

**Universal Credit Review
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 LITRG welcome the opportunity to feed into the Department for Work and Pensions' informal review of universal credit. We understand the review is considering the support across the three themes of tackling poverty and helping people manage their money, making work pay and improving work incentives, and maximising universal credit's potential and its impact on customers. We have limited our submission to areas where we can add most value – which are where there are interactions with tax rules and the tax system and in looking at the treatment and impacts of income in the universal credit system, in particular areas where there are potential benefits from better guidance and smoother interactions with the tax system. We have made practical recommendations that support universal credit's original goals of making work pay, easing the transition into work and simplifying administration for both claimants and government.
- 1.2 Claimants can deduct unreimbursed work-related expenses from employed earnings, which could lead to a higher universal credit award in some cases, but awareness of this rule is low and guidance is lacking. LITRG recommends DWP urgently update online guidance and universal credit award notices to inform claimants and staff, with clear instructions on how to report such expenses.
- 1.3 With payrolled benefits in kind mandated from April 2027, there is a need for DWP to clarify their position in respect of benefits in kind. Originally it was intended benefits in kind would be taken into account as income for universal credit purposes, but this was not enacted initially. It is unclear whether the intention is to exclude benefits in kind permanently as income or whether the intention remains to bring them within scope of universal credit. Claimants need certainty on this point and, if a decision is taken to include benefits in kind as income, thought needs to be given about how it would impact those who are already in receipt of benefits in kind if the rules change.
- 1.4 In relation to pension contributions, we continue to see a poor level of understanding about how different types of pension contributions affect universal credit awards and how they should be reported and taken into account. While improvements have been made, confusion persists around salary sacrifice and private pension contributions. We recommend DWP:

- Produce guidance on the impact of salary sacrifice for universal credit, especially where it can affect thresholds
- Publish guidance setting out the DWP position in relation to 'excessive' pension contributions both internally and externally

- 1.5 This review is also an ideal opportunity to re-visit some of the rules for those claimants who are self-employed. In particular, we believe universal credit would be more effective and reliable if the rules for business expenses for tax and for universal credit were more closely aligned.
- 1.6 The trading and miscellaneous income allowance in the tax system can lead to confusion and potential under-reporting of earnings for universal credit claimants (with consequent uncertainty and disengagement) and clearer guidance would help mitigate this risk.
- 1.7 Further, we believe the way the minimum income floor policy currently applies, in terms of the period over which a claimant's self-employed earnings are assessed, is unfair, does not reflect the realities of self-employment, does not improve work incentives nor help people manage their money. A more equitable solution, that still meets the objectives of the original policy, would be to allow self-employed earnings to be assessed as an average over a period. It cannot be right that a self-employed person who earns the same as their employed counterpart over a 12-month period receives less universal credit.
- 1.8 HMRC are introducing their new tax initiative to digitise reporting of self-employed earnings and rental income called Making Tax Digital for income tax. Universal credit claimants are currently not exempt from Making Tax Digital requirements. Opportunities may be available for the sharing of data but this will require close liaison with HMRC to explore the benefits for DWP and claimants and we recommend a consultation is carried out to explore various options.
- 1.9 In terms of work incentives, we believe there is an opportunity to improve the way earned income is measured in the application of the administrative earnings threshold. The current approach does little to incentivise those with a mix of earnings from employment and self-employment.
- 1.10 Increasing numbers of people claiming universal credit are likely to work in the gig economy, that is, working through online platforms. There are many questions about how claimants should report aspects of the income that they get from this type of activity and questions about consistency of decision making by DWP. This can so easily discourage and confuse claimants or prove unwieldy to constantly have to challenge or be challenged by DWP about the value of their monthly awards. We believe the situation would be improved by DWP publishing specific guidance for the growing number of people working in this sector.
- 1.11 Claimants who receive pension income have their universal credit awards reduced by the gross value of the pension payments, even where they pay tax on those payments. This means their universal credit awards are reduced by more than the amount of income they actually receive. This leads to inconsistency in the system – we believe there is opportunity to change the rules to reflect people's net position.
- 1.12 Uncertainty about rules and entitlement has a negative effect on universal credit achieving its aims. We would urge DWP to publish some guidance, with illustrative examples, about miscellaneous

income. We appreciate not every scenario can be covered and this is no doubt a more obscure source of unearned income but the impacts of getting it wrong can be significant and guidance would help alleviate those concerns.

- 1.13 We recommend the benefit cap should be based on gross rather than net earnings for fairness and consistency with other thresholds.

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 who are least able to pay for professional advice. We also produce free information, primarily via our website www.litrg.org.uk, to help make a difference to people's understanding of the tax system.
- 2.2 LITRG works extensively with key stakeholders such as HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the tax system. LITRG also considers the welfare benefits system, and other related systems, to the extent that they interact with tax.
- 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 Our submission focuses on those areas where we can add most value – where there are interactions between the tax and benefits systems. When universal credit was introduced, three of the stated aims were to:
- Encourage people to start paid work or increase their hours by making sure work pays
 - Make it easier for people to manage the move into work
 - Simplify the system, making it easier for people to understand, and easier and cheaper for the government to administer
- 3.2 We have identified a number of issues, all of which we believe require relatively straightforward fixes, to ensure the rules work as intended and support those aims rather than work against them. Where the current rules, processes or guidance are unclear or unhelpful this leads to uncertainty, inconsistency and difficult administration all of which hinder the effectiveness and reputation of universal credit.
- 3.3 The changes and improvements we suggest in this paper would relieve the burdens on both claimants and DWP, improve consistency and administration and build trust in the system which will play a valuable role in advancing the three particular themes of this review. We leave it to others to offer thoughts on topics such as the claim process, payments and award values. LITRG's main focus,

and where we can add the most value, is in looking at the treatment and impacts of income in the universal credit system, in particular areas where there are potential benefits from better guidance and smoother interactions with the tax system.

4 Earned income – employed earnings

4.1 Unreimbursed expenses

- 4.1.1 When calculating earned income, the universal credit rules allow for a deduction for any unreimbursed work-related expenses from the claimant's employed earnings figure¹. Broadly speaking, allowable expenses under this provision mirror tax provisions for work related expenses. This information is not provided to DWP by HMRC and must be reported by the claimant themselves. However, this rule is not promoted in the information about universal credit on the GOV.UK pages and can only be found either from the legislation or from searching the official staff guide, Advice for Decision Making. Most universal credit claimants are not aware of the Advice for Decision Making manual, nor should they be.
- 4.1.2 We raised the issue of unreimbursed expenses in 2018 and Sir Stephen Timms, then in opposition, kindly tabled a Parliamentary Question on the issue - asking the then Secretary of State for Work and Pensions what steps he was taking to inform claimants that they can deduct unreimbursed expenses against their income in order to obtain a higher payment of universal credit. The answer was that DWP were in the process of updating their external communication products and guidance for staff to ensure that claimants are made aware that unreimbursed work expenses can be offset against the income².
- 4.1.3 We continue to hear concerns that claimants are unsure whether and how to report such unreimbursed expenses to DWP and also that they struggle to persuade DWP officials that such deductions should be made from their employed earnings. In some cases people continue to be unaware that this rule exists and that their award should be higher if they have certain unreimbursed expenses.
- 4.1.4 Despite the assurances given in 2018, we are not aware of any external communications products that explain this point and it is not clear whether claimants are made aware of this through the universal credit application process or at any other points, for example when they start a new job or on each award notice. The position is also unclear for those who may receive only partial reimbursement of their work-related expenses – any guidance should cover this point.
- 4.1.5 Unreimbursed expenses are a key feature of certain types of employment, for example those in the care sector. Better understanding of this rule, for both DWP staff and claimants, would help ensure people receive their correct entitlement. **We recommend that DWP should, as a priority, explicitly make claimants aware of these rules by including information in online guidance and by including messages on universal credit award notices (if they are not there already). Such guidance should**

¹ [The Universal Credit Regulations 2013](#) (reg55(3)(a))

² <https://questions-statements.parliament.uk/written-questions/detail/2018-03-21/133803>

explain clearly how to report unreimbursed expenses to be taken into account for their universal credit award. Internal processes and staff training should be updated to ensure the process works smoothly and staff are aware of it.

4.2 *Benefits in Kind*

- 4.2.1 Currently, benefits in kind such as company cars and private medical insurance are not taken into account as earned income for universal credit, even though HMRC treat them as earnings for tax and they were earned income in the tax credits system. We understand the longer term aim is to include benefits in kind as income for universal credit. With the mandation of payrolled benefits in kind coming from April 2027, **we think there is a need to confirm the position of benefits in kind for universal credit so that claimants can have some certainty. This should include confirmation of what will happen for those currently receiving benefits in kind that are not taken into account should the rules change, as this is likely to have a significant impact.**

4.3 *Pension contributions*

- 4.3.1 This is a topic that has long attracted attention and seems to have been the cause of considerable confusion and, perhaps, error. We note that some improvements have been made, for example resolution of issues relating to net pay schemes and the administrative earnings threshold (AET) and improved guidance for claimants, but concerns remain.
- 4.3.2 In our experience, there is a great deal of confusion generally (both amongst members of the public but also sometimes government staff) about the different ways that pension contributions can be made, how tax relief is given and the impact on benefits. This is not a new situation; we saw a great deal of confusion in the tax credits system on this same point.

Salary sacrifice

- 4.3.3 One way of making pension contributions is through a salary sacrifice arrangement – where an employee sacrifices some of their salary and in return their employer makes a larger pension contribution to the employee’s pension pot. The employee and employer make a national insurance contribution saving. We understand that the level of employed earnings taken into account for the universal credit award is after the amount of salary foregone and, in many cases, this means the claimant receives a higher universal credit award than would be the case without the salary sacrifice. As salary sacrifice involves a contractual salary change, the amount of gross salary (taxable pay) reported to HMRC through RTI by the employer is lower – which feeds through to DWP for the universal credit calculation.
- 4.3.4 However, because the earnings figure is lower, that can risk the claimant falling below one of the key earnings thresholds in relation to the work-related requirements or benefit cap. The administrative earnings threshold, the conditionality earnings threshold and benefit cap are set in terms of earnings levels that are equivalent to a certain number of hours worked at the national minimum wage, but they are defined as a monetary value. It is therefore possible that although salary sacrifice is not allowed to reduce the individual’s hourly rate below their national minimum wage, they may still find they unwittingly fall below one of these thresholds due to their choice to use salary sacrifice even though they may be working the required number of hours for the various thresholds. **In the**

short term, we recommend better guidance is provided to help people make informed choices around salary sacrifice options and the potential impact on universal credit (including the various thresholds). In the longer term, we think DWP should consider whether there is any legislative or process change that could ensure such people do not fall below the various thresholds simply due to their decision to use salary sacrifice rather than a different way of contributing to their pension.

Excessive pension contributions

- 4.3.5 We are aware of a small number of cases where it appears DWP have attempted to argue a claimant's pension contributions have been excessive and they have either disallowed the deduction or treated the claimant as having the equivalent earned income under the deprivation of income rules. We do not agree with either approach from our analysis of the legislation and think there is no cap on the amount of pension contributions that can be deducted when calculating earned income. **If DWP's position and interpretation of the legislation is that there is a limit to the amount of pension contributions that are acceptable for universal credit, we believe better guidance and information for claimants and staff about the parameters of any restriction is needed. This guidance should set out when DWP would seek to apply such a restriction, and what is regarded as 'excessive', so that claimants know what the position is, can understand any decisions and, if they choose, challenge through the appropriate channels.**

5 Earned income – self-employed earnings

5.1 Business expenses

- 5.1.1 In universal credit, the rules covering business expenses for calculating self-employed earnings differ from the tax system in several respects. Our 2017 report 'UC- lifting the burdens for the self-employed'¹ highlighted some of these disparities between reporting for HMRC and for DWP and those points largely remain today. Some key examples of the misalignment of self-employment rules for tax and universal credit purposes are as follows:

- Most business expenses are allowable for tax purposes if they are wholly and exclusively for the business to trade. For universal credit however, business expenses need to be wholly, exclusively for the business and also reasonably incurred. 'Reasonably incurred' is not defined in legislation and it is therefore up to DWP officials to determine if an expense is reasonably incurred but there is a lack of clear guidance for DWP staff or claimants leading to both confusion and inconsistency. This 'reasonableness test' also appears in other social security means-tested benefit rules and, anecdotally, we have seen suggestions that although the business expenses have met the reasonably incurred threshold in those other benefits, they are being disallowed for universal credit, without explanation for the change in adherence to the test.

¹ https://www.litrg.org.uk/sites/default/files/self-employed_claimants_of_universal_credit-lifting_the_burdens.pdf

- Although the use of cash basis accounting for tax purposes is now the default option¹, the cash basis for tax is not fully aligned with that for universal credit and it cannot be assumed that what is correct for tax purposes is also correct for universal credit purposes. Further divergence can be seen with the changes to the cash basis for tax purposes from April 2024, for example there is no longer an interest restriction for tax purposes and yet for universal credit the monthly limit of £41 remains.

5.1.2 Our concern is that the different rules for universal credit and for tax lead to confusion and additional work for claimants. The lack of clear guidance for claimants and for DWP staff leads to inconsistent decision-making and unnecessary follow-up or repair work. In our paper, 'Online platforms – the changing landscape for the self-employed'² we explore these issues in more detail, with particular emphasis on the increasing number of people earning through online platforms such as delivery drivers.

5.1.3 **We recommend that the reasonableness rule is removed from universal credit and that consideration is given to aligning the universal credit rules with the tax system. This would make the system administratively more straightforward for claimants, easier to explain and it would mean decision makers do not need to review every expense and make a decision on its reasonableness.**

5.2 *Trading Allowance*

5.2.1 There is a trading and miscellaneous income allowance for tax purposes but no equivalent in universal credit. There appears to be a high level of general awareness about full relief trading allowance and that you do not need to pay tax or complete a tax return if you earn £1,000 or less. However, there is a clear risk of confusion for universal credit claimants not reporting £1,000 or less of self-employed earnings or miscellaneous income to DWP because they mistakenly think this income follows the tax rules and does not need to be declared. **Publication of clear guidance on GOV.UK universal credit pages and on screens where people declare income and some communications directly to universal credit claimants would be beneficial.**

5.3 *Minimum income floor*

5.3.1 We understand the rationale behind this policy and the need for balance when determining to what extent the state should support businesses that make little profit, but we continue to have concerns about the fairness of the policy for those who do have viable businesses but who suffer due to the inflexibility of the rules relating to expenses and monthly assessment periods. It should not be the case that a self-employed person can receive a much lower universal credit award than their employed counterpart – even though they both earn the same over a 12-month period. The

¹ an election can be made to use the accruals basis instead, and certain self-employment trades are not allowed to use the cash basis

² <https://www.litrg.org.uk/reports/online-platforms-changing-landscape-self-employed>

universal credit rules do not currently reflect the reality of self-employment, where it is common for people to have fluctuating income and expenses.

- 5.3.2 As things currently stand, when DWP determine whether to apply the minimum income floor to an award (assuming the claimant is not exempt), they generally look at the self-employed earnings in the assessment period¹. This means, where a self-employed claimant has a large business expense in that assessment period or a dip in receipts so that their net profit is relatively low that month, they risk having the minimum income floor applied to their award. When combined with the surplus earnings rules², this can lead to a very bumpy and unpredictable pattern of universal credit support. By contrast, a claimant with similar annual self-employed earnings but whose business trades with a very regular receipts and expenses pattern is less likely to have an assessment period where their net profit is low and less likely to have the minimum income floor applied. Overall, they may well earn the same level of earnings from their business annually, but the effect of the minimum income floor means that one will receive less universal credit support over time than the other, simply due to the nature of their business.
- 5.3.3 The stated objective of the minimum income floor was to remove state support for businesses that were not viable in the longer term. Arguably, it achieves this aim when considering those who have low profits over a 12-month period. However, as explained above, it unfairly impacts those who do have viable businesses and who are making a profit above the minimum income floor over a 12-month period but who, due to the nature of their self-employed business, have fluctuating incomes.
- 5.3.4 This seems an unfair approach to financial support provided to people who fundamentally earn perhaps the same level of annual earnings. We believe this significant unfairness could be addressed whilst retaining the general principles of the minimum income floor in respect of those businesses that are not, in the longer term, viable – for example by allowing an average monthly earnings figure taken over a more reasonable timeframe to be used. The basis of averaging income is already established in the conditionality rules. We recommend that DWP explore this, and other options, to amend the legislation in order to address this unfairness. It does not support the principle of making work pay, especially when self-employment offers many benefits to those who need some flexibility.
- 5.3.5 We understand concerns that there may be a risk of income manipulation in order to maximise universal credit entitlement with this approach, but **we believe that could be addressed by giving DWP the option to direct the period over which the self-employed earnings should be averaged in cases where that particular risk is evidenced and the proposed averaging by the claimant is not supported by the income/expense profile of the business.**
- 5.3.6 Allowing self-employed claimants a choice of averaging income over a period of time would benefit the many self-employed claimants who have natural fluctuations in the frequency of their receipts and expenses. It would mean that these businesses would be less susceptible to the highly complex

¹ The exception to this is that a loss in one period can, in certain circumstances, be carried forward to a later period.

² Presently the surplus earnings disregard remains at £2,500 but originally it was intended to lower it to £300 which would exacerbate this issue.

surplus earning rules and not be unduly penalised by the minimum income floor regulations. In our paper, 'UC – lifting the burdens for the self-employed'¹ we explore this, and other recommendations, in more detail.

5.4 ***Making tax digital for income tax***²

- 5.4.1 Making tax digital for income tax will start to be introduced by HMRC from April 2026 and will eventually affect self-employed individuals (as defined for tax purposes) and individuals receiving property income with annual gross income of more than £20,000 from their self-employment and property letting. Those with annual gross income of £20,000 or less from these sources are not currently in scope of making tax digital. The new system will mean taxpayers with trading income will need to submit quarterly updates to HMRC to declare business/property income and expenses for the period covered by the update. There are several potential opportunities for DWP and HMRC to join up in some way to make use of this quarterly date for universal credit awards, along similar lines to the real-time information employed earnings data that HMRC share on a monthly basis.
- 5.4.2 There is some merit in exploring how making tax digital and universal credit could link together – not least because without it, universal credit claimants who fall within making tax digital will need to make at least³ 17 reports a year (12 for universal credit, 4 quarterly making tax digital updates and 1 tax return) and the figures for each, as explained above, are not exactly the same. When making tax digital was first introduced, we proposed exempting universal credit claimants.
- 5.4.3 If universal credit claimants are not exempt from making tax digital requirements, **we recommend that DWP and HMRC consult on potential options for alignment between making tax digital and universal credit. This could include everything from the sharing of data that is used by DWP to identify possible error and fraud all the way to full alignment whereby submission of data for universal credit or making tax digital would feed across to the other system automatically. The pros and cons of each should be fully explored.**
- 5.4.4 For this to work, as a minimum, the reporting periods for making tax digital and universal credit assessment periods would need to be aligned in some way which will mean either HMRC or DWP will need to do make significant changes and the tax and universal credit rules for expenses and receipts need to match - or to be made very clear to claimants and DWP staff where they don't so that clear and proper processes can be introduced to still allow DWP to make use of making tax digital data. We are very happy to have further conversations with officials about this topic.

¹ https://www.litrg.org.uk/sites/default/files/self-employed_claimants_of_universal_credit-lifting_the_burdens.pdf

² <https://www.gov.uk/government/collections/making-tax-digital-for-income-tax#contents>

³ A quarterly return is needed under making tax digital for each self-employed trade as well as for property income. So for example, if someone has 2 trades, there will be 8 quarterly updates, the final tax return and 12 universal credit reports – making 21 in total.

5.5 ***Administrative Earnings Threshold and self-employment***

5.5.1 This threshold is the level of income below which DWP require a universal credit claimant to undertake the most intensive work-related requirements. However, in calculating the claimant's earnings to determine whether they reach the threshold, only employed earnings are considered and any self-employed earnings or unearned income are ignored. We believe this hinders people who are not in gainful self-employment but who may have a mixture of employed and self-employed work. **This could be alleviated by amending the rules to include all earned income (employed and self-employed) in the test of whether a claimant meets the threshold.**

5.6 ***Gig economy work***

5.6.1 We recommend that DWP urgently produce some guidance for online traders claiming universal credit and, in that guidance, clarify some specific points of potential difficulty, such as:

- the distinction between, for example, selling unwanted personal possessions and online trading which provides self-employed earnings
- timing of receipts and expenses which are held on the platform in relation to the UC assessment period; when they should be declared –for example, is it when the income is received into the platform, or allocated to the UC claimants platform account or paid out to a holding account (such as PayPal) or the claimant's bank account?
- examples of expenses that DWP would deem as incurred unreasonably, in particular, in relation to online traders but also more widely
- how DWP treat the value of 'payments in kind' for online traders (do claimants need to report these and if so, do they need to provide evidence of the value?)
- where DWP determine the claimant is not in gainful self-employment as an online trader, provide some guidance around the need to still declare receipts and expenses as self-employed income (unless its perhaps unearned income, in which case, see point below)
- provide some information about what kind of scenario, if any, DWP would decide to treat receipts from online selling/providing services on an ad hoc basis as unearned income because they're taxable as miscellaneous income rather than being from a trade, profession or vocation (with some illustrative examples).

6 **Unearned income**

6.1.1 Unearned income directly reduces a universal credit award pound for pound. Only those items listed in the rules count as unearned income which on the face of it make the rules quite straightforward, but there are some ambiguities.

6.2 ***Deductions for tax***

6.2.1 The rules do not allow any deductions from unearned income. This means where a claimant has unearned income such as retirement pension (a limited number of claimants over state pension age claim universal credit as a result of managed migration from tax credits and others may be in a mixed age couple claim) on which they pay income tax, their award is reduced by more than the amount of unearned income they actually receive.

6.2.2 This does not seem to sit well with the principle that universal credit is intended to supplement and respond to the amount of money a claimant has available to them in an assessment period. In such a case, the award is based on more income than the claimant actually receives. **We recommend further consideration be given to whether deductions for tax can be accommodated in the unearned income rules – as it was in many legacy benefits.**

6.3 *Miscellaneous income*

6.3.1 Miscellaneous income is classed as unearned income for universal credit. We have commented above on the potential confusion where a person's miscellaneous income for tax purposes may fall within the trading allowance for tax.

6.3.2 Another weakness in the current position is that it appears unclear what DWP would class as miscellaneous income. The rules do not require DWP to follow HMRC's tax determinations about miscellaneous income and the absence of any clear information, or even examples, presents another opportunity for misreporting by claimants and incorrect awards by DWP. **We recommend that DWP publish more detailed guidance about their approach to miscellaneous income and what counts as miscellaneous income for universal credit purposes.**

7 **Thresholds**

7.1.1 There are a number of thresholds in universal credit including the administrative earnings threshold (AET), the conditionality earnings threshold (CET) and the benefit cap which can affect work conditionality requirements and sometimes the amount of universal credit an individual can receive. There are a number of anomalies that we have come across with these thresholds that mean they work against the principle of making work pay and make universal credit complicated for claimants to understand. We think with a number of small changes, these anomalies – which are likely unintended consequences – can be addressed.

7.2 *Administrative Earnings Threshold (AET)*

7.2.1 Broadly, the AET is used to decide the degree of work activity that someone is expected to do if they are in the all-work requirements group. If someone earns below the AET (or the combined AET if part of a couple) then they must show they are actively looking for more or better paid work or be available for work. If someone earns above the AET they will not have regular meetings with a work coach. Currently the AET is set by reference to 18 hours at the National Living Wage – currently £12.21 per hour - (not adjusted for age) converted to a monthly amount by multiplying by 52 and dividing by 12. The current AET is therefore £952.38 for each monthly assessment period. When determining if someone meets the AET – it is their gross income in that assessment period (after deduction of any payroll giving but before deduction of tax, NI and pension contributions) that is taken into account.

7.2.2 We have noted above that the AET should include self-employed earnings – so that someone who does employed work and self-employed work can meet the threshold as they are working the required number of hours and self-employment is a legitimate form of work.

- 7.2.3 The premise of the AET is that it is based on someone working 18 hours a week at national minimum wage – but converted into a monthly monetary threshold. However, the method of conversion means that someone working 18 hours a week at the national living wage paid weekly, two weekly or four weekly will fall below the AET – even though they are working the required number of hours. This is because the legislation converts the threshold to a monthly amount and those paid weekly, two-weekly or four weekly fall below a monthly calculated AET in several assessment periods.

Example

Mason is a single individual who works 18 hours a week and is paid the national living wage of £12.21 an hour. He is paid 4 weekly and receives £879.12. Over 12 months, he has 11 universal credit assessment periods where he fails to meet the AET of £952.38 even though he works 18 hours a week. He has one universal credit assessment period where he meets the AET because he has 2 x 4 weekly pays taken into account in that period.

- 7.2.4 The above example gives an extremely unfair result due to the decision to calculate the AET in the prescribed way – even though it is based on working 18 hours a week.
- 7.2.5 We understand that DWP have guidance for staff which allows them to override this rule for claimants who are paid weekly, fortnightly or 4-weekly and treat the claimant as though they meet the AET where their pay meets the equivalent of 18 hours per week paid at the national living wage. **We recommend that DWP amend the public facing guidance for claimants who work at least 18 hours a week but who are paid on a different frequency to recognise this issue and so they that know they can ask DWP to treat them as meeting the AET.**
- 7.2.6 We would also highlight that this issue also affects those who have transitioned to universal credit from other benefits including tax credits. Transitional protection is lost where earnings fall below the AET in three consecutive months (providing it was above the AET in the month the individual transitioned). We have seen a particularly concerning case where someone received a small bonus in the month they transitioned which put them above the AET in that month, but they usually work 18 hours at national living wage and are paid four weekly. The next 3 months, due to way the AET is calculated as a monthly threshold, they lost their transitional protection even though they were working the required 18 hours. This unfairness should be addressed otherwise the rules are not incentivising work and are treating people with similar circumstances (working 18 hours a week) differently depending on their pay frequency.

7.3 ***Conditionality Earnings Threshold (CET)***

- 7.3.1 Broadly, the CET is the amount a claimant needs to earn in order to be placed in the no-work requirements group. The CET is an individual threshold and is calculated using the National Minimum Wage for the claimant's age x the number of hours they are expected to work (or 16 hours if they fall into certain groups) converted to a monthly amount by multiplying by 52 and dividing by 12.
- 7.3.2 As with the AET mentioned above, the same issue can occur here where someone who is paid 4 weekly, even though they are working their expected number of hours, falls below the CET due to the way the legislation calculates the threshold on a monthly basis. **We recommend that DWP**

amend the public facing guidance for claimants who are paid on a different frequency but whose earnings meet the weekly equivalent of their CET, to recognise this issue and so that they know they can ask DWP to treat them as meeting their CET.

7.4 **Benefit cap**

7.4.1 The benefit cap is a limit on the total amount of benefit someone can receive. However, the benefit cap does not apply in relation to an assessment period where an individual has earnings equal to 16 hours at the national minimum wage, converted to a monthly amount by multiplying by 52 and dividing by 12.

7.4.2 The benefit cap is based on net earnings in an assessment period (after deduction of tax, NI and pension contributions). This means that someone can inadvertently fall below the level if they make pension contributions or have a tax debt coded out. This does not seem to match with the other thresholds within universal credit (the AET and CET) and it is not clear what rationale exists for setting the benefit cap based on net earnings rather than gross. **We recommend that DWP explore options for making this a gross threshold in line with AET and CET which would better link to the hours worked and is not subject to fluctuation from other items such as tax debts.**

8 **Limited companies**

8.1.1 We continue to see and receive queries from people struggling with the application of universal credit rules in the case of limited companies. The rules are complex, there is little DWP guidance and there are a number of issues which we think would benefit from further discussion on this topic to ensure the universal credit rules meet their intended objectives, that staff and claimants understand the rules and that guidance is clear and comprehensive. DWP staff are not tax experts nor usually experienced in the complexities of limited companies and the way in which they can be run, what the different structures mean for universal credit and how the rules should therefore apply. **We recommend DWP set up a working group with experts in this area to discuss how the current rules are working (or not working as the case may be) and come up with a series of recommendations that could make this part of the system function better for both DWP and claimants.**

9 **Conclusion**

Universal credit is now embedded as the main system of mean-tested support for people of working age in the UK. Now that migration from legacy benefits is almost complete, this is an ideal time to look again at some of the rules, processes and guidance to find options to make the system better, fairer and easier to navigate whilst ensuring it evolves to meet the stated aims of the policy behind it. LITRG are pleased to take this opportunity to share our thoughts and welcome any invitation to work with DWP to help develop the ideas in this paper.

LITRG
20 January 2026