

## LOW INCOMES TAX REFORM GROUP

### Response to the Department of Children, Schools and Families consultation 'Ending Child Poverty: Making it Happen'

#### Summary

- The Low Incomes Tax Reform Group (LITRG) acknowledges the Government's progress in lifting some 600,000 children out of poverty, but believe that to meet their 2020 target more attention needs to be paid to the various interactions in the tax, tax credit and benefit systems and the disincentives to work that currently exist.
- We are supportive of the Government's aspirations set out in the consultation document, and recognise the importance of the building blocks identified. Although the document briefly details some of the barriers that people may face in meeting these aspirations, we believe that removing these and other barriers will be the key to success in this area.
- One of the major barriers to parents moving into work is the availability and cost of childcare. We reiterate our recommendation made to HM Treasury in September 2008 that financial support for childcare should be removed from the tax credit system.
- At the very least, if help with childcare costs is to be kept with the tax credit system, we would recommend that a review of the qualification criteria is carried out to identify the particularly vulnerable groups who need childcare help but who do not meet the criteria, and for whom the lack of financial support will act as a barrier to work.
- We remain concerned about the negative publicity surrounding the tax credit system, mainly due to overpayments. However, the system continues to be beset with administrative problems such as severe correspondence delays, poor quality helpline advice and processing delays. We recommend that the Government provide the necessary resources, in light of the current recession, for HMRC to increase urgently the number of staff in the Tax Credit Office and improve the quality of the training which they receive.
- In addition, we recommend that an immediate review is carried out by a combination of Jobcentre Plus and HMRC of their notification and escalation processes. HMRC need to ensure that claimants' tax credit problems are rectified as quickly as possible through a dedicated caseworker approach.
- We welcome the recognition of the importance of helping parents stay in work, not just to enter work. This is particularly so for parents who suffer the onset of a disability and wish to remain in their job. We recommend that any future plans provide adequate support for this group.
- We feel that the current 'fast track' disability element process in tax credits is inadequate and not responsive enough for those who become ill whilst in work. We recommend a review of the fast track process.

- For many groups, the 16 hour working week requirement of Working Tax Credit is restrictive. Coupled with the fact that the earnings disregards in means tested benefits have not been updated for many years those who are unable to work more than 16 hours can find the overall system unresponsive. We recommend that the 16 hour rule for tax credits is reviewed, along with an urgent review of the disregards in means tested benefits.
- We think that there is merit in formally re-examining the balance that exists between the various elements of tax credits to establish whether in the light of experience in the last 6 years they are appropriate to current needs.
- We believe that passported benefits are just as important as mainstream benefits and tax credits in helping people into work and thus lifting families out of poverty. Various Government departments have developed passporting requirements that may be reasonable when considered in isolation, but highly confusing for claimants when taken together. We recommend a review of the passporting system.
- The importance of free school meals in helping families out of poverty has been widely recognised. However, receipt of Working Tax Credit disentitles the recipient from free school meals, thus many are better off on benefits than in work. We recommend that the qualification requirement for free school meals be re-examined.
- We are generally supportive of the aims of the Better Off In Work Credit (BOIWC), however we are concerned that it will not help those who need it most as it fails to take into account the loss of passported benefits. We recommend a review of the qualification criteria for the credit.
- The various interactions between tax, tax credits and benefits create many disincentives to work, not least because of the high marginal deduction rate that exists on moving into work (70%) caused by the interaction of tax, national insurance and tax credits. One way to tackle this problem would be to reduce the rate at which tax credits are tapered away. We suggest that this option be reviewed.
- The current Education Maintenance Allowance (EMA) guidelines in England, Wales and Northern Ireland, are not responsive for those families who find themselves faced with falls in income, for example, through redundancy. We recommend that the EMA guidelines are amended to allow re-assessment of entitlement where a family has a fall in income of 15% or more.

## Background

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. 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. LITRG are particularly concerned with how the current tax, tax credits and benefit systems interact and thus impact upon policy initiatives to improve work incentives and reduce child poverty.

## Introduction

4. We welcome the opportunity to respond to this consultation document. We acknowledge the Government's progress to date in lifting some 600,000 children out of poverty, however there is clearly still a long way to go before the Government's child poverty target is met.
5. The document talks about the four key aspirations that the Government believe will need to be achieved if their vision of eradicating child poverty by 2020 is to be successful. We are supportive of the aspirations of the Government to raise incomes so that more parents are in work that pays and to ensure that financial support is responsive to family situations. However, we believe that in order to meet these aspirations and lift more children out of poverty, more needs to be done to address the various disincentives to work that currently exist in the tax, tax credits and benefits system.
6. Over the last couple of years, most changes to the social security system have been aimed at moving more people, including those with disabilities, into work. Indeed the consultation document reiterates that the Government believe work is the best way out of poverty.
7. In a submission to the Work and Pensions Committee's inquiry into child poverty in September 2007 we expressed our concern that these plans to move more people into work failed to address adequately the various complicated interactions of the tax, tax credits and benefits systems that mean sometimes work does not pay. As well as acting as a disincentive to work, these negative interactions act as a barrier to helping families with children out of poverty. Disappointingly, some 18 months later the same barriers seem to exist. We discuss this further at para 37 ff.

## Response to the consultation questions

8. The consultation document poses 5 questions. Our response seeks to address only the first two questions.

Q: Does the 2020 vision, as set out in Chapter 2, capture the key areas where action is required to ensure the greatest impact on reducing child poverty?

9. As set out in our introduction, we are supportive of the Government's aspirations set out in the document. In particular, we welcome those aspirations that seek to increase employment and raise income so that more parents are in work that pays, and also those that seek to improve financial support for families to make it more responsive to their situation.

Q: Are the building blocks the right ones to make progress towards 2020, including for those groups at particular risk of poverty?

10. Box 2.1 sets out the building blocks in relation to employment and adult skills. We are pleased to see acknowledgement of the barriers that exist for parents

who are moving into work and strongly agree that these must be removed in order to give parents the best chance of success.

11. We also welcome recognition of the importance of helping parents stay in work, and not just move into work. In many of our previous consultation responses, particularly on disability issues, we have raised concerns about the lack of help for those who want to stay in work and may find it difficult to do so, for example because they are suffering the onset of illness. We recommend that any future plans provide adequate support for this group.
12. In addition we feel that there are many areas within the tax, tax credit and benefit system that at present work against these aspirations. Some of them are identified in the paper, some are not. We believe that without addressing these problems in the tax, tax credits and benefits systems, the Government will be hindered in their attempts to meet their 2020 target. The remainder of our response sets out those areas that we feel are currently a barrier to achieving the Government's aspirations.

## Childcare

13. Box 2.1 of the document sets out the Government's vision in relation to employment and skills. This seeks to ensure that more parents enter, stay and progress in work as well as tackling the various barriers that parents face in achieving this. One of the barriers identified is childcare.
14. Earlier this year, the Daycare Trust<sup>1</sup> published their annual childcare costs survey which showed that not only are childcare costs rising rapidly above inflation, parents are finding it difficult to find suitable childcare locally. This is particularly true for those with disabled or older children.
15. The latest changes to Income Support have seen many more lone parents move into work as they are no longer able to qualify for Income Support. In December 2007 we, in conjunction with Child Poverty Action Group and Community Links, published a report called *Interact: benefits, tax credits and moving into work*<sup>2</sup> which sought to look at work incentives and interactions. As part of this report, interviews were carried out with claimants about their experiences of the tax and benefits systems. Our findings showed that childcare costs and the availability of childcare were two of the most important factors for parents when trying to move back into work.
16. The Tax Credit system has provided unrivalled help with childcare costs. However it is not without its problems. The childcare element of tax credits is tightly targeted and many of those who need childcare are unable to claim it under the current rules. An example is a couple where one parent works and the other is a carer of a disabled child where they are also responsible for one or more non-disabled children. Under the tax credit rules, they have no access to the childcare element.
17. The childcare element is linked to eligibility for Working Tax Credit. This means that if eligibility for WTC is lost, the childcare element disappears at

<sup>1</sup> <http://www.daycaretrust.org.uk/article.php?sid=381>

<sup>2</sup> <http://www.litrg.org.uk/news/index.cfm?id=483>

the same time. We have seen many tax credit overpayments caused by this. In addition, those on low incomes are likely to have very high awards if they claim the childcare element. This means that any resulting overpayment is likely to be very high.

18. As a result of these problems, and the fact that so many tax credit claimants have difficulty applying the very complex rules on averaging childcare, **we recommended in our response to HM Treasury's consultation document on tax credit delivery<sup>3</sup> that the Government should consider moving childcare out of the tax credit system.** We believe such a solution, which would pay the claimant or provider directly as costs are incurred, has considerable merit.
19. At the very least, if help with childcare costs is to be kept with the tax credit system, **we would recommend that a review of the qualification criteria is carried out to identify the particularly vulnerable groups who need childcare help but who do not meet the criteria, and for whom the lack of financial support will act as a barrier to work.**
20. Our *Interact* report highlighted a growing problem for those who work atypical hours or who have children with special needs. Both of these groups find it difficult to access appropriate childcare, and along with many other parents, are forced to use informal childcare. This is often provided by relatives. There is no support for such families. If more recognition, preferably financial, was given to these groups, as well as parents who choose to sacrifice a salary to provide their own childcare, we believe this would help relieve the burden on finding paid formal childcare.

## Tax credits

21. Tax credits have helped millions of families since the system began in 2003, and has been far more successful than any of its predecessors. However, we believe that there is still a long way to go before the current system reaches its full potential.
22. Paragraph 30 of the consultation document talks about the financial support offered through the tax credit system and the importance of this for people moving from benefits into work. According to this paragraph, financial support is offered '*through a responsive system of tax credits which means that in the current economic circumstances, families are getting more help when they need it*'. We are concerned that the current tax credit system is not as responsive as it should be, which means that in some cases it hinders people trying to move in to work.
23. Tax credit awards are initially made based on previous year income. However, the system allows families the opportunity to have their award revised to be based on an estimate of current year income. The ability to do this is important if there is a fall in income as compared to last year, which is a growing reality for many families in today's economic climate. For those who have a fall in income early in the tax year, it is likely their tax credits will be revised upwards. However for those who have a fall in income later in the

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<sup>3</sup> <http://www.litrg.org.uk/news/latest.cfm?id=593>

year, they may not be entitled to any more tax credits, even though their income may have fallen by a large amount.

24. This is because tax credits spread income out evenly across the tax year. Take someone who earns £50,000 per year. Their initial tax credit award will be based on an income of £50,000 spread evenly over the whole year. If they lose their job 3 months before the end of the tax year, even though they have no income for that period, their tax credit award will still be based on the £37,500 they earned in the first part of the year. Depending on their circumstances, this may mean they have to wait until April to get an increase in tax credits.
25. Since submitting our response to the Treasury's consultation on tax credit delivery<sup>4</sup> in September 2008, we have seen little improvement in the problems which we highlighted at that time. We still see claimants who face considerable delays in receiving payments of child benefit and tax credits. One recent example involved a claimant who applied in July 2008 and is still waiting for a tax credit decision. There seems to be a clear lack of adequate procedures in place to allow such cases to be escalated and resolved as soon as possible.
26. The consequence of delays in processing claims is that they can act as a work disincentive. This is especially the case for those who are claiming childcare costs, as they still have to make payments to the childcare provider. We have seen cases where this has led to parents giving up jobs because they could not afford to pay for childcare without their tax credits.
27. Confidence in the tax credit system is still being impacted by the high number of overpayments since 2003. Although we were pleased to see the latest figures showed a fall in the overpayment figures, many people are still apprehensive about claiming tax credits due to the negative publicity linked with overpayments. This is not helped by the continuing administrative difficulties in dealing with correspondence. **We recommend that the Government provide the necessary resources, in light of the current recession, for HMRC to increase urgently the number of staff in the Tax Credit Office and improve the quality of the training which they receive.**
28. For those who are moving from Jobcentre Plus benefits into work, 'fast track' processes are in place to ensure a smooth transition from benefits to tax credits. For lone parents moving off Income Support due to the recent legislative changes, special procedures have been put in place between DWP and HMRC. We welcome these processes, which, if used, seem to work well. However, we come across many cases where DWP tell claimants to apply directly to HMRC. This means that they are not known to HMRC as urgent cases and any delays in processing those claims have a devastating impact on the families involved, and ultimately may lead them to leave work and go back to DWP benefits.
29. **We recommend that an immediate review is carried out by a combination of Jobcentre Plus and HMRC of their notification and escalation processes. HMRC need to ensure that claimants' tax credit problems are rectified as quickly as possible through a dedicated**

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<sup>4</sup> <http://www.litrg.org.uk/news/latest.cfm?id=593>

**caseworker approach.** The recent ‘In work/Out of work’ pilots announced as being extended nationally are welcomed in this area. However our concern remains that more joined up working is needed between HMRC and DWP to ensure that no claimants can fall between the gaps.

## Disabled parents

30. In December 2003, we published a report titled ‘*Disability in tax and related benefits: the case for a modern and coherent approach*’. In that report we recommend that the 16 hour rule for WTC be reviewed for people returning to work by stages while recovering from an illness or disability, and that the ‘fast track’ processes for the WTC disability element be reconsidered.
31. Over five years later, the same problems remain with the fast track process. The Government’s vision in the consultation document is not only to help more people into work, but help them to stay and progress in work. This is particularly relevant to those who become ill whilst in work, for example with a slowly degenerative disease, or where full recovery may take a long time. However, the current fast track rules are so restrictive that they do not provide any real assistance to this group. **We recommend once again that the fast track eligibility rules be reviewed or replaced with an acceptable substitute eligibility test (we suggested some options in para 2.7.14 of our Report).**
32. For parents who have disabilities, or others who are offered jobs with low hours, the 16 hour rule to qualify for WTC is restrictive. For many years we have suggested a review of the earning disregards in the benefits system. Failure to update these disregards creates a gap whereby people with low incomes, who do not work enough hours to qualify for WTC, earn too much to qualify for benefits. This in itself is a disincentive to work. **We recommend that the 16 hour rule for tax credits is reviewed, along with an urgent review of the disregards in means tested benefits.**

## Couples

33. Recent reports have claimed that there is an imbalance between the child support given to lone parents as compared with couples.
34. Through our work we see many gaps in support and question the logic for their existence. We now have experience of six years of tax credits and as the government is reviewing the whole area of childcare support, it would seem to be appropriate to consider whether current evidence shows the balance between the various elements of tax credits is still appropriate.
35. Accordingly we would support a formal review of the appropriateness of the current balance between the various elements of tax credits, including the support given to couples.

## Interactions and disincentives to work

36. The consultation document outlines the Government’s commitment to make sure that parents have the right support and rewards for work. The current tax, tax credits and benefit systems create many interactions that often mean

work does not pay. For a family already in poverty, the incentive to move into work is considerably diminished. We believe that the Government's plan to eradicate child poverty will be severely hampered if more attention is not given to these negative interactions and disincentives.

37. The tax credit system provides the main financial support when someone moves into work. They may also have entitlement to Housing Benefit and Council Tax Benefit. However, it is 'passported benefits' that are often the determining factor in whether people are better off in work.
38. Our 2007 *Interact* report highlighted the importance of passported benefits. Of all of the passported benefits, one of the most important for families with children is free school meals. To qualify for free school meals, a family must be in receipt of certain means tested benefits or receive CTC only with income under a certain level. As soon as the family move into work and start to receive any WTC, they lose that entitlement. This is so, even if their overall income is lower than it was on benefits. **We believe that the current rules form a barrier to work, and recommend that the criteria for free school meals be re-examined bearing in mind the needs of those on a low income who receive WTC.**
39. It is not just free school meals that are important in this context. Help with health costs and other passported benefits can have large financial importance to families claiming out of work benefits. This means that when they enter work, the loss of these benefits has to be factored in to their budget.
40. The current passported benefit system is complex, so that claimants find it difficult to understand. We are concerned about the lack of clear information given to claimants about their entitlements.
41. The complexity of the passported benefit regime has developed because each Government department has developed different qualification criteria. Whilst each set of criteria may be reasonable viewed in isolation, when viewed as part of the whole regime of passporting they become confusing and difficult to understand. We have recommended in the past that much more can be done by DWP and HMRC to make sure that they bring these entitlements to the attention of claimants and to automate the process as far as possible. In light of the Government's wish that working families should be able to see a clear way out of poverty, **we suggest that a review of the passporting system is carried out to further this aim.**
42. The introduction of the in work credits has helped some way towards making the transition from benefits to work. However, combined with the fact that tax credits are based on previous year income and have a £25,000 disregard, they make budgeting difficult. It often comes as a surprise for claimants after their first year in work that they lose not only the in work credit, but also a substantial amount of tax credits.
43. In response to concerns that some people may be worse off in work and in attempt to make sure that work pays, the Government piloted the 'better off in work credit'. At the time of the announcement, LITRG welcomed this proposal with some reservations. Our understanding is that the credit will not take into account passported benefits when determining if someone is 'better off' in



work. Due to the importance and value of passported benefits to out of work families, we think that excluding those benefits from the determination if someone is better off will make the credit far less effective than it could be. **We therefore recommend a review of the criteria for determining who qualifies for the credit.**

44. The various interactions between tax, tax credits and benefits create many disincentives to work, not least because of the high marginal deduction rate that exists on moving into work (70%) caused by the interaction of tax, national insurance and tax credits. Unless this high marginal deduction rate is reduced, when considered in combination with passported benefits and loss of other benefits such as housing benefit and council tax benefit, it will remain a large disincentive to work. **One way to ensure that claimants keep more of their earnings from work as their benefit is gradually withdrawn would be to reduce the tax credits taper rate. We recommend that this option be reviewed.**
45. Finally, we would like to draw attention to the Education Maintenance Allowance (EMA). The scheme was introduced in order to help children from low income families remain in education by providing them with a weekly payment. We are fully supportive of the aims of the scheme in this respect, and as the consultation document identifies, educational opportunities for low income families are very important.
46. It concerns us that in England, Wales and Northern Ireland, the design of the scheme and the rules under which it operates mean that the scheme is more generous for families who have income rises, but less generous for those who have income falls and even claiming means tested benefits. This is because entitlement to EMA is based on previous year income. There is only very limited scope for in-year re-assessment and no ability to have it re-assessed where one or both parents lose their job.
47. This means that a child from a family claiming Income Based Job Seeker's Allowance because the earner has lost his or her job may not be able to access an EMA for an academic year.
48. We believe that this rule goes against the principles of the EMA and makes it ineffective for those who need it most. Indeed, the Scottish EMA has rules which accommodate such families by allowing re-assessment based on current income where there is a fall in income of more than 15%. We think this is a sensible solution. **We recommend that the EMA guidelines are amended to allow re-assessment of entitlement where a family have a fall in income of 15% or more.**