Care Leaver Payment: consultation
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 Our response focuses on tax and benefits considerations in the development and delivery of the Care Leaver Payment.

1.2 Although we stop short of advocating a particular policy approach, given the stated intention for the payment and the fact that the Scottish Government views care leavers as potentially disadvantaged, we think consideration should be given as to whether the Care Leaver Payment should be exempt from income tax and disregarded in the calculation of benefits payments.

1.3 If the payment is to be treated as taxable income, we set out key considerations, such as the need to consider the categorisation of the payment under legislation and the practicalities of collecting tax on the payment. If tax is to be deducted at source, we set out the need to consider the practicalities for recipients of reclaiming overpaid tax and the need for clear guidance and support for recipients of the payment. We stress the importance of the Scottish Government and HMRC working closely to ensure good operational processes, as well as communications for recipients.

1.4 For benefits purposes, we look at the implications of the payment being taken into account when calculating entitlements. We note that the Scottish Government must work closely with the DWP to ensure any legislative amendments are made, such that the payment fulfils the policy intent.

1.5 The Scottish Government should also try to ensure that it incorporates learning, not only from its own experiences of introducing other new support payments in Scotland, but also from the experiences of colleagues in the Welsh Government, in relation to their basic income for care leavers pilot. Although, we acknowledge that in some cases, these experiences relate to regular instalments rather than one-off payments.

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2 About Us

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

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

3.1 We welcome the opportunity to respond to the Scottish Government's consultation on a Care Leaver Payment.

3.2 The majority of the questions concern policy decisions, in relation to such issues as eligibility criteria and the form the payment should take. These are not issues we are able to comment on. However, with our focus on interactions between the tax system and related systems, such as benefits, there are a number of other areas that we think need to be considered as the Scottish Government develops this policy. So, our response focuses on question 21.

4 Q. 21 Is there anything else you think the Scottish Government should consider in the development and delivery of the payment?

4.1 ***Tax and National Insurance contributions***

4.1.1 Consideration will need to be given as to whether the payment is taxable, and if so, how it should be treated for tax purposes. We do not advocate for a particular approach. However, given the intention in terms of benefits (see below), and the Scottish Government's views of care leavers as potentially vulnerable and disadvantaged, it is worth considering whether to exempt this one-off payment from tax, which may be simpler administratively, for the recipients, Scottish Government and HMRC. This would be in line with the treatment of other payments designed to help individuals who face extra costs, such as unpaid carers and those with disabilities. We look at the implications of the payment being taxable versus exempt from tax in the following paragraphs.

4.1.2 The proposal is for a one-off payment, so if it is taxable, it is likely that it could be treated as taxable miscellaneous income under Part 5 of the Income Tax (Trading and Other Income) Act 2005. In this case, if there was agreement that the payment fell specifically within Chapter 8, Part 5, then the Trading Allowance[1] (Chapter 1, Part 6A) may be available to offset against the payment, depending on the care leaver's precise circumstances. This removes up to £1,000 of the payment from the charge to income tax. If the care leaver had taxable income exceeding the personal allowance, this would minimise the amount of the Care Leaver Payment that would be charged to tax, leaving them more of the payment available to assist them. We understand that the Welsh Government's monthly payment to care leavers is viewed as taxable under Chapter 7, Part 5, meaning that the Trading Allowance does not apply[2]. However, the Welsh monthly payment is more akin to a basic income (and has tax deducted at source). It therefore serves a subtly different purpose to the proposed Scottish payment, so different tax treatments may be justified.

4.1.3 If the preferred option in delivering the policy objective was to exempt the payment from tax, this could be under Part 6 of the same Act. We expect this would require legislative amendments to Chapter 9, Part 6.

4.1.4 It appears unlikely that the payments would be subject to National Insurance contributions (NIC) because the payments do not constitute 'earned income'. However, one question is whether the payment should entitle the recipient to National Insurance credits. This may help young people who are at risk of having gaps in their National Insurance record. Although young people may have plenty of time to build up the number of qualifying years to be eligible for a full state pension, having credits could help them apply for more immediate state benefits[3]. Given the proposal is for a one-off payment, this may not be feasible, but the issue could be considered.

4.1.5 More broadly, if the payment is taxable, the government must decide how to collect any tax liability that arises on the payment. Will tax be deducted at source, by whichever body has responsibility for paying it? Or will the recipient have a responsibility to contact HMRC, so that they can collect the tax either through Pay As You Earn (PAYE), if the recipient is in employment, or through Self Assessment?

4.1.6 If tax is deducted at source automatically, under PAYE for example, but this results in the recipient overpaying tax and being eligible for a tax refund, what mechanism will apply for reclaiming the tax – will a form R40 suffice (completing boxes 7.4 to 7.6 in relation to the payment), or will the care leaver have to complete a Self Assessment tax return to obtain a tax repayment?

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[1] https://www.litrg.org.uk/tax-guides/self-employment/what-trading-allowance

[2] https://www.gov.wales/basic-income-pilot-care-leavers-overview-scheme

[3] Benefits such as contribution-based Jobseekers Allowance and contribution-based Employment and Support Allowance, require, as a precondition to entitlement, that the worker pays (or is credited with) NIC for a sufficient length of time during relevant tax years. If you do not qualify for contribution-based Jobseekers Allowance or Employment or Support Allowance because of your National Insurance record, income-based alternatives, including Universal Credit in some areas, may be available.

4.1.7 The personal allowance applicable throughout the UK is currently £12,570 per annum. This level means that, if the care leaver has a low income (which seems a realistic possibility given the disadvantages faced by care leavers as noted in the consultation document), and tax is deducted at source from the Care Leaver Payment, the recipient is likely to be eligible for a tax refund. This creates a couple of key issues. Firstly, there is a cash flow issue for the recipient, who would receive the £2,000 payment net of either 19% or 20% tax, depending on the rate set for the tax deduction. This would mean they would only receive approximately £1,600 at the time the payment is made. Secondly, the care leaver would have to submit a tax refund claim, which could take months to obtain – an administrative burden for both the care leaver and HMRC. Also, to obtain the tax refund, the care leaver would need to be aware that the tax refund is available and would also need to be confident of completing the HMRC form necessary to obtain the tax refund. Given the barriers that care leavers face, it would not be surprising if many care leavers were to miss out (due to lack of awareness or inability to make a claim) on a proportion of their Care Leaver Payment if it is taxable and tax is deducted at source. This could be exacerbated if a care leaver does not have a long-term fixed address or is homeless.

4.1.8 If the payment is taxable, but the recipient receives it gross (no tax is deducted at source), this may create an administrative burden if the recipient has taxable income in excess of the personal allowance. The care leaver would need to notify HMRC of the receipt of the payment, to enable HMRC to collect the tax. HMRC would then either have to arrange to collect the tax through PAYE (if the recipient has a source of PAYE income), or by asking the care leaver to complete a Self Assessment tax return, or by issuing the recipient with a Simple Assessment.[4] If the payment must be declared on a Self Assessment tax return, then there would need to be a clear decision, and guidance for care leavers, as to where to include the payment in that return.

4.1.9 We expect the Scottish Government will liaise closely with HMRC, who have responsibility for the administration of both tax and NIC. This would be important both in respect of communications, guidance and support for care leavers in respect of the Care Leaver Payment, but also in respect of operational and administrative processes. We understand that there was partnering with CAB Cymru in respect of the Welsh basic income care leavers pilot, to provide care leavers with help on budgeting and tax administration. Scottish Government could consider whether there are any key stakeholders that could provide direct, practical assistance to care leavers in respect of the Care Leaver Payment.

4.2 ***Benefits***

4.2.1 The treatment of the payment for Universal Credit (UC) needs to be explored. The likely options appear to be that the payment is treated as capital only or as unearned income. Alternatively, the payment could be disregarded in the calculation of UC. We note that, according to the consultation document, the current intention is that "the receipt of this payment should not negatively impact an individual's entitlement to other support". Disregarding the payment in the calculation of UC and

[4] https://www.litrg.org.uk/tax-guides/tax-basics/what-simple-assessment

other benefits would perhaps be the best way to achieve that intention. We consider the implications of different treatments for UC purposes in the following paragraphs.

4.2.2 If the payment is treated as unearned income, for example under Reg. 66(1)(m) of the Universal Credit Regulations 2013, then how it is taken into account depends on what period the payment is in respect of, under Reg. 73 of those same regulations. As a one-off payment, if it is unearned income, it may be fully offset against a recipient's UC entitlement in the assessment period in which it is received, and any amount of it remaining unspent in the following assessment period is likely to be treated as capital (Reg. 46 of the Universal Credit Regulations 2013). Regardless of whether it is taken into account in one assessment period or over more than one, unearned income still reduces a UC award pound for pound.

4.2.3 If the payment is treated as capital, then the government must consider whether to amend the legislation such that it is disregarded as capital, under Schedule 10 of the Universal Credit Regulations 2013. This would be similar to the treatment of a few other grants and payments implemented by the Scottish Government in recent years, such as carer's assistance – young carer grants. Note that capital up to £6,000 does not affect UC, capital between £6,000 and £16,000 attracts tariff income which reduces the UC award and capital over £16,000 removes entitlement to UC.

4.2.4 The current UC regulations are unclear whether payments such as this would be taken into account (if they are designated capital or income) as a gross amount or net of any tax (if taxable) and therefore recipients could find their UC awards impacted by a greater amount than they actually receive. In addition, as noted above, if tax is deducted automatically from the payment at source, some recipients could be entitled to a tax refund so there also needs to be consideration of how such a tax refund would be treated for UC.

4.2.5 We expect the Scottish Government will liaise closely with DWP, which has responsibility for delivering UC. This should ensure that any necessary legislative amendments are made such that the payment fulfils the policy intent.

4.3 ***Student finance applications***

4.3.1 The treatment of the payment for student finance applications also needs to be explored. Most types of income need to be disclosed on student finance applications so that the amount of eligible student loans can be calculated.[5] Recipients of the payment who apply for student finance will need to know whether to disclose the payment and where to include it on the application form.

4.3.2 Interaction with the Care Experienced Student's Bursary should also be considered as some care leavers will be eligible for this bursary instead of student loan finance.

LITRG
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[5] As explained on the Student Awards Agency Scotland website: https://www.saas.gov.uk/need-to-know/household-income-guide/your-student-income