previous tax year. If the current year's income is lower than the previous year's, entitlement is based on the lower, current year's, figure, and more credit will be due. If the current year's income is higher by no more than £25,000, the award is unchanged. But if it has gone up by more than £25,000 above the previous year's income, entitlement is based on the current year's income less £25,000, and an overpayment will have arisen. An overpayment may also arise where circumstances have changed during the award period, the rate of tax credit payable has changed with them, and either the claimant did not inform HMRC swiftly enough, or HMRC delayed processing the change. It is also possible for overpayments to result from an official error, such as a computer malfunction, or a claimant being given wrong advice.

Because entitlement is sensitive to changes in circumstances, there are a number of such changes that claimants are obliged to report to HMRC within one month.

Tax credits are by their nature unpredictable. For this reason, it is not known what a claimant's entitlement for a given tax year will be until that tax year is finished.

Tax credit overpayments and their recovery

There are two ways in which HMRC recovers tax credit overpayments: by deduction from an ongoing award, or by direct collection from the claimant or former claimant.

The first method, deduction from an ongoing award, is used when tax credits are still in payment and the award is to the same claimant or claimants. The deduction from the award is at a percentage rate, which varies depending on the means of the claimant.

- Those on IS, incapacity benefit, JSA or a very low income face a deduction of no more than 10 per cent of their ongoing payment.

- That percentage rises to 25 per cent for those whose tax credits are less than the maximum award, but more than the family element of CTC only.

- People in receipt of only the family element have no restrictions placed on the amount by which their payments can be reduced to recover an overpayment.

The second method of recovery, direct collection, is used when tax credits are no longer in payment or they are being paid to a different claimant or claimants. For example, following household breakdown, an overpayment accruing on a previous joint claim will be collected directly from either or both of the former partners. It cannot be collected by deduction from a new tax credit award paid to either of them.

Income tax and national insurance contributions

Income tax is payable each tax year by individuals on their income from most sources over and above their personal allowance. The basic personal allowance applicable in the tax year 2007/08 to most taxpayers under the age of 65 is £5,225, which equates to about 20 hours work each week at the national minimum wage. Therefore, the majority of full-time workers on low incomes pay income tax.

Tax allowances are low in comparison with, say, the 1960s because for all of the 1970s, and for part of the 1980s, they did not keep pace with rising levels of inflation. That was changed by what became known as the Rooker-Wise Amendment, taking effect in 1982. That law provided for tax allowances to be automatically uprated annually in line with inflation, unless Parliament decided otherwise. The occasions when Parliament has decided otherwise since 1982 are infrequent, so by and large tax allowances have risen with inflation since then. But that has not altered the mismatch between allowances and inflation that built up in the previous decade, so that income tax continues to be payable by those on quite low incomes, in contrast to earlier in the last century.

Tax is payable in 2007/08 at a starting rate of 10 per cent on the first £2,230 of taxable income. Thereafter, the basic rate of 22 per cent applies. For example, a person with £8,000 income can expect to pay tax of £342 – that is, nil on the personal allowance of £5,225; 10 per cent on the next £2,230; and 22 per cent on the remaining £545. The higher rate of 40 per cent is payable on taxable incomes of over £34,600 (or £39,825 before deducting the basic personal allowance).

In 2008/09 the 10 per cent starting rate will be abolished on earned income. Although the basic rate will be reduced to 20 per cent, many earners on low incomes will pay more tax. The Government justifies this on the grounds that higher levels of WTC will offset the extra tax payable. However, by no means all people in work are eligible to claim WTC.

Income tax is not payable on all sources of income. For instance, means-tested benefits are largely tax-free. However, all earnings, whether from employment or self-employment, are taxable, subject to deductions for certain types of expenses that vary according to whether the taxpayer is employed or self-employed.

Hand in hand with income tax on earnings are national insurance contributions, a form of social security contribution which entitles the payer to certain 'contributory' benefits – eg, incapacity benefit if s/he falls sick and cannot work, and the state retirement pension. It is worth noting that, unlike means-tested benefits, contributory benefits are generally taxable.

The point at which national insurance contributions start to be payable is known as the 'primary threshold', which at £100 a week in 2007/08 is approximately level with the basic personal allowance for tax. Employees pay 'primary Class 1' contributions at a rate of 11 per cent above the primary threshold, and 1 per cent above the 'upper earnings limit' of £670 a week (2007/08). Employers pay national insurance contributions on their employees' pay at 12.8 per cent, subject to rebates if the employer offers a pension scheme where joiners 'contract out' of entitlement to the state second pension. Self-employed people pay Class 4 national insurance contributions at a rate of 8 per cent on earnings between the lower profits limit of £5,225 in 2007/08 and the upper profits limit of £34,840, and 1 per cent thereafter. Self-employed contributors are also liable to pay Class 2 contributions at a rate of £2.20 a week if their earnings exceed £4,635 a year. It is the Class 2 contribution that entitles the self-employed to contributory benefits.

There is also a bracket of earnings between the 'lower earnings limit' and the primary threshold at which earners pay no contributions, but nevertheless accrue entitlement to contributory benefits. The lower earnings limit in 2007/08 is £87 a week.

For most low-income employed earners, once they start paying income tax at 10 per cent rising to 22 per cent, they are also paying national insurance contributions of 11 per cent – an effective rate of 33 per cent. That, combined with the withdrawal rate of 37 per cent of WTC, gives rise to a 'marginal deduction rate' of 70 per cent in total. The fact that, at these low levels of income, workers are likely to keep only around 30 per cent of what extra they earn has an adverse effect on work incentives.

Employed earners are generally taxed under Pay As You Earn (PAYE). With each pay cheque, an appropriate amount of tax and national insurance is deducted and detailed on the accompanying payslip. Earners should also receive a PAYE notice of coding, which shows how their PAYE code is made up from allowances and deductions. Error rates can be high, particularly where there are multiple sources of income (eg, more than one job, or an occupational pension in addition to earnings from a current employment).

Self-employed earners assess themselves by means of an annual self-assessment tax return. Their tax is due for each tax year by the following 31 January, but most will have to pay tax on account of their final liability. This involves making payments on 31 January in the tax year and 31 July after the tax year, with any balance paid on 31 January following the tax year.

Summary

A multiplicity of fiscal rules and provisions apply to working-age adults across three different systems. Each system operates under a high degree of complexity. In this study, we have sought to assess the extent to which the intersections between and across these systems support or deter people from moving into or increasing hours of paid work.

Two

Methodology

The Interact team sought to understand the interactions of the tax, tax credit and social security systems by taking a two-fold approach: a technical phase and a qualitative analysis of claimants' experience. The technical phase was used to design the interview schedule, which was then used to conduct the semi-structured interviews (see Appendix B). The rationale and objectives, as well as the development of the two phases of the study, are described below.

The technical phase

In the technical phase of the study the team created a number of hypothetical models of individuals' circumstances and journeys in and out of employment, looking at the interactions between tax credit and benefit entitlement, and income from employment, with a focus on identifying whether work 'pays'.

In addition, the team addressed the ways in which the tax credits system is administered and how this affects those in receipt of tax credits, especially considering the financial implications of overpayments and the recovery process.

The hypothetical cases illustrated how the take-up of tax credits has consequences for eligibility for other benefits, such as housing benefit (HB) and council tax benefit (CTB). Of special concern to the team was the loss of passported benefits, such as health benefits, school meals and access to the social fund.

As the technical phase progressed, the team became increasingly aware that the interactions would also be influenced by external/structural components in wider society, such as the employment market, the housing market and the provision of childcare. These factors added even more complexity to the hypothetical circumstances, resulting in complicated calculations. The end result of many of these interactions showed that a multiplicity of outcomes was possible and added unpredictability to whether work 'pays'.

In constructing the models, we identified and incorporated a number of factors that from our experience in providing advice on benefits and tax credits we knew to be sources of confusion and difficulty. These were:

- the circumstances of an individual (family structure, work or worklessness, health or disability, housing, numbers and ages of children);
- eligibility and entitlement to government support through the benefit and tax credit systems; *and*
- how an individual interacts with the relevant agencies, such as Her Majesty's Revenue and Customs, Jobcentre Plus or the local authority.

Given the myriad possible scenarios within the welfare system, the team concentrated on three particular factors: work incentives, child poverty and disability. The case studies were put together to explore particular life events, rather than to illustrate a known interaction (see Appendix A for a complete description of the technical case studies). Although the case studies were 'hypothetical', in the interview phase of the project we found the types of events and the issues they raised were replicated in the real world.

The data collection phase: sample and interviews

In this phase of the project (which partly overlapped with the technical mapping phase), we undertook a qualitative study, interviewing a number of individuals in receipt of tax credits and social security benefits in, out of, or contemplating paid work.

The interviews offered a snapshot of how individuals saw the importance of tax credit awards to family finance; their contribution to childcare and the viability of paid employment; access to or loss of passported benefits once a tax credit award is received; and the ways claimants dealt with the administration of the tax credits system.

The research collected information on:

- the working of the system as perceived by the recipients (eg, flexibility and responsiveness to changing circumstances);
- assistance provided to people in filling in application and/or renewal forms, explanation about changes in awards and overpayments by government agencies and voluntary organisations;
- beneficiaries' perceptions of the systems of financial support available, and their impact on poverty and work incentives;
- the economic and emotional impact of changes in circumstances affecting tax credit awards (eg, overpayments, the reduction in the amount of award due to an increase in income, and the loss of passported benefits, HB and CTB);
- the smoothness of the tax credit system when people's circumstances change;
- recipients' views on what needs to change to make the system more effective in its administration and responsiveness to people's needs.

The team interviewed claimants whose experience would allow us to illustrate in real life how those receiving tax credits and benefits experience the impact of the interactions identified from the technical study.

The interviews

In July 2007 the team interviewed 30 tax credit and benefit recipients. The team set out to interview individuals with characteristics and issues closely resembling those outlined in the technical phase.

The team was not able to apply the case study research method used in the technical phase. This approach was not suitable due to limited time and resources. We opted for one-hour, semi-structured interviews.

The sample

Thirty individuals came forward who were willing to share their experiences with us. The sample was made up as follows.

Sex: The team interviewed 27 women and three men.

Age: Four interviewees were in their late 20s, five in their early 30s, ten in their mid to late 30s, and 11 in their 40s. Of the three men interviewed, one was in his early 40s and two in their 30s.

Ethnicity: Using the Census definition of ethnicity, we had 11 interviewees who could be categorised as White, 11 Black, six of Asian descent and two from other ethnic groups.

Employment status and/or means of economic support: Twelve of the interviewees were in full-time employment, seven worked part time, three received income support (IS), three received jobseeker's allowance, two cared for their disabled child and one looked after children but did not receive IS as her husband worked full time.

Number of children and type of tax credit: All of the interviewees had children and were claiming child tax credit. Three of the interviewees also received working tax credit. Ten interviewees had one child, 12 had two children, five had three children, and three had four or more children.

Living arrangements: Twenty-three interviewees were lone parents. All of these were part of a couple when their children were born. Most had separated from their partners some time before the introduction of the tax credits system, thus the separation did not have any impact on their tax credit awards. Seven of the interviewees had partners or were married.

Place of residence: Twenty-seven interviewees lived in the London Borough of Newham and three in north London.

Type of accommodation: The overwhelming majority of those interviewed (22) rented their accommodation. Of these, half rented from the council, seven from a housing association and four from a private landlord. Six of the interviewees lived in owner-occupied accommodation and two had been placed by the council in temporary accommodation.

Help with housing costs: Eighteen interviewees did not get any financial help with housing costs. Three said that they got some support towards paying the rent. The remaining nine interviewees said that most of their rent and council tax was covered by benefits.

Three

Claimants' experiences

Receipt of in- and out-of-work financial support is important if the twin goals of eradicating child poverty and making work pay are to be achieved. In our interviews we sought to identify claimants' experience of and attitudes to such support in the light of these twin policy goals. We also observed the impact the administration of the tax credit and social security systems has on achieving these policy objectives.

In our research we identified two sets of factors that affect the experience, receipt and impact of financial support.

- **Individual factors:** people's assets (social and family networks, and educational background) are central to the way they relate to welfare systems and cope with the governing rules and their implementation.

- **Structural elements:** housing, childcare provision and employment type.

The contribution of tax credits to people's income

The interviews show that the tax credits system contributes to reducing child poverty by increasing the income of families with children. The claims made for the impact of the so-called 'progressive universalism' of the system, that all get something but those who have least get most, was also reflected in the interviewees' experience: the award was essential for the majority of interviewees who had low incomes, whereas the tax credit award mattered less for individuals and households with more income from paid employment.

Respondents largely acknowledged the benefits of the tax credits system. They thought that tax credit awards demonstrated the Government was trying to help them improve their standard of living.

'They have been paying me. I'm happy to get the money. I don't have a problem maybe, actually maybe my income is not enough so they are helping because we are just suffering here, working to pay bills…'
(Interviewee C)

But at the same time we observed adverse effects, as increased income jeopardised people's access to passported benefits, such as free prescriptions, free school lunches for children and discounted travel, which may make these individuals and families – at least subjectively – financially worse off.

The essentials

Many of the families did not hold paid employment. They relied on income support (IS) or jobseeker's allowance (JSA). Three households with low incomes from paid employment received tax credits. For both groups of families, receipt of tax credits was important.

'I think it's very helpful, especially when I was on the lower end of the rung… the initial job I had was only about £10,000 pa, so the tax credit really bumped it up quite a bit and even now that I'm nearly double the salary that I was on then, it still helps. It's still a help to have that.'
(Interviewee V)

'CTC [child tax credit] is the one that really helps. Even if my husband isn't working we get it. It helps because it is weekly.'
(Interviewee E)

Passported benefits

The rise in income as a result of the tax credit award also had a negative effect. People lost their passported benefits, such as health benefits and free school meals. In the interviews we discovered that people on benefits had tended not to consider these benefits in the calculation of their income because they were not paying for them. But when receipt of tax credits meant claimants were no longer eligible to receive the means-tested passported benefits, they realised their financial significance. Claimants had to use their income to pay for the items, which diminished the financial gains from the tax credit award, and sometimes they chose to do without them unless absolutely necessary.

'Income support paid my rent, school meals and health benefits. When I started working I didn't lose the exemption card for health because I don't earn enough. When my son was in the hospital I didn't get income for meals and transportation. If you work you don't get that. If you are on income support you get travel expenses.'
(Interviewee H)

In tax credits recipients' view there is a trade off between getting the goods and services for 'free' because of their low income and getting more cash awarded in tax credits. In the view of some of the interviewees, the risk of using more of their tax credit to buy the passported services is a deterrent to increasing their income via paid employment.

For others, the decision to work (and especially to work more hours) to increase their income and standard of living unexpectedly produced an undesired impact: the loss of their passported benefits.

'… two years ago I had a stroke and every month or every other month I have to pay £30 for tablets… that's £30 and I know I can't bargain for that because it is my health. My wages have increased and the ability to access things, I could have accessed and I can't. So therefore, I actually feel a lot worse off, very worse off, very much so, very much so. So it is, has been, quite difficult … obviously when I was at the lower end of the working tax credit, then obviously you get the exemptions. So I used to get the exemptions for pills and things and even things like dentist bill, you know. I need to go to the dentist every six months, but I won't go every six months because I really cannot afford to go every six months.'
(Interviewee T)

In the technical studies we were able to reflect the cost of some lost passported benefits, such as free school meals, where the costs were relatively straightforward. Other passported benefits, like NHS exemptions, were more difficult to quantify as their worth differs from person to person. The value of passported health benefits, such as free prescriptions, depends on people's particular circumstances. For instance, for people with chronic illness and in need of daily medication the loss of this passported benefit would be more detrimental than for someone who is relatively healthy. From the responses, however, it is clear that the financial implications of lost passported benefits (particularly where there is uncertainty about entitlement because of individual circumstances) are an important factor, albeit one whose significance is not necessarily realised until a move has been made into work.

We show some of the impacts of lost passported benefits in Case Studies Two and Three in Appendix A.

Take-up, stigma and uncertainty

Some respondents seemed unaware or reluctant to acknowledge they were entitled to tax credits. They thought tax credits were for people on IS, very low incomes, or incapacity benefit. This suggests a lack of knowledge and understanding about the way tax credits work.

'I didn't think of putting myself in a certain kind of scenario and working out whether I would be entitled, so I just automatically assumed, whereas for service users I will ask them what they earn, bang it all in and find out exactly what they might be entitled to. But not for myself, I didn't do that. So eventually I decided to see what happens. So I tried and there I was; I was entitled to almost £200 a month…'
(Interviewee W)

'When the working tax and the child tax credit first came into force, I did not apply for it at all. I didn't understand it. It's only when I was watching *Working Lunch* programme it dawned on me I should apply. So I made a phone call and it was very easy.'
(Interviewee U)

'A colleague of mine said to me 'Have you applied for working tax credit?' and I said 'I don't think I'm eligible.' Because I thought I owned my own home and had a mortgage, etc etc I wouldn't be eligible, I thought my earning bracket would be too high, but I associated it with other sort of income support and that type of benefit.'
(Interviewee B)

Once aware of entitlement, however, there was little sign of stigma associated with the receipt of tax credits.

Choice of payment arrangements

Tax credit claimants, especially those in receipt of child tax credit, appreciated the choice of arrangements about the payment of the award. The majority decided to receive it weekly and they valued the fact that, without fail, the transfer was made at the end of the week. They said that they could count on this money, which enabled them to budget their expenses and make payments on time.

'I get the money on Thursdays or Fridays and I get my JSA every other week. It helps a lot over the weekend and the following week. With the child tax credit I can pay for food in the weekends. It does help. If I didn't have it, it would be hard. It might not be exactly what I need but it is something that I know it is coming.'
(Interviewee J)

'[Since I started receiving CTC] … what has changed is that I'm able to space out, work out, what I can pay. And also, I know the money's for the children so, therefore, I can use it more on them, take them out and do things more with them, with the help of the money as well. So, that helps…'
(Interviewee D)

'…since he [Gordon Brown] brought this in, to me getting every week either £90 or £100 and I can manage the money because the money is guaranteed to be there every week. So it's been a blessing. It's been a blessing to me.'
(Interviewee U)

The ability to rely on the system makes a difference. People feel in control of their lives and are able to plan and budget, although this certainty could be undermined when overpayment recoveries take place, especially if claimants had thought they were in receipt of tax credits to which they were entitled (see below).

Work incentives and hours rules

In the technical phase we found a disproportionate gap in net income for an individual working 15 or 16 hours per week. At this level of hours, our modelling suggested a substantial difference in net disposable income for only one additional hour's work. Thereafter, however, for some claimants, especially members of couples and those with high housing costs, further increases in working hours made little difference. (See Case Study Two in Appendix A).

In the interviews we were able to confirm this concern. Working more did not pay, as people do not experience significant financial benefits. Claimants voiced their opposition to the decrease in their tax credit award as their income from paid employment increased. They did not understand the relationship between income from employment and tax credits. They considered that the inverse relationship between tax credits and income from paid employment discouraged people to increase their hours of work because they would not be financially better off.

'Working tax credit is less than £10 a week. I have been offered a full-time job but I declined it because if I come to work five days a week I will increase my wages and I will get nothing from the WTC [working tax credit] and also from the CTC.'
(Interviewee A)

'I used to get WTC but I now only get CTC. They used to give me £120 and now I do not get anything in WTC. For working 30 hours per week I only get £20 more pounds for my CTC than what I got when I was working 16 hours a week. It does not make any sense.'
(Interviewee N)

'I applied for WTC and they said that I was not eligible because I did not work 30 hours per week. When you are looking after a child with a problem, they should be helping you. I was shocked.'
(Interviewee K)

'[My husband] … was working 30 hours and saw the amount reduced and it is about the same. He was offered more hours to work and he wanted to increase his income and it took us to where we were before. He didn't get any benefits.'
(Interviewee E)

Claimants thought that the risks of being in paid employment were not rewarded in the same way as those who rely on social security benefits. They felt penalised by the tax credits system for trying to be financially independent and saw IS recipients as being 'encouraged' to be economically 'dependent' on government support.

'I worked in a lot of kids' work programmes and you see people in there who for many, many years [have received benefits] and part of it angers you.'
(Interviewee T)

'Women on income support get a lot more than people who are leaving their children and going to work. They have the latest trainers, tracksuits, Timberland. They cost money. I think that there should be more [of] an incentive for people to go back to work.'
(Interviewee P)

'Citizens are suffering. Other people who understand the system they are playing with it… there are just many people who try to work constantly, who work hard then ask for a council house and cannot get it and I see other people who don't deserve… who weren't paying their council tax, weren't people who deserve it…'
(Interviewee C)

Income fluctuations during the year

In the technical phase we explored income fluctuations during the year and showed how the initial award of tax credits is based on the finalised income of the preceding tax year. If income rises during the current year, the tax credits award stays the same, provided the current year's income does not exceed the preceding year's income by more than the 'disregard' of £25,000.

The disregard only protects rises in income 'above' the level of the preceding year's income, but not rises in income 'below' that level. When a claimant's income falls below the level of the preceding year's income, then rises again to reach that level, the rise in income from the lowest point up to the level of preceding year's income is not protected by the £25,000 disregard. This generates a recoverable overpayment.

The effect of this rule is illustrated and further explored in Case Study One.

In our interviews we observed that the application and understanding of this rule could produce different outcomes, with some claimants reporting that changes in income did not generate an overpayment, while in other cases it did. Sometimes this was because people chose not to inform Her Majesty's Revenue and Customs (HMRC) about changes in circumstances and income, and waited until the end of the fiscal year. Those people were not overpaid, but neither did they receive the tax credits to which their drop in income entitled them. On the other hand, those who did inform HMRC of their fall in income received their full entitlement, but risked an overpayment if their income levels were to recover later in the year.

'The work and wages vary. My hours are quite flexible. I don't call them to let them know about the changes in income. I did get an overpayment…'
(Interviewee H)

'I was on maternity leave… they have this huge bracket and I didn't see any changes in money when my circumstances changed.'
(Interviewee L)

'In July 2005 I went on maternity leave and called them and let them know about the baby. I called them and let them know that I started working, to

keep my situation updated. They said that I had an overpayment and had to pay it back.'
(Interviewee N)

Lone parents and paid employment

Lone parents who are not in employment are generally eligible to receive IS until their youngest child reaches 16. New government proposals are to revise this to age 12 from 2008, and age seven from 2010 (DWP, 2007b). One effect of this may be an increase in the number of people claiming tax credits, thus creating a greater number of interactions between paid employment, benefits and tax credits awards, but for little perceived financial gain.

Our interviews suggested that tax credits are not an incentive to work for lone parents on IS.

'When my children turn 16, I don't know if I would be better off working. I won't be receiving anything. My adviser says that I have to go out and work. After my child turns 16, I don't have any other choice but either go to work or apply for jobseeker's allowance.'
(Interviewee Q)

Lone parents who were working were doing so predominantly for non-financial reasons: they wanted to fulfil their lives as an employed individual; their work ethic led them to want to earn their living rather than rely on what they saw as handouts; and they wanted their children to have a similar work ethic and appreciate working life.

'They used to give £120 [in WTC] and now I do not get anything. For working 30 hours my CTC… I only get 20 more pounds than I got when I was only working 16 hours. Just for £25 more it does not make any sense to be working. … I just think that I would prefer to be working. The issue is that I don't see myself staying at home. I like working. It is nice to have a working life and go home and enjoy my children. And also provide my children with an example of working and how to earn your money.'
(Interviewee N)

Educational attainment, skills and confidence

The majority of the interviewees did not have qualifications beyond GCSE level. Three had received university education, five had obtained A levels and the rest had some level of secondary education, but had not obtained any qualifications. Of those who were working, two had managerial positions, three were involved in training and some management, and the rest did not have any supervisory responsibilities.

About half of the interviewees were not sure of their literacy and numeracy skills and about the same proportion did not have IT skills.

Those on IS were usually women who had been out of the job market for more than three years. Their qualifications and skills were fairly limited. Their time on IS had been spent looking after their children, which in turn had further limited their options on the type of jobs for which they could apply.

Three respondents looking for paid employment because their entitlement to IS was about to end had started training on interview and IT skills. Two of these were anxious about the risks and pitfalls in the world of paid employment.

'… I don't have the confidence to go and apply for jobs. I went to a job interview and I did fine with the first three questions, but did not do well with the last one. I did not get the job… for two weeks I was working in the kitchen in the City and I didn't realise how intense [it was] work-wise and you needed to get organised and I was not used to it and knocked my confidence.'
(Interviewee J)

'I started working in a kitchen as a chef, but the place was so hot that I had to quit because I collapsed one day.'
(Interviewee K)

Job security

Interviewees who were working for voluntary organisations or a local authority had secure jobs. However, two interviewees who worked in the private sector had been laid off and were receiving income-based JSA. They wanted to return to work, but were having difficulty finding a well-paid job. However, they expressed the determination to get another paid job because they did not want to stay on benefits.

Childcare

Childcare costs and time with their children were two essential components in mothers' decisions to be in paid employment.

'… for me is not an incentive. I will say that's one of the reasons why I don't take a full-time job. I have been offered a full-time job, but I have declined that, because I say, no, what's the point of me coming to work five days a week, working more, spending less time with my child, now going to university, just for doing work and not receiving anything from the tax credit.'
(Interviewee A)

'When I started working again (after having my child), I wanted to increase the income for my family but I was working really hard and spending time away from my children and the amount of money I was paying for the childminder I was not left with a lot frankly. I thought our family income would increase, but it didn't.'
(Interviewee E)

Tax credits and childcare costs

Some interviewees said that the childcare component of WTC was a help to family finances and enabled them to continue working. Female respondents said that part of their decision to go into work was based on tax credits paying nursery and childcare fees.

'… the money that is helpful for me is the money for the childcare… because I receive the money weekly and it helps me pay the childcare for my daughter.'
(Interviewee A)

'I would not be able to work. This is a big help. I really would not be able to work. Financially it is very, very good.'
(Interviewee O)

For some of the interviewees, the childcare component of working tax credit was crucial to their decision to go to work because childcare costs were contributing to mounting debts.

'I would be in massive debt if the tax credit hadn't contributed towards my son's nursery fees… but every day I thank Gordon Brown for bringing this in because when my son, the 18-year-old, was going to nursery, I was so much in debt with nursery fees…'
(Interviewee N)

'It is as simple as that. Without the child tax credit and the working tax credit I wouldn't go back to work. It wouldn't be worth my while. But to go out there and work and pay nursery fees, it's just suicide without it [CTC and WTC]. My health would deteriorate, the kids wouldn't thrive. It really would be suicide without it. I'd be left with no choice. I wouldn't think twice about handing in my notice if the working tax credit and child tax credit wasn't in force. I would hand in my notice, as simple as that.'
(Interviewee U)

Childcare and atypical work

Flexibility in hours of work and leave to attend to children's illnesses and school breaks was as important as income from paid work to the mothers we interviewed.

Some of the female interviewees were able to find employment that fitted in with school times. They could take care of their children after school, and occasionally the children went to after-school clubs and/or were picked up or looked after by relatives and neighbours.

'I made a deliberate decision to find work either in school or term time so I would be there at the end of the school day because I knew there was a massive problem with regard to childcare for after school.'
(Interviewee U)

Not all, however, were able to choose the type of employment they had. Most of the respondents were working typical hours (nine to five). One was working atypical hours (nightshifts).

Respondents who worked atypical hours were pushed outside government support systems and reported that they had had to use informal childcare. In addition, there were limited options for after-school childcare. Many parents in this situation expressed frustration that the childcare element of the tax credits was not available to help with their childcare costs.

'I do not get the childcare component [of the tax credit] for my younger son (two and half years old) because neighbours help and childminders that are not registered.'
(Interviewee N)

'I am a housing shift worker. When I work at night I have to pay somebody to stay in the house and look after my 15-year-old daughter. This person is not certified to be a carer. I have to pay out of my pocket because she is somebody who lives in the neighbourhood, you can't find a childminder at those hours in the evenings…'
(Interviewee S)

Children with special needs

Another issue is childcare for children with special needs. This type of service is limited and parents often use neighbours to provide childcare, paid out of the parent's own pocket.

'My younger child is in nursery and I get the childcare component to pay for the fees. For my second child I do not get this component, he is 11 years old and he is partly sighted. He is picked up by a neighbour and I pay her services out of my wages.'
(Interviewee O)

Other parents decided to look after their children after school. However, they resented the fact that because they were working, their carer's allowance was taken away.

'I don't think [the tax credit] is an incentive. For someone on income support you get your rent paid, your council tax paid. If you are working you don't get carer's money. If you are on income support you do. If you work, that stops and I don't see the logic of it.'
(Interviewee H)

Parents with children with profound disabilities have limited or few options for paid employment because of the nature of their children's disabilities. They cannot access qualified childcare to look after their children.

'I don't get the childcare component because I find it difficult to leave the children with a childminder. I really don't think that childminders are qualified to look after my children…They need constant care and looking after. I have to look after them all the time once they are home from school.'
(Interviewee B)

Even if the childcare facilities were available, a couple where one partner works while the other cares for a disabled child does not qualify for the childcare element of WTC. This is a further barrier to disabled people or their carers seeking work, illustrated in Case Study Three.

Age of children

Childcare provision is fundamentally centred on primary school-age children. The service for children age 11 and older is limited (Buck, 2007). Parents with children between the ages of 11 and 16 experience difficulty finding suitable childcare. This can encourage some to use informal paid childcare with relatives and neighbours, the cost of which is not recognised in the childcare component of the tax credits. This can increase the financial burden on already poor families.

'… as the kids get older there's no childcare. They expect obviously a 12-year-old to be able to look after themselves, but yet they say it's illegal that I leave my child inside on her own and obviously this is not safe and legal. So you are kind of caught

between a rock and a hard place, really because there are no playschemes or no schemes for 12-year-olds.'
(Interviewee T)

Housing provision, housing costs and incentives to work

Our technical mapping exercises demonstrated the financial implications of moving into or increasing hours of work on receipt of help with housing costs. But it was not clear from our interviews to what extent the cost and type of people's accommodation affected people's decision to go back to work.

'I went to the council to get bigger accommodation and be able to have a relative living with us and help look after the children. This would enable me to work and help with the family finances. We cannot afford privately-rented accommodation. My husband works full time for an agency and makes £14,000 a year to support himself, me and two children.'
(Interviewee E)

One respondent on IS expressed some concern about housing and the impact on her housing benefit (HB) of moving into work. She was searching for work but did not have information about how getting a paid job would affect her housing costs that were currently being met by benefits.

'The only thing that puts me off is the cost of my accommodation. I live in temporary accommodation for which I pay £350 per week. At the moment I receive housing benefits, but when I start working I would have to pay the cost of housing myself.'
(Interviewee Q)

Another voiced her concern about the 'unfairness' of the HB system for those who work and have HB taken away or substantially reduced because it is means tested. She thought that the reduction or removal of this benefit would make people think twice about getting paid employment.

'If you are on income support and in council accommodation you are laughing. If you are in a rented accommodation there is no way in hell that you ever will go back to work because the rent in private property is too much money. It is just ridiculous. They would never be able to get a job that pays enough to cover the rent, let alone be able to afford other things the family needs. Why would anyone go and get a job when the benefits pay the rent. There are places where you pay rent of £200 to 300 a week and you will never be able to pay that.'
(Interviewee H)

Administration issues

A variety of experiences were reported by our interviewees about the administration of the tax credits system. In general, interviewees were positive. Most of the respondents were grateful for the awards because they topped up their income. However, negative comments arose regarding overpayments and the mechanisms used by HMRC to collect them.

The application and renewal process

Recipients pointed out the complexity of the system when applying for the first time to receive tax credits. They highlight the ease of renewing the award by telephone. They stressed the helpfulness of customer service officers.

'I applied in writing and the form is quite daunting. I was on maternity leave and had to make the time to fill it out. I phoned them and I found them quite helpful. I informed them of the changes in circumstances. When you ring them they wait for you to get the form, they explain things to you.'
(Interviewee L)

'I do not understand the type of tax credit I am receiving and I cannot understand the forms. I must say that I just skip the form and call them up. I cannot complain about the phone service. They do not take a lot of time. It is just a relief. They wait for you to get the right information you need.'
(Interviewee P)

'I didn't understand much about the calculation, they do to tell you how much you are going to receive. For me it was quite easy to fill out the form, it was straightforward, the only thing is when you're asked your income and things like that… you have to go to pay slips, but for me it was very easy. I would say it was because I received the training about how to fill in the form.'
(Interviewee A)

'I just completed the form myself. If I had any problems with filling it in I just called them up and asked them. The first time was a bit difficult but then after that, the subsequent times, it was quite easy to do.'
(Interviewee T)

People who had been on IS were helped by their advisers to apply for tax credits.

'I got [WTC and CTC] when I started working because I was on benefits before. The employment agency did it. They said, OK you are working, this is what you are going to apply for now.'
(Interviewee H)

'I was getting child benefit and [Jobcentre Plus staff] said that I also could get CTC. They told me at the Jobcentre Plus that I might be eligible. They helped me with the form and it was quick. I gave the information and just signed it. They sorted out the information for me.'
(Interviewee J)

Complexity

People's responses indicated a lack of understanding of the relationship between levels of income and tax credits awards. People did not know whether or not they were getting the right amount of award because they did not understand the calculations, yet claimants are expected to understand and to notify HMRC if there are errors in the award. Failure to do so leads to problems (such as overpayments arising) and, in turn, financial hardship.

'I don't have a clue about my entitlement, how the calculations are made or anything.'
(Interviewee S)

'I still don't understand how they worked it out. Again, the accompanying document that they give you to work your way through… well, it's terrifying. It is a huge pamphlet and it's in fairly easy-to-follow English, but the actual arithmetic… I couldn't understand one single bit of it. I've had to rely purely on the fact that they understand my figures and that I'm getting the right rate.'
(Interviewee B)

'To be quite honest, not really [she does not really understand where the amount awarded is coming from]. But so I'd kind of take it at face value.'
(Interviewee T)

Overpayments

Claimants were unprepared for overpayments when they arose. Many reported they were not aware of any problems until they received a letter letting them know about the overpayment, had their weekly or monthly payments stopped altogether, or had a reduced payment.

Respondents experienced overpayments because their circumstances changed during the year. The most common changes were taking maternity leave and changes in hours worked.

'… the thing I found the most difficult was that because they're working it out a year behind… when I moved from maternity leave back into part-time employment, that seemed to throw a spanner in the works because they couldn't seem to get their heads around that… I notified them, obviously, as soon as the situation happened…'
(Interviewee B)

Some claimants were aware of the need to inform HMRC of their changes in circumstances and were surprised to incur overpayments when they had been careful about notifying HMRC. Though some found the overpayment understandable, given the fact that the awards were based on the previous year's income, the majority were unable to explain or understand the source of the overpayment.

'To be honest, you just get the information and you don't check. I supposedly got a note about an overpayment. I was not able to understand where this overpayment is coming from. How come there is an overpayment in the first year and four years later you get the notice that you have been overpaid?'
(Interviewee M)

'After the review of the year 2005/06 I was told we had been overpaid by £2,000. I was shocked because I had no idea where it came from. I had informed HMRC about our circumstances when they changed.'
(Interviewee A)

Others expressed anger because they assumed that it was the system's responsibility and felt that they should not be made to pay. They thought they had provided the information required and should not be penalised by being asked to pay back the overpayment.

Hardship

Some respondents were adversely affected when they had to pay back the overpayment. They struggled to make ends meet because they were used to the amount they were receiving and were spending accordingly. Others, however, were able to re-adjust their budgets and make do with what they received. These interviewees had higher incomes and levels of academic attainment. Although the award contributed to their income, its absence did not mean wrecking the family budget.

'I got the letter to say that I'm overpaid. I wasn't surprised, to be quite honest, because my wages now are over £20,000. As far as I am concerned, I would say I would only pay it back in instalments at a rate that I can afford. So far as I'm concerned they are not going to put me in poverty, when they are designed to keep me out of poverty.'
(Interviewee T)

'They deduct about £30 a week. I gradually needed to adjust my budget to the amount I receive.'
(Interviewee N)

Methods of repaying overpayments

Respondents with overpayments experienced one of the two methods of recovery: direct collection or deduction from current awards (see Section Two). Claimants felt they did not have the choice between one or the other. When the deductions from current tax credit awards were made, respondents said they had no say in the amount taken from their weekly payment.

Direct collection of overpayments can be particularly distressing because of the methods used by HMRC. The opening approach is usually by means of a letter, which recipients often find threatening and intimidating in tone. It is not always immediately apparent to the recipients of such letters that by ringing a given telephone number they can negotiate a 12-month instalment option (or even longer if they can show hardship).

'They just wrote, 'You owe us this, could you pay it by such a time or else'. I just saw the letter and thought, 'Oh, no, I owe them, so therefore I'd better pay it before anything else happens or they might decide to send more letters'. I had jewellery, so I had to put that in the pawn shop to pay that off. Yeah, that was the only way to do it.'
(Interviewee D)

The deductions from current tax credit awards were not known to those with overpayments until they realised that the weekly payment was either stopped or reduced.

'… I remember receiving the paperwork back and them saying that they'd made an overpayment and they were going to reduce my payments by, I think, about £20 per month over the period of time… it doesn't feel like a huge impact, but over a year's period, then yes, that is a big impact. So something else has to be taken away from another area to pay for [childcare]. So, yeah, it doesn't really feel a hell of a lot at the time when you're reading it, but then over the year's period it does have quite a big impact.'
(Interviewee B)

'I've got an overpayment and I can read it on the form, but I don't understand it because I'm still getting money and they are clawing the money back. So I'm only having to assume that they are giving a third of what I should be getting but that's still better than nothing.'
(Interviewee U)

'I did get an overpayment and they stopped it. I phoned but they did not give me an option about paying it back. They said it was going to stop until the money was paid up. The WTC was stopped and the CTC carried on. It was about six months that I had without it… you have to spend less money because you simply do not have it. You have to take from Pete to give it to Adam.'
(Interviewee H)

Lack of consistency in customer service

There was a mixture of responses regarding the helpfulness, clarity and knowledge of those staffing the customer service line. Some interviewees praised the service they received.

'On the telephone they try to be as helpful as possible. So when I get their customer services on the phone I can't fault them at all. They're fairly quick at getting to the phone.'
(Interviewee W)

'I did it all through the phone… she was really helpful and she gave me the name and told me to ask for her. That way they would understand what we are talking about.'
(Interviewee J)

But there were concerns about the quality of the service in relation to information about overpayments. Those who received an overpayment notice wanted to know their source. The claimants contacted the HMRC customer line. They did not receive clear answers to their queries. They said they were frustrated because at the end of the phone call they were no clearer about the overpayment than before they made the call. They thought that staff only restated what was contained in the letter and did not respond to their query about the origin of the overpayment and the specific amount.

'They do not give you a satisfactory response. They continue restating what the letter says. There is no point arguing with them. The phone calls have not been helpful. They do not provide additional explanation.'
(Interviewee N)

'… when you call there the information they give you is confusing. When you finish, it was the same as not calling them. Sometimes they say, 'Could you hold a minute? I'm going to talk to my supervisor,' and they go. They come back and say, 'OK, we are going to review your case, we will write to you.' But it never happens.'
(Interviewee A)

Four

Conclusions and recommendations

The Interact study has taken a set of hypothetical case studies and worked through the technical implications for tax, tax credits and benefits. It has then tested the results against a series of interviews. In doing so, it has given us a greater understanding of the way in which a mix of individual circumstances, responses and experiences intersect with a complex system of fiscal measures to create a situation where a move into or towards paid employment, or to increase hours of work, gives rise to a range of unpredictable outcomes, to which individuals may or may not be able to adapt. This understanding, while not new, does not seem to have resulted in a coherent set of policy or delivery responses – at least from claimants' perspective. Individuals experience systems that are:

- generous, but complicated;
- confused;
- contradictory in impact or intent;
- frequently changing;
- sometimes well, but at other times, poorly delivered;
- bureaucratic;
- non-strategic;
- not joined-up;
- sometimes welcomed but which can create some mistrust.

We conclude, therefore, the following.

- The range of different benefits and tax credits that go to make up part of the welfare state as a whole are both intrinsically complex, and complex in their interactions with each other.

- This double layer of complexity leads to confusion among claimants as to their entitlements at any given time, and how the system is likely to react to changes in their circumstances or patterns of behaviour.

- While many interactions between different benefits and tax credits have positive or coherent policy effects, a substantial number are contradictory, with (say) the granting of one benefit leading to the withdrawal, or curtailment, of another, thus making the claimant worse off.

- The advent of tax credits, in particular, has changed what was previously a relatively reliable, fixed system of benefits into one that is constantly changing with alterations in claimants' circumstances. No one knows what is going to happen to them from day to day; it follows that no one knows what their tax credit and benefit entitlement will be next month, next week, or even the next day. This makes it impossible to know for certain, or for advisers to advise, whether a claimant will be better off in the longer term doing x rather than y – for instance, staying on benefits or going into work – when a complex set of calculations based on today's circumstances can be transformed by a change in those circumstances.

- The quality of delivery of benefits, particularly tax credits, is patchy. This is possibly a function of the system complexity referred to earlier and of inadequate resources being made available to the agencies responsible.

- Tax credits have achieved their objective of relieving child poverty to a considerable extent, but not always in a sustained way. As shown above, the effect of changes of circumstances may be to change entitlement and that can lead to overpayments, which in turn can reduce claimants to the relative poverty they experienced before (or worse). Direct collection of certain overpayments, combined with the way they are communicated to claimants, can exacerbate the situation.

- There is appreciation of the extra financial help offered by tax credits and in-work benefits, but little understanding was demonstrated by the individuals we spoke to of the basis of their entitlement. Some spoke of unpleasant surprises, such as the loss of passported benefits and overpayment recoveries, though no mention at all was made of the impact of direct deductions from income by way of income tax and national insurance contributions. Individuals often expressed a sense that remaining on benefits would, in reality, mean they would be better off (though this did not always mean that individuals chose not to work).

- Fiscal systems, such as tax credits and benefits, are to some extent designed with the intention of creating incentives, particularly to enter or stay in work rather than remain on benefits. But fiscal considerations are by no means the only, or indeed the main, reason for people's decisions on such matters. Societal factors, such as levels of educational attainment and housing costs, can be equally persuasive. Where housing costs are high, a person who has difficulty in securing anything other than a low-paid job may be better off remaining on benefits. Other societal factors include whether suitable childcare facilities are available of the type and at the time people need, and the attitudes of parents (particularly lone parents) towards the desirability of work on the one hand, or caring for their children on the other.

From the claimant's perspective all of these considerations have to be juggled when contemplating a move into work or increasing hours of paid work, but frequently the implications of such a move become clear only after the move has taken place. Moreover, while individuals can describe the impact on their and their families' lives, they are frequently unable to understand or explain why they experience certain financial consequences, and their attempts to gain this understanding from professionals who ought to be able to advise them do not always meet with success.

Our conclusion from the study, therefore, is that much remains to be done to improve the reality and the perception of gains from employment for low-income families, especially those who experience a range of barriers to labour market participation or whose circumstances are fluid and subject to frequent change. The recommendations that follow suggest improvements that will be vital if the Government's twin objectives of ending child poverty and achieving full employment are to be met.

Recommendations

Strategy and governance

- The Government should clarify its objectives for the tax, tax credit and benefit systems. These should be clearly designed to achieve the goal of eradicating child poverty and support the ambition of securing full employment.

- A coherent and holistic strategy is needed across government to bring about those objectives. That strategy must be supported by a set of outcome targets, and/or incorporated into appropriate public service agreements in the next comprehensive spending review, which should be 'proofed' against these aims.

- One government department should be given the overall responsibility for these aims and should be measured by reference to the achievement of them. That department should be responsible for the ownership of the 'total customer experience'.

- Any proposed change to a benefit, tax credit or tax rule should be checked or 'proofed' for possible interactions with other existing systems, which might detract from the delivery of its policy objective. The expertise of the Social Security Advisory Committee should be harnessed to provide such an overview.

- Policy and practice must be aligned in each of the systems to secure achievement of the child poverty and full employment goals. Benefits and tax credits must be set at a level that lifts families out of poverty in and out of work. Financial disincentives to taking or increasing hours of paid work should be eliminated.

- The tax, tax credit and benefit systems should be designed from the perspective of the experience of the individual claimant and in the light of lessons learned from the Wallsend pilot.

- Systems should be designed around individuals' life events, not around technology or departmental needs.

- A 'sounding board' or 'claimant advisory panel' should be set up to facilitate design and delivery.

- The Work and Pensions and Treasury select committees should jointly oversee the activities of the relevant government departments, holding joint inquiries from the perspective of the overarching policy goals.

- The National Audit Office should consider conducting an inquiry into 'value for money' of the interactions as presented in this report.

Systems and processes

- Better education and information are needed to ensure greater understanding of entitlements. These include localised take-up campaigns and improved explanations of awards and recoveries.

- Staff training and awareness of the fiscal instruments managed by other departments must be improved.

- Better-off calculations must take full account of lost passported benefits and the wider costs of moving into work or increasing hours of work, including tax and national insurance contributions.

- The system should be smoothed so that different payment and award periods (eg, weekly, four-weekly, annually) are aligned to claimants' needs.

- Passported entitlements (eg, to free school meals and subsidised health costs) should be extended on a universal basis to reduce the disincentives that loss of passported benefits create.

- A review of the tax and benefit systems (including tax and national insurance rates and allowances, and taper rates and disregards for benefits and tax credits) should be undertaken. This should aim to reduce or eliminate the financial disincentives from taking or increasing hours of paid work and ensure the systems complement each other in their mutual interactions.

- Adequate access to independent advice, including more face-to-face advice, should be available to claimants, to take account of the complexity of the system and the variety of individual needs.

Further Interact research

The Interact project has identified a number of issues in the tax credit and social security systems and in their interactions with each another, which act as barriers to parental employment. Our work has suggested a number of ideas for further research, which include:

- further interviews to investigate 'crunch' points in people's lives, such as death, disability, marriage and the birth of a child, and the effects these have on the interactions between different systems;

- research, including interviews, to investigate the experiences of groups not considered in this study. These could include people who are self-employed, from specific minority ethnic groups, migrants or refugees.

The Interact partners are exploring how we might take some of this further research forward.

Appendix A

Technical case studies

The following are outline summaries of the findings of our technical case studies and the tax/benefit implications. They are necessarily brief for the purposes of this Appendix, but the original materials generated by the technical team are voluminous. For example, the tax/benefit position of Mike and Jenny in Case Study One is illustrated by an 11-page spreadsheet. We mention that here if only to give some clue as to the sheer complexity of the systems which affect people's lives and choices.

Although the case studies are 'hypothetical', we would not be surprised to find them replicated in the real world, if not in exact detail, at least the types of events they describe and the tax/benefit issues they raise. Indeed, featured in the interviews were:

- childcare issues;
- choices about entering work or staying on benefits;
- type and hours of work that did not fulfil the qualifying conditions for entitlement to working tax credit (WTC);
- in-year overpayments where income falls then rises again;
- passporting issues;
- carers and work.

Little is said in the summaries about the mainstream tax and national insurance effects, largely because they follow a predictable pattern, rising gradually as income increases. At the low level of earnings with which we are concerned there was nothing unusual or surprising about the behaviour of the tax or national insurance liability we examined. That is not to say that the cause of simplification could perhaps be better served if the system did not take away in tax what it hands over in tax credits or benefits, or that work incentives might not be enhanced by less punitive marginal deduction rates at low wage levels. But these are broader questions, which have been exhaustively analysed elsewhere and are not within the scope of this report.

Case Study One

The young couple: Mike and Jenny

In 2005/06, Mike is 24 years old and earning £10,000 a year in a job, working 30 hours a week. His partner, Jenny, is 23 and doing a part-time level 3 NVQ computer course. She does not get her fees paid because she does not live in one of the 24 pilot areas for adult learning grants.

She has tried to sign on for work, but has been told that her contribution record is insufficient to qualify for contribution-based jobseeker's allowance (JSA). She cannot get income-based JSA as her partner is working more than 24 hours a week and, in any case, there is a question as to whether she is available for work, as she regards her NVQ course as a priority.

Mike does not yet qualify for WTC because he is not yet 25 (at Mike's age, only those with children or a disability can qualify).

Moving on to 2006/07, Mike turns 25 and as he works 30 hours a week he now qualifies for WTC. The family's income goes up appreciably.

At the end of May, Mike reports an increase in pay. This does not affect the couple's tax credits award for 2006/07 because the rise in income is within the £25,000 'disregard' – ie, the amount by which a claimant's income can increase in a tax year without it affecting the tax credits award for that tax year.

Despite changes in income during the year 2006/07, Mike has been paid tax credits on the basis of an annual income figure of £10,000, that being the previous year's income. This will be the figure on which the award is finalised.

In February 2007, Mike's pay is cut to £9,000 a year, but as this does not cause his overall income in 2006/07 to fall below the £10,000 he was earning in 2005/06 there is no change in the award. Mike keeps Her Majesty's Revenue and Customs (HMRC) informed of the changes in his pay at all times. Because of this, Mike's first payments of WTC in 2007/08 reflect the actual income figures for 2006/07, despite the fact that his income has fallen.

But with Mike's pay cut, the household's income in 2007/08 is bound to drop. Mike therefore asks for his 2007/08 award to reflect the couple's current year's projected income. Their tax credit payments increase substantially.

In early December 2007, Jenny goes to work for 20 hours a week and her wage is added to the household income in 2007/08.

This increase in income creates a tax credits overpayment for two reasons. Firstly, their projected income for the whole tax year has risen above the estimate they gave HMRC when they asked for their award to be adjusted to reflect Mike's pay cut. Secondly, income increases are not covered by the disregard to the extent that they are below the 'benchmark' level of income for the previous year, so that if a claimant's income falls below that benchmark, then starts rising again, the subsequent rise is not covered by the disregard.

In February, Mike's hours are cut. Although between them the couple now work more hours than when Mike started qualifying for WTC, because neither of them works 30 hours a week they cease to qualify for WTC. (Note that different rules apply to disabled workers and to people with children.)

Points arising from this case study

The restrictive conditions of claiming working tax credit

Workers without children in their early-twenties find it difficult to qualify for financial support. In 2005/06, when Mike is working and Jenny is studying, there is no support available for them because Mike does not qualify for tax credits because he is only 24 and Jenny gets neither JSA nor assistance with the fees for her course.

When income fluctuates during the year

We showed in Section Two how an 'initial' award of tax credits is based on the finalised income of the preceding tax year. We also explained how if income rises during the current year, the tax credits award stays the same, provided the current year's income does not exceed the preceding year's income by more than the 'disregard' of £25,000. But the disregard only protects rises in income 'above' the level of the preceding year's income. A claimant's income may fall below the level of the preceding year's income, then rise again to that level. This rise, below the level of the preceding year's income, is not protected by the £25,000 disregard and, therefore, gives rise to a recoverable overpayment.

Accordingly, under the tax credits regime, when claimants' income falls during the tax year, they have a choice. They can either do nothing, in which case they will continue to receive tax credits at the level set by the 'initial' award. Or they can ask for their award to be reassessed on the basis of an estimate of their current year's income. If their estimate is based on the lowest amount which their current income reaches and does not take into account any anticipated or possible future increase, they may find that they have over-estimated their entitlement. This is because, as explained in the Introduction, tax credits income is assessed day by day and deemed to accrue evenly over the tax year. The finalised income figure for the year will, therefore, be an average, so that an overpayment will arise based on the difference between the lowest point to which income fell and the finalised 'averaged' figure. This overpayment will have to be recovered from future payments, or directly from them if their award ceases.

Perhaps a more common scenario than Mike and Jenny's is where a female worker goes on maternity leave, her income drops, then she returns to work when her leave is over and her income rises again. We heard in interviews how the operation of this rule can cause hardship in such cases. More fundamentally, many people in low-paid work do not have security of employment or know what their hours will be over a future period of time. The absence of a cushion if their pay increases (perhaps because their hours increase) means they face an automatic overpayment. This can be a serious disincentive to increasing hours of work or may encourage some to delay their return to work if it is thought that this will adversely affect their tax credit award.

When working hours fall below the threshold

When Mike's hours drop, the couple's income falls drastically. They are no longer entitled to WTC because Mike is not working enough hours, nor can they secure JSA as they are working too many hours. Their predicament illustrates the 'black hole' into which people can fall when they are between JSA or income support (IS) on the one hand, and WTC on the other. This is a place where work incentives are sparse, if they exist at all, sometimes driving people into the informal economy. This is perhaps the most surprising interaction here: when Mike's hours fall, one would expect the state support systems to cushion the blow – but instead they take away the couple's tax credits while not paying them JSA. Mike and Jenny's predicament is exacerbated by having to repay directly to HMRC the overpayment which arose because they claimed more tax credits in the previous tax year when their income fell.

Housing benefit and council tax benefit

We began to explore the interactions between Mike and Jenny's housing benefit (HB) and council tax benefit (CTB) and their WTC entitlement, which would vary considerably depending on whether they were in social or private sector housing, and whether their rent was restricted. On the whole, HB/CTB entitlement decreased roughly in tandem with the rise in earnings and fall in WTC entitlement. However, as the interviews have shown, once HB falls away, the claimant is exposed to the rigours of the housing market in terms of often unaffordable rents.

A further point on HB is that the amount of tax credits that is taken into account as income reflects any overpayment being collected by instalments from the ongoing award. In other words, it is the net payment of tax credits that is used, after taking account of the overpayment recovery. This is not the case, however, when tax credits stop and any outstanding overpayment is collected by direct recovery (as with Mike and Jenny). Surely, if it is right that income should be reduced by repayments of overpaid tax credits, then the manner of the recovery should be immaterial? Income for HB/CTB purposes should reflect the debt to HMRC, whether that debt is paid by recovery from an ongoing award or by direct collection.

Case Study Two

The lone parent: Sandra

Sandra, age 40, has three children aged 16, 14 and 13. She has a house in a rural area with a mortgage, a car loan, various white goods on credit, credit card debts and catalogue debts. She has a small amount of savings from an inheritance from her grandmother.

In 2005/06, Sandra is working full time for a care agency at a low hourly wage. She is receiving WTC, child tax credit (CTC) and child benefit. She has passported entitlement to exemption from health charges, but she is not entitled to CTB and her children do not receive free school meals.

Turning to the year 2006/07, Sandra receives a small pay rise, which slightly increases her total net disposable income. This is, however, counteracted shortly afterwards when Sandra has a small drop in tax credits. This occurs because Sandra's provisional payments are based on her 2004/05 income – the award is then revised to be based on her actual 2005/06 income, which was slightly higher than in 2004/05. Sandra's fourth child is born in October. She starts maternity leave four weeks before the birth of the baby and continues to receive WTC throughout her maternity leave period (26 weeks).

Sandra's drop in income during her maternity period, together with the fact that the first £100 of maternity pay is disregarded for tax credits, gives her an increased tax credit entitlement. This is because when Sandra starts maternity leave she reports that her current year's income will drop substantially and, therefore, her award is revised and based on a lower current year estimate of £5,000. The new award also includes a sizeable underpayment derived from spreading her new total annual income for 2006/07 back over the first six months of the tax year. This underpayment is paid to her in a lump sum.

This increase in her tax credits, combined with the saving in travel costs as she is no longer going to work, substantially increases her net disposable income during the first six weeks of her maternity leave. Her tax credits go up again when her baby is born, bringing about another increase in her net disposable income. But this is short lived, as after six weeks, Sandra faces a large drop in income when her maternity pay reduces from 90 per cent of her wages to statutory maternity pay (SMP) of £108.95. At this point, Sandra is still better off on a net weekly basis than when she was working full time. This is because the drop in wages (from full to SMP) has be counteracted by the savings in travel costs and the increase in tax credits as a result of the birth of her baby and having her award revised to be based on her current year's income.

By the start of 2007/08, Sandra's maternity pay has stopped. Because Sandra lives in a rural area she cannot, at this point, find adequate childcare provision and, therefore, has to stop working. She claims IS, receives maximum CTC, full CTB and free school meals. Help with paying her full housing costs is restricted until after 26 weeks have expired (she will, however, receive half her housing costs after eight weeks). Net disposable income is now considerably lower than it was when she was receiving maternity pay.

In addition, she is caught in the same tax credits trap as Mike and Jenny. When Sandra went on maternity leave she had her tax credit award revised on an estimated current year's income of £5,000. This was a commonly made error on Sandra's part, due to the complexity of her changing circumstances. In fact, her actual income for the year turned out to be higher than her estimate. The spreading of tax credits income over the whole tax year has resulted in her having an end-of-year overpayment of over £200. This is collected from her continuing award, reduced, therefore, by 10 per cent.

At the beginning of September, Sandra's tax credits decrease substantially each week as her older child left home in June 2007. This is slightly countered by an increase in her IS due to her full housing costs being included from mid-September. In addition, by the end of September 2007 Sandra's overpayment from 2006/07 has been fully recovered and her tax credits increase. Her tax credits fall again in October, when she loses the baby element.

After 12 months on IS she is offered part-time work for her old agency, but at a lower wage (£6 an hour). We looked at whether working 15 or 16 hours a week and whether using formal or informal childcare would make a difference to her finances.

Working 15 hours a week, Sandra loses almost as much in IS as she gains in wages. In addition, what she spends in formal childcare tilts the balance and she is worse off in work. As she is not entitled to WTC, she receives no help with childcare. (Another option for her is to ask a family member to look after the child, in which case her childcare costs would be nil and she will gain a small amount by going to work, although she would have to pay her travel costs.)

Working 16 hours a week, however, Sandra gains entitlement to WTC and the help with childcare that goes with it. Her tax credits will increase, but she loses all her IS and is no longer entitled to full CTB or free school meals.

After four months, Sandra decides to give up her job, as she was better off overall when on benefits. (Even using informal childcare at no cost, she was still slightly better off not working.)

Under new regulations in force from April 2007, Sandra will continue to receive WTC for four weeks after she finishes work. However, this will be taken into account as income when calculating her IS entitlement while she continues to be paid WTC during the four-week period.

Points arising from this case study

Disproportionate difference in net income between 15 and 16 hours work

The difference in net disposable income depending on whether Sandra works 15 or 16 hours a week is disproportionate. Sandra's particular circumstances and the interaction between the systems have meant there is a significant difference in income per week for only one hour's work. This is primarily because there is no help with childcare costs when working 15 hours, whereas working 16 hours entitles Sandra to the WTC childcare element. It seems that this is a certain disincentive to work, particularly in cases where childcare costs are high.

Loss of passported benefits when entering work

Another contributory factor in Sandra's predicament is the loss of passported benefits when she enters work and relinquishes benefits. We have tried to quantify some of these passported benefits. Free school meals are relatively straightforward – they are worth the cost of the meal – but other benefits like health benefits are more difficult to quantify as their worth differs from person to person. In Sandra's case, the loss of full CTB entitlement and free school meals was a major factor in her decision to give up work and go back on benefits. In addition, Sandra incurs travel-to-work costs, which undoubtedly for many people are relevant in determining whether or not they are better off in work.

Case Study Three

Disability and work: Jim and Eve

In the tax year 2006/07, Jim has been looking for work for eight months while claiming contribution-based and income-based JSA. The couple have two children, one of whom, Devin, is disabled and for whom they receive disability living allowance (DLA) middle rate care and higher rate mobility components. Eve (who stays at home to look after Devin) claims carer's allowance (CA). The family also receives full HB and CTB, maximum CTC (including the disabled child element for Devin) and child benefit. In addition, they get free school meals and are exempt from NHS charges.

At the beginning of August 2006, Jim is offered three jobs at a relatively low hourly wage, each with different working hours. Whichever job Jim takes, the family will lose their income-based JSA and with it the automatic entitlement (or 'passport') to maximum HB, CTB and CTC. Jim will, however, be entitled to some WTC.

Jim wants to return to work and increase his skills. He therefore decides to take the job, enabling him to work 16 hours a week and allowing him to continue to help his wife with their disabled child and other child. With Jim working 16 hours a week, the family is still entitled to a small amount of HB and CTB. But overall, taking into account the travel costs Jim incurs getting to work and the loss of free school meals, they are marginally worse off by Jim taking his job for 16 hour a week at a low wage.

In the event, Jim loses his job in mid-October 2006 because the company has not got sufficient work to keep him on. He re-claims income-based JSA and again the family receive their passport to full HB, CTB and CTC. The family also regain their free school meals and save on Jim's travel costs.

Jim is approached by a friend who tells him that he can find him a job for 20 hours a week, paying £10 per hour. His friend explains that the job is paid 'cash in hand'. This would be paid in addition to his benefits. However, Jim realises that the consequences of accepting this offer can mean large overpayments of benefits and tax credits, as well as penalties. In addition, there would be implications of doing such work for tax and national insurance record. Jim therefore decides to decline.

However, in April 2007 Jim decides to work full time when he is offered a labouring job. He starts working 38 hours a week for an annual salary of £16,000. Eve now loses the dependant's amount she received in her CA for Jim when he was on income-based JSA.

Because Devin is disabled, he has to go to a school some distance away from the family's home. Eve must, therefore, arrange childcare for the couple's other child, Daniel, for an hour before and an hour after school. However, she cannot claim the childcare element of WTC because, to be eligible on a joint claim, both members of the couple must be in work (or one must be in work and the other incapacitated or in prison). It is not sufficient for one to be in work and the other a carer.

Jim and Eve receive WTC and CTC. Their provisional award is based on the last set of income details HMRC has, which is an estimated income for 2006/07. After completing the renewals process, as well as being due a refund of tax credits for 2006/07, Jim and Eve have their 2007/08 award revised to be based on the actual previous year's income of just over £5,000. The consequence of this is that they are now receiving maximum WTC and CTC – a substantial amount.

However, this may create a false sense of security for the family if they do not grasp how the tax credit system works. Even though Jim has taken a substantially higher paid job than he has had previously, the family are receiving more tax credits. If their circumstances continue to remain the same throughout the year, their 2007/08 award will be finalised on the very low 2006/07 income figure. However, caution must be exercised. The couple benefit from the £25,000 disregard in comparing their 2007/08 income with their 2006/07 income. This benefit will disappear when their 2008/09 award begins. Accordingly, while the family may be in exactly the same circumstances with the same income as throughout 2007/08, they will face a massive decrease in tax credits, as their 2008/09 award will be based on their actual earnings in 2007/08.

Four months after starting work, Jim is involved in an accident. He receives statutory sick pay (SSP) and Eve can, once again, claim the adult dependant element of CA. Their tax credits remain the same because Jim is counted as still in remunerative work. However, their overall income drops significantly due to Jim's lost wages (although this is slightly counteracted by increased HB/CTB).

Jim continues to be unable to work and at the end of the SSP period moves onto short-term higher rate incapacity benefit (IB). He is no longer entitled to WTC, but under new rules Jim will continue to receive it for four weeks after his entitlement ends. This will, of course, be taken into account when assessing HB and CTB. In addition, Eve is no longer entitled to the adult dependant addition in her CA. This is because of the overlapping benefit rules (with Jim's IB).

After four weeks, WTC ends and the family face yet another drop in their income. Although at this point their HB/CTB increases, they try to apply for IS as they are struggling financially, but their income is too high to claim.

The family has less money than previously, so Eve decides to take a part-time job. She loses her CA, and HB and CTB are also affected. After eight weeks, the carer's addition in their HB stops. She concludes that the family does not gain sufficiently to warrant her continuing in work.

Points arising from this case study

Interaction between carer's allowance and working tax credit

The interaction between CA and WTC makes it virtually impossible for a carer to gain financially by combining work with her/his caring responsibilities. There is also no help with childcare costs for the couple's other child because only one adult is in paid employment. Yet additional childcare costs arise for the family as a result of Devin's special needs.

Appendix B

Interview schedule

Personal information

Where do you live? (Ask for the neighbourhood, area)

Do you live in an apartment or a house?

Is your accommodation rented or owned? Are you renting from a private landlord, the council or a housing association?

What is you sex? (This one question can be ticked by the interviewer)

What is your age? (Here we could provide age groups to be ticked)

Also, we could ask about their ethnic background. Again, we could provide some broad ethnic classifications based on the more detailed ethnic classification used by the Office for National Statistics.

The purpose of this part is to have some sense of whether or not, for the interviewees, these characteristics would make any impact on their perceived reality of the benefit and taxation system.

The use of the benefit and tax systems

What kind of benefits are you getting?

How did you find out about your entitlement to these benefits?

How long have you been in receipt of these benefits?

Have these benefits remained the same?

Have you become entitled to other benefits? Since when?

Are you still in receipt of benefits?

Did you at any point stop receiving these benefits because you were not entitled to them?

How has the granting and receipt of benefits been for you (eg, lengthy, hard to understand, etc)?

Administration of the benefit and tax systems

Do you fill in the application and renewal forms every time?

If you need help, who do you go to? Jobcentre Plus, a charity organisation, a relative, a friend?

Do you understand why you get the benefits you get?

Are you clear about the amounts you have received every month and every year?

If you are not clear, do you ask for clarification? Where do you go to?

What do you do if and when you have received notice about a drop in the amount you receive, and/or that a given entitlement is to cease?

How do you deal with delays in the payment of benefits? Do you call the Revenue and Customs department, the Jobcentre Plus? Do you go to the Jobcentre Plus? Do you go to a charity organisation? Or do you go to a local tax enquiry office?

Is there any difference in the consideration to your problem/concern between a government department (office) and the charity organisation you went to?

Do you have any idea whether or not the time when you make the claim will affect your entitlement?

Impact of the benefit and taxation systems on people's lives

How has the receipt of benefits helped to fulfil your economic needs?

In your view, how important is the benefit you receive?

Have your entitlements changed? Has this been upward or downward change?

Have you received, according to Revenue and Customs, an overpayment of your entitlement?

How did the notice of an overpayment affect you (eg, economically and emotionally)?

Were you asked to pay this overpayment back?

Did you think you were able to 'negotiate' paying back the overpayment or was it imposed on you?

Were you aware how the overpayment had arisen? Did you (or your adviser) try to find out from the Tax Credit Office or from a local tax office, and what was your experience?

Changes and transitions: people's circumstances

Are you employed? Part time or full time?

If you work part time or are staying at home, do you think that by returning to work or working full time you would be better off?

Is your work (hours and income) stable? If not, how often has it changed in the last year?

Do you think that the instability of your income from employment affects the level of tax credits you receive?

How do you cope with the instability of income from employment and the changing entitlements?

Do you think that if your circumstances were to change, the tax credit and benefit systems would help you cope?

Do you think that your changing circumstances (eg, divorce/separation, new baby, a child leaving home) would affect the level of entitlement to tax credits and benefits?

How, in your view, would the system need to change to deal with your changing circumstances?

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