

LOW INCOMES TAX REFORM GROUP

RESPONSE TO THE DWP CONSULTATION DOCUMENT: NO-ONE WRITTEN OFF: REFORMING WELFARE TO REWARD RESPONSIBILITY

1. EXECUTIVE SUMMARY AND SUMMARY OF RECOMMENDATIONS

- 1.1.1 The Low Incomes Tax Reform Group of the Chartered Institute of Taxation is pleased to have the opportunity of responding to this important consultation.
- 1.1.2 We are supportive of the Government's targets to eradicate child poverty and help more people into work, but feel it is futile to attempt welfare reform without considering the tax credit system in detail.
- 1.1.3 Whilst the paper puts forward many proposals directed at those who are out of work, there are few proposals for those who are already in work and wish to remain in work.
- 1.1.4 We believe that the success of any proposals relating to welfare reform relies on better joined up working between Government departments. **We therefore urge that consideration be given to the impact of all of the proposals in the paper across Government.**
- 1.1.5 We have on numerous occasions identified the problems associated with the 'fast track' process of the tax credit system. **We recommend that an urgent review of the fast track process is carried out to ensure that the tax credit system becomes responsive for those who develop a disability whilst in work.**
- 1.1.6 **We recommend that better processes are embedded between Jobcentre Plus (JCP) and HMRC in order to ensure smooth transitions for the most vulnerable claimants which will allow them to remain in employment.**
- 1.1.7 We remain concerned about the work disincentives created by the gap between the points where entitlement to means tested benefits ends and tax credits entitlement starts. **We therefore recommend the 16 hour requirement for Working Tax Credit be reviewed along with the earnings disregard levels in means tested benefits.**
- 1.1.8 The current rules relating to the childcare element of Working Tax Credit mean that families where one person works and the other is a full time carer cannot claim childcare. This acts as a disincentive to work and as such **we**

recommend that childcare provision is extended to those where one partner works and the other is a full time carer.

- 1.1.9 We are supportive of the aims of the Better Off In Work Credit, however we feel that the Credit fails to meet these aims if it does not include passported benefits in the calculation of entitlement. **We therefore urge that the Credit be reviewed to ensure it takes into account a person's real financial position including passported benefits and travel to work costs.**
- 1.1.10 The complexity of the passported benefit regime causes confusion for claimants and makes it difficult to establish entitlements. **We therefore recommend that a cross-Government review of the regime be carried out.**
- 1.1.11 The low levels of the earnings disregards in means tested benefits, coupled with the 16 hour requirement to claim WTC, acts as a disincentive to work for many. **We urge the Government to review the current earnings disregards.**
- 1.1.12 We regard the provision of advice and information about benefits, tax credits and tax to be vitally important. Many of the proposals in the paper are aimed at moving people into work. It is therefore vital that JCP staff are adequately equipped to provide people with accurate information about their entitlements and tax position when they enter work.
- 1.1.13 Travel to work costs, when coupled with loss of benefits, can act as a disincentive to work. **We recommend that a review of travel costs in the tax system be carried out to identify whether any changes can be made, particularly in relation to disabled people, to support the proposals in the paper.**
- 1.1.14 At present those who have been in receipt of Incapacity Benefit (IB) and its predecessor since before April 1995 currently receive their long term IB tax free. We are concerned about this group of people during the migration to ESA and therefore **seek assurances from the Government that this group will continue their tax free status.** Also, **we would advocate that adequate training of JCP and HMRC staff on the operation of PAYE on ESA be put in place at the earliest opportunity.**
- 1.1.15 We welcome the plans to extend the individual budget pilot programme and to give adults with disabilities more control over how money is spent on their support. However, to enable users of direct payments to make an informed choice about the nature and funding of their care, it is paramount that good sources of information are available to them about the administrative obligations they will sign up to (PAYE, NIC, minimum wage, etc) if they become an 'employer' of a carer or personal assistant.
- 1.1.16 Many disabled employees are at a disadvantage in having to bear additional work-related costs over and above those borne by their non-disabled colleagues. Employers may be assisted in meeting such costs through the Access to Work scheme, and we are pleased that funding for that scheme is to be increased. But much more needs to be done both to publicise it amongst employers, and administratively to make it more accessible and responsive in ensuring the additional costs of workers with disabilities are met.

- 1.1.17 While we accept the case for disregarding maintenance payments for all benefit and tax credit purposes, the wider implications of so doing also need consideration. In many cases a couple with children will be less well off than a lone parent in otherwise similar circumstances. Given that more children in poverty live in couple households than in lone parent households, the Government's child poverty targets will be met only when the issues facing couples are tackled as vigorously as those facing lone parents.

2. INTRODUCTION

2.1 About us

- 2.1.1 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.
- 2.1.2 The CIOT is a charity and the leading professional body in the UK concerned solely with taxation. The CIOT's primary purpose is to promote education and the study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient tax system for all affected by it – taxpayers, advisers and the authorities.
- 2.1.3 We welcome the opportunity to respond to this latest consultation document on welfare reform.

2.2 General comments on this consultation

- 2.2.1 In various submissions over the years we have welcomed the Government's commitment to end child poverty by 2020, and are broadly supportive of the initiatives put in place to achieve this. In our view, the tax credit system is fundamental to meeting this objective, and we firmly believe that it would be futile to attempt welfare reform without considering the tax credit system in detail. It is therefore disappointing to see little discussion of tax credits throughout the paper.
- 2.2.2 Many more children who live in poverty live in families where at least one adult is in work than live in workless families. The Green Paper has little mention of proposals for this group, which we believe is a missed opportunity to make progress towards the 2020 target.
- 2.2.3 We also believe much more could be done for those who become disabled whilst in work. There are many proposals in this paper, and its predecessors, relating to those who are disabled and out of work, but very few to support those who become disabled whilst in work and wish to remain in their job.
- 2.2.4 We remain concerned in particular about the various disincentives to work that exist in the current system. In particular, more attention is paid to moving people into work than to the interactions between tax, tax credits and benefits which are such that in some cases work may not pay.

- 2.2.5 It is also vitally important that those people who are moving from benefits into work should receive up to date, accurate advice about their income position. Early, accurate information about entitlements, including passported benefits, will allow people to make informed decisions about their circumstances. In addition, people moving from benefits into work need full explanations of how their benefits will work, not just immediately, but over the first couple of years.
- 2.2.6 Passported benefits are just as important as mainstream benefits and tax credits in lifting people out of poverty. Government departments have developed a very complex passporting regime, and whilst the criteria may appear reasonable in isolation, they are highly confusing when put together.
- 2.2.7 In our view, joined up working between Government departments across the whole range of proposals in the Green Paper is vital to ensuring success. The combined effect of different policies developed at different times and implemented by different departments causes confusion and complexity for the claimants at the core of the system. We urge that consideration be given to the impacts of all of the proposals in the paper across Government.
- 2.2.8 Our response seeks to highlight the key areas of the tax, tax credit and benefit system where we believe changes could be made to support these two key groups and help achieve the longer term Government targets for reducing poverty and improving work incentives ('poverty and work targets').

3. TAX CREDIT SYSTEM

- 3.1.1 We acknowledge the positive impact that the introduction of new tax credits has had on reducing child poverty and helping low income workers.
- 3.1.2 Tax credits are the primary system of support for millions of families. Those who receive means tested benefits rely on Child Tax Credit for payments for children, whilst those who work on a low income rely on Working Tax Credit as additional income. In addition, many families rely on the childcare element of Working Tax Credit to help with their childcare costs so that they can remain in work.
- 3.1.3 In the light of this we find it surprising that the Green Paper makes little reference to the tax credit system, and believe that the Government cannot make progress towards their current poverty and work targets without addressing some of the fundamental flaws in the current system.
- 3.1.4 We recently submitted a detailed paper to HMRC/HM Treasury in response to their consultation on tax credit delivery¹. We hope that the responses received to that consultation will be considered more widely as part of the Government's welfare reform agenda. Below we identify particular areas of the tax credit system that we feel are currently negatively impacting on the Government's ability to meet their work and poverty targets.

3.2 The fast track process

- 3.2.1 The disability element of tax credits allows those with qualifying disabilities to qualify for Working Tax Credit providing they work more than 16 hours per week. The purpose of this element is to encourage those with disabilities into

¹ <http://www.litrq.org.uk/news/index.cfm?id=593>

work. Conversely the so-called 'fast track' process in the Working Tax Credit Regulations (SI 2002/2005, Regulation 9(6)) are geared towards helping those who become ill whilst in work to qualify for the disability element if they continue working.

3.2.2 In recent years we have made regular submissions to various consultations regarding the deficiencies of the fast track system. We first highlighted these deficiencies in our December 2003 report *Disability in tax and related benefits: the case for a modern and coherent approach*.² Five years later, we are dismayed to find that the same problems exist.

3.2.3 In our report we identified the following problems with the fast track process:

- the length of time claimants have to be off work before they can claim the disability element under the fast track makes the expression 'fast track' something of a misnomer;
- it does not help people whose treatment is complete within the time but who still experience loss of earnings;
- it does not help those who continue working despite their disability, or who develop a debilitating condition (such as deafness) over time while in work;
- in general, the rules are too bureaucratic to be of any real assistance to those who need it most.

3.2.4 The thrust of the welfare reform programme thus far has been to replace Incapacity Benefit with Employment Support Allowance, consequently moving many claimants either on to Job Seekers Allowance or into work. In our view, not enough attention has been paid to helping those who become disabled whilst in work to remain in work if they are able and willing to do so.

3.2.5 Once again, we recommend that an urgent review of the fast track process be carried out to ensure that the tax credit system remains responsive for those who develop a disability whilst in work.

3.3 Tax Credit administration

3.3.1 Many of the proposals in the Green Paper are around moving more people from benefits into work. However, in our experience, transitional problems in moving from one to the other can sometimes result in people giving up the job they have just started.

3.3.2 The success of any such proposals will be undermined if the tax credit system fails to deliver vital money on time. Paragraph 4.25-4.27 of the paper talks about supporting more partners into employment. For families with children, it is likely that the childcare element of WTC will become vitally important. Delays in the processing of tax credit claims will mean that these families are without the payments they need to meet their childcare bills and remain in work.

3.3.3 It has recently been announced that the 'in work and out of work processes' pilots between HMRC, DWP and local authorities will be rolled out on a national basis.

² <http://www.litrg.org.uk/news/index.cfm?id=72>

- 3.3.4 We are supportive of the aims of the programme and welcome the Government's commitment to create better processes. However, we do have some initial concerns regarding the rolling out of the processes on a national level. It is vital that the processes that were used during the pilots are able to cope with increased numbers. In addition, it is equally important that all of the Government departments involved have adequate escalation routes in place for problems that may occur. It is crucial that vulnerable claimants who are moving in or out of work receive support if things go wrong with their claims.
- 3.3.5 The 'fast track' process that has existed between Jobcentre Plus and HMRC has not worked to its full potential. In our experience, the process is not known by all JCP staff and therefore leaves the most vulnerable claimants without support.
- 3.3.6 We therefore recommend that better processes are embedded between JCP and HMRC in order to ensure smooth transitions for the most vulnerable claimants which will allow them to remain in employment.

3.4 Working hours requirement

- 3.4.1 At present, WTC is only available to those who work at least 16 hours per week. There will be significant numbers of disabled people who may only be able to work for a few hours per week. As the Government is aware, entry to tax credits from employment remains an issue for those whose earning capacity is being reduced by disability but who have not yet lost their job.
- 3.4.2 The report by Child Poverty Action Group, Community Links and ourselves entitled *Interact: tax credits, benefits and moving into work* (December 2007) ('the Interact Report') highlighted the cliff edge between working 16 hours a week and being entitled to WTC, or working say 15 hours and missing out on entitlement. The illustrations in the Interact Report showed that this could be a significant disincentive to work for some claimants.
- 3.4.3 The driver behind many of the proposals in the paper is to move more people into work. Accordingly we recommend that the 16 working hour requirement for tax credits be reviewed in conjunction with the level of disregards in the benefits system (see 4.3.4).

3.5 The childcare element

- 3.5.1 LITRG have acknowledged the generous support given through the childcare element of WTC. Without the childcare element, many lone parents and couples would be unable to stay in or enter into work.
- 3.5.2 At present the childcare element of WTC is not available where one person works and the other is a carer. This has resulted in some particularly harsh results for families who have a disabled child, where the parent with main responsibility finds it impossible to attend to the needs of the children at the same time.
- 3.5.3 LITRG urge the Government to extend the provision of childcare support to couples where one person is working and the other is a carer.
- 3.5.4 There are other deficiencies with the childcare element, which act as a clear barrier for families and do little to help when their circumstances require it the

most. Under the current rules couples where one partner is studying do not qualify for the childcare element, nor do those couples where one person has to go abroad for a temporary period.

4 MAKING WORK PAY

- 4.1.1 There are several references in the Green Paper to ensuring that new changes, particularly those in relation to the benefit system, make work pay.
- 4.1.2 As briefly mentioned above, work does not always pay. Complex interactions between the tax, tax credits and benefits systems mean that some people can be worse off when moving into work. Very significant numbers of people still face marginal deduction rates in excess of 60%.

4.2 Passporting Benefits

- 4.2.1 Paragraph 1.15 of the document mentions the improved financial support that will ensure work pays. Whilst we acknowledge the steps taken by the Government through initiatives such as the In-Work Credit and the Better Off In Work Credit pilots, we feel that these programmes are deficient due to their lack of consideration for passported benefits.
- 4.2.2 The Interact Report highlighted the importance of passported benefits in determining whether a person was better off in work. Those interviewed for the report did not include passported benefits in their income whilst on benefits (generally because they were 'free'), but once they moved into work and lost those benefits, they realised their financial significance.
- 4.2.3 In our view it is impossible to carry out better off calculations which form the basis of assessment for In-Work Credits if passported benefits are not considered.
- 4.2.4 The complex and confusing passported benefit system that has developed can itself act as a disincentive to work. In particular someone on benefits and drawing the Child Tax Credit, hence entitled to free school meals and/or healthy start vouchers, will lose that entitlement if, on going into work, they claim the Working Tax Credit. In previous responses we have highlighted concerns about the lack of information for claimants about their entitlements to passported benefits.
- 4.2.5 Even when claimants ascertain the existence of another benefit, there is often confusion about the detail and qualification criteria. Each Government department has developed its own set of criteria, normally by reference to tax credits or DWP benefits. Whilst in isolation these criteria may seem perfectly reasonable, viewed together there is a set of different and confusing requirements across the range of benefits.

4.3 Earnings disregards

- 4.3.1 For many years we have urged the Government to carry out a review of the earnings disregards for various benefits.
- 4.3.2 The failure to upgrade the earnings disregards in means tested benefits over many years has increased disincentives to work.

- 4.3.3 As discussed above, the number of hours required to claim WTC is currently 16 (30 in some cases) and so failure to have adequate earnings disregards in benefits means that people fall into a 'black hole' whereby they do not work enough hours to qualify for WTC, but work too many hours to qualify for benefits.
- 4.3.4 If the Government wants to ensure that work really does pay, we recommend an urgent review of earnings disregards across the benefit system, combined with the review of the qualifying working hours requirement in working tax credit as recommended at 3.4.3.

4.4 Advice and Information

- 4.4.1 The key focus of the Green Paper is to provide more support but greater responsibility for claimants. LITRG welcome the Government's goals to help people find and retain work through a more personalised service.
- 4.4.2 We believe that proper advice and information about tax, tax credits and benefits should be central to the personalised service offered by Jobcentre Plus.
- 4.4.3 Whilst it is important to provide help finding work, it is equally important that a person is assisted in claiming their correct entitlements to support their moving into work and staying in work.
- 4.4.4 In one of our recent submissions regarding lone parents and work, we highlighted the key areas that we felt it was important for advisers to explain to claimants in preparing them adequately for the work place. This included:
- the income tax liability of the individual, bearing in mind their overall circumstances;
 - the vagaries of the PAYE system depending upon the time of year work starts;
 - the differences between the PAYE and Self-Assessment systems and what that means for how net income may be received (i.e. the cash flow differences);
 - the national insurance position and the different classes of contribution;
 - the impact of any features in the new employment which can lead to unexpected tax liabilities;
 - the distinction between employment, self employment and agency work as far as employment rights/tax issues are concerned.
- 4.4.5 Advice such as this will ensure that an individual is better able to cope with the new world of work and also give claimants a realistic idea of their net income for budgeting purposes.
- 4.4.6 Very much linked to this is accurate advice on benefit and tax credit entitlements. The interaction of the In-Work Credit with the £25,000 disregard in tax credits can mean that in the first year of returning to work, a person will be much better off financially than in their second and third years.
- 4.4.7 It is vital that all advisers, including those in the private sector, make claimants aware of their long term position when helping them find work so

that there are no unpleasant surprises when overall income falls after the end of the first year.

5 TAX ISSUES

5.1.1 LITRG believe that there is scope for changes to the tax system to support the objectives outlined in the Green Paper.

5.1.2 Whilst a chapter is dedicated to changes to the benefit system in order to support people into work, there is no mention of changes in the tax system that could also provide similar support.

5.2 Travel to work expenses

5.2.1 The Interact Report identified that the costs of getting into work, when added to the loss of benefits, can make it less advantageous to work than to stay on benefits. Travel costs may be a significant barrier for those at the lower end of the income scale.

5.2.2 In a recent submission to HMRC ³we suggested a review of the tax system could consider how to overcome this issue. We believe that this point is equally relevant for the Green Paper. Whilst the bulk of the proposals are aimed at moving people into work, the financial costs of taking up work can act as a disincentive.

5.2.3 Disabled people, because of their disability, generally incur higher travel costs than non-disabled people. There is some recognition of this within the tax system in that no taxable benefit arises where employers contribute towards home-to-work travel, but employees who do not work for such generous employers have no deduction available for them in meeting the extra cost themselves.

5.2.4 We originally made this point in our 2003 Disability Report, and we noted that travel costs were identified as a barrier to work in the recent RADAR debate around the proposals in the Green Paper.

5.3 Tax treatment of Employment Support Allowance

5.3.1 Income-based ESA is not taxable, whilst contribution based ESA is classed as taxable income.

5.3.2 We have made various submissions regarding the tax treatment of contribution based ESA both before and since the ESA Regulations were promulgated. We are particularly concerned for those existing pre 1995 Incapacity Benefit claimants who currently receive long term IB tax free. We would therefore like to have assurances that when those claimants move to ESA they will retain their existing tax free status.

5.3.3 We also note that regulations have recently been laid to allow DWP to operate a modified form of PAYE on ESA. It will be necessary for advisers in Jobcentre Plus and HMRC to explain how these provisions will work in practice. We would advocate adequate training be put in place at the earliest opportunity.

³ <http://www.litrg.org.uk/news/index.cfm?id=597>

5.4 Online filing

- 5.4.1 In our response⁴ to a recent consultation by HMRC regarding online filing, we noted HMRC's concerns about the impact of online filing for people with disabilities and drew their attention to additional issues they needed to address for this group of people. The key focus of this Green Paper is to get more people with disabilities into work, not just as employees but also as self employed workers. Either group might be within Self-Assessment (SA) and required either to submit a paper tax return by 31 October, or be potentially liable to a late filing penalty if they do not submit an online return by 31 January. Not all people with disabilities are comfortable with using the internet and SA itself carries additional obligations within an already complex tax system.
- 5.4.2 In addition we are concerned with the impact that full mandation of online filing for employers, with effect from 2010, will have on those currently in receipt of Direct Payments and Individual Budgets (see 5.6 below).
- 5.4.3 As mentioned above cross-departmental working is crucial for the success of large scale reform. It is hoped that more joined up working will therefore mean that in future holistic consideration will be given to the impact of schemes such as online filing in light of the objectives of the Green Paper.

5.5 Individual Budgets

- 5.5.1 We welcome the plans to extend the individual budget pilot programme and to give adults with disabilities more control over how money is spent on their support. However, the tax treatment of direct payments is not straightforward, and in addition to the matters set out in para 5.11 of the Green Paper, it is essential that people are told of the administrative obligations they sign up to when they become an 'employer' of a carer or personal assistant.
- 5.5.2 The requirements imposed on direct payments employers are not confined to tax, onerous though PAYE and NIC reporting and other compliance may be. They also include rules about the national minimum wage, working hours, and other obligations of being an employer.
- 5.5.3 Our report *Independent living, direct payments and the tax system* (January 2008)⁵ explores the issues in depth, and emphasises that they are not solely a matter for HMRC. A joined-up approach is required by all the Government departments responsible for aspects of policy on direct payments, including (apart from HMRC) the Department of Health, the local authorities, the Department for Business, Enterprise and Regulatory Reform (BERR), and the DWP.
- 5.5.4 Chapter 4 of our January 2008 report cited above sets out our recommendations as to how such a joined-up approach should proceed. Good sources of information, designed specifically for users of direct payments, about the requirements imposed on them by Government as a whole, is paramount if they are to exercise an informed choice about the nature and funding of their care.

⁴ <http://www.litrg.org.uk>

⁵ <http://www.litrg.org.uk>

5.6 Other tax relief for employers and employees

- 5.6.1 Many disabled employees are at a disadvantage in having to bear additional work-related costs over and above those borne by their non-disabled colleagues. As noted above, the extent to which they are assisted with those additional costs often depends on how generous their employers are in paying or reimbursing them, since any amounts paid directly by the disabled employee cannot be claimed as a tax deduction.
- 5.6.2 Employers themselves may be assisted in meeting such costs through the Access to Work scheme and we are pleased to note that funding for this scheme is to be increased, although disappointed by the timescale for implementation. However, much more needs to be done both to publicise the scheme amongst employers, and administratively to make the scheme more accessible and responsive in ensuring the additional costs of workers with disabilities are met.

6 FURTHER COMMENTS ON PROPOSALS IN THE GREEN PAPER

6.1 Disregard of maintenance payments for all benefits

- 6.1.1 While we fully understand the need to increase the proportion of cases where maintenance payments are paid by a non-resident parent to a parent with care, and hence accept the case for disregarding maintenance payments for all benefit and tax credit purposes, the wider implications of so doing also need consideration. The effect is that payments, which may easily exceed £100 a week, will not be taken into account in determining benefits and tax credits. At the same time comparatively small increases in employment or other income lead either immediately or in due course to significant reductions in benefits and/or tax credits depending on the steepness of the particular taper(s) in question. As a result similar families with the same income before benefits and tax credits may find themselves in a very different position after those benefits and tax credits are taken into account. Similarly a widow who draws the Widowed Parent's Allowance will find that it is taken into account in assessing her income: she may ask herself why, if her husband had left her in life, any support she received would be disregarded. The fairness of this needs to be questioned.
- 6.1.2 Moreover, in part because, unlike benefits, the tax credits available to a couple are no more than those for a lone parent while the incomes of the partners are aggregated, in many cases a couple with children will be less well off than a lone parent in otherwise similar circumstances, in some cases by as much as £7,000 a year or more even after additional housing costs are taken into account. Given that more children in poverty live in couple households than in lone parent households, the Government's child poverty targets will be met only when the issues facing couples are tackled as vigorously as those facing lone parents. One way of so doing would be implicitly to recognise more fully the cost of maintenance for couples who live together. The very significant financial penalty for couples who live together compared with those who live apart (even after account is taken of housing costs) may deter individuals coming together.

