



## **Bereavement Benefit for the 21<sup>st</sup> Century**

### **Department for Work and Pensions consultation**

### **Response by the Low Incomes Tax Reform Group**

#### **1. Executive summary**

- 1.1. LITRG welcomes the opportunity to comment on a proposed redesign of bereavement benefits. We do so from the background of our experience with bereaved taxpayers and the complex interactions they can face with the tax, tax credits and welfare benefits systems – all at a time of significant personal upheaval and emotional distress.
- 1.2. We recommend that early consideration be given, with detailed consultation between the DWP, HMRC and interested external parties such as ourselves, as to the tax status of any new system of bereavement benefits.
- 1.3. Arguably, it would be administratively straightforward for all concerned if such benefits were to be entirely tax-free. If, however, they are to be taxable, there are significant logistical challenges in ensuring that the tax system operates efficiently so as to ensure payments are taxed at source. Underpayments of tax and the potential distress of facing a later tax bill should be avoided at all costs. We outline the current failings of the Pay As You Earn (PAYE) system in this respect, which must not be perpetuated.
- 1.4. Whilst welcoming the suggestion that bereavement benefit claimants should be encouraged to consider their work options at a time which is right for them, we wonder whether the position of those with limited ability to work, such as those with caring responsibilities for disabled children, has

been fully considered. Also, we are concerned from current ESA and JSA experience that encouraging claimants into self-employment could lead to adverse tax consequences if the associated support on HMRC compliance obligations is non-existent or inadequate as it appears to have been to date.

- 1.5. If the contributions record of the deceased not in the UK but elsewhere in the EEA is not sufficient to qualify a survivor for bereavement benefits, we believe that a challenge could be mounted under European law.
- 1.6. Finally, we outline concerns that the policy of bereavement benefit entitlement based upon marriage and civil partnership status is anachronistic in the modern age. Moreover, this appears to be out of step with tax credits - and, in due course, Universal Credit - entitlement to which is assessed on a household basis looking at co-habiting couples regardless of marital status.

## **2. About LITRG**

- 2.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.
- 2.2. 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. Background**

### **3.1. *LITRG's bereavement work***

- 3.1.1. LITRG published a report in November 2009 on bereavement and related tax issues<sup>1</sup>. Much of the focus in that report was on older people who are bereaved and the resulting tax consequences, but it also commented on the complexities of bereavement generally.
- 3.1.2. The consultation document acknowledges the complexity people come up against when claiming bereavement benefits. However, it does not recognise the additional problems faced when claimants have to interact with more than one government Department.
- 3.1.3. In redesigning bereavement benefits, it is essential to consider early on the interactions with the tax system and for the DWP to work with HM Revenue and Customs and interested stakeholders to

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<sup>1</sup> See 'Bereavement and the Tax System – a LITRG report'

<http://www.litrg.org.uk/reports/2009/bereavement-the-tax-system-a-litrg-report>

ensure that claimants are not caught between the two. At such a distressing time, claimants would not wish to be faced with an unexpected tax bill, or indeed presented much later with such a bill. This would undermine the certainty of support which the government wishes to provide from an early stage<sup>1</sup>.

- 3.1.4. Whilst we acknowledge that there is a Tell Us Once scheme being rolled out nationally which should allow many notifications of a death to be made in a single step, it does not follow from this that matters are co-ordinated by the local council, DWP and HMRC after notification has been made. Indeed, we are aware of instances where matters are not co-ordinated even within the same Department – for example, one part of DWP might be chasing for overpayments of a certain benefit yet the surviving family has to chase a different part of DWP for a final balance owed from another benefit which has been underpaid.
- 3.1.5. There needs to be a much greater understanding within central and local government administration of the processes involved in obtaining Probate or letters of administration and that it might well take the survivor a long time for the survivor to get authority to deal with the estate, or ascertain full details of what it contains.

### 3.2. ***Guidance to claimants***

- 3.2.1. Guidance to bereavement benefit claimants must be clear as to the tax status of payments they are due to receive, whether tax-free or taxable. Moreover, if benefits are to be taxable, claimants must be advised of how any tax deductions are to be made from the payments at source, or whether they separately need to make contact with HMRC to ensure they are taxed correctly. The information currently available – the DWP1027<sup>2</sup> – is lacking in terms of the taxation of existing bereavement benefits and is in major need of review. We should be happy to help with such a review.

## 4. **The tax status of bereavement payments in the new system**

- 4.1. As claimants of bereavement benefits are likely to be emotionally distressed and will find financial matters are difficult to deal with (as acknowledged in the consultation document), if any bereavement payments are to be taxable in the redesigned system, it would be preferable if the correct tax were to be deducted from them at source. This would provide the certainty of knowing the balance of the payment is theirs to spend and manage as required and avoid the unnecessary confusion of reporting payments separately to HMRC or sorting out the tax consequences following the payment.

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<sup>1</sup> As mentioned at the bottom of page 8 of the consultation document under ‘our principles for reform’.

<sup>2</sup> ‘What to do after a death in England and Wales’, last updated January 2009  
<http://www.dwp.gov.uk/docs/dwp1027.pdf>

- 4.2. At present, lump sum bereavement payments are tax-free and regular payments are taxable. If the lump sum payment were to become taxable, we think that the DWP (in detailed consultation with HMRC and external stakeholders) should consider carefully how this would be taxed.
- 4.3. As substantial lump sum payments are envisaged in either option outlined in chapter 4 of the consultation document, it would be unwise to make gross payments to claimants and then later claw back a tax liability. Therefore, if such sums are taxable, the ideal would be for the DWP to operate full PAYE on the payment, but the tax deduction would need to reflect the claimant's circumstances.
- 4.4. With PAYE data being available much earlier than it is now under real-time information (RTI)<sup>1</sup>, operating the correct tax code might be achievable in some cases. However, we would envisage problems with this in that there may well be a change in the claimant's circumstances following the bereavement, which would not necessarily be reflected in the available RTI data at the time of making the payment. However recently it has been obtained, RTI data is, after all, still a historical record which does not take into account current or future circumstances.
- 4.5. Therefore, what would be the options for taxing bereavement payments at source? One might envisage a system similar to taxing a state pension lump sum – a flat rate deduction, which does not take the recipient over into a higher rate of tax. However, this relies on a declaration by the claimant as to their tax status – ie, more form-filling, which bereavement benefit claimants might not be capable of at the time.
- 4.6. On balance, it would arguably be preferable to make all bereavement payments tax-free. This would minimise complexity and administration costs for all concerned – the benefit claimant, DWP and HMRC. It would also bring the payments into line with Universal Credit, which will be a tax-free benefit.
- 4.7. We would be pleased to assist with further consultation on this point in due course. The consultation notes that the Government 'will need to explore the tax implications of continuing this [tax-free] treatment with a larger lump sum payment before taking a final decision on the taxability of a new payment...'. Such exploration should involve detailed consultation with interested parties such as ourselves.
- 4.8. ***The level of a lump sum bereavement payment and its taxability as against a target personal tax allowance of £10,000***
- 4.8.1. We wonder whether the Government might consider that effectively the bereavement payment would be 'tax-free' in either option 1 or option 2 being, as it is suggested, a maximum of £10,000 and coming in at a time when the personal tax allowance may already have reached that level in accordance with the Coalition's aspiration.

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<sup>1</sup> Real-time information is the system under which employers and pension providers will submit PAYE data to HMRC when payments are made to employees and pensioners, rather than on an annual basis as is currently the case. See <http://www.hmrc.gov.uk/rti/index.htm>

- 4.8.2. However, this is not the same as the payment actually being tax-free because, depending on the claimant's other circumstances, there could still be a resulting tax liability.
- 4.8.3. We would not, for example, wish to see claimants of this benefit forced into self assessment in order for the tax to be collected as, in the absence of the DWP operating PAYE on bereavement payments, there would be no other suitable mechanism to do so.
- 4.9. ***A monthly allowance***
- 4.9.1. It is not just the taxability of the lump sum payment that should come under scrutiny. If option 2 were followed through, with a larger lump sum payment than now followed by a monthly allowance, the tax status of that allowance would need considering.
- 4.9.2. At present, there is a gap in the system in that the DWP do not operate PAYE on taxable bereavement benefits. In the PAYE automatic reconciliations exercise that has been ongoing since the autumn of 2010, LITRG has seen cases where, for example, widowed parent's allowance has not been factored into a taxpayer's PAYE code where the claimant has gone back to work following a bereavement.
- 4.9.3. In this respect, there is precious little to alert the claimant that the benefit is taxable or what they have to do to ensure that their tax is correctly accounted for. The P46<sup>1</sup> when starting a new job does not mention bereavement benefits, therefore a claimant is likely to be under-taxed from the point of starting work as they will select statement A on the form and be awarded a full personal allowance against their wages.
- 4.9.4. This problem must not be perpetuated in any new system and indeed it ought to be addressed now so that the potential for claimants to under-pay tax is removed from the current system.
- 4.10. ***Encouraging claimants to re-engage with the labour market***
- 4.10.1. Whilst the policy of ensuring that bereavement benefit claimants re-engage with the labour market at a time appropriate to them appears to be basically meritorious, we have some concerns.
- 4.10.2. First, there seems to be no acknowledgement in the consultation of particular support for those left to bring up children with special needs or disabilities, for example. This might impact on their ability to work.
- 4.10.3. Second, we are aware that the system of support which aims to get benefit claimants into work has, in some cases, encouraged people into self-employment. This might be an appropriate route for some who are bereaved and, due to child care responsibilities or other factors, would welcome the additional flexibility that self-employment might bring.
- 4.10.4. The flipside of this encouragement is that there has been little support for claimants in understanding the tax consequences that flow from starting one's own business. Moreover, HMRC have been challenging tax credits claims of some people who have taken this route on the basis that

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<sup>1</sup> See <http://www.hmrc.gov.uk/forms/p46.pdf>

the profits they have achieved are not reflective of the working hours they claim to have invested in the business – in some cases, using the national minimum wage as a benchmark for expected income.

- 4.10.5. Those who have been bereaved might initially struggle to get a business off the ground, with their time and inclination to work varying with their emotional state or adjusting to new circumstances, so it would not be appropriate to deem them to be earning the national minimum wage for the purposes of Universal Credit entitlement, for example.

4.11. ***Entitlement to bereavement benefits based upon NI contributions (or credits) of the deceased***

*Possible impact of integrating the administration of income tax and national insurance contributions*

- 4.11.1. The consultation outlines the proposed future basis of claims to bereavement benefits, based on contributions (or NI credits) of the deceased. It should be borne in mind that there could be some low-income workers who could fall out of entitlement if national insurance was to be redesigned to work more like income tax, ie on a cumulative basis rather than earning period by earnings period (and employment by employment)<sup>1</sup>.

*European issues*

- 4.11.2. Furthermore, presumably the deceased having a contribution record in the European Economic Area (EEA) will be enough to qualify the survivor for UK bereavement benefits? If this is not the case, we believe that a challenge could be mounted under European law.

4.12. ***The scope of entitlement to bereavement benefits***

- 4.12.1. Whilst matters of policy are arguably outside of LITRG's remit, we would comment on one further aspect of this consultation which strikes us as inconsistent and confusing for claimants.
- 4.12.2. The consultation says that the aim is to review the current bereavement benefit system from the viewpoint of the modern world, rather than the one in which it was designed and has developed, via tinkering around the edges, over the years.
- 4.12.3. It therefore seems contradictory that the paper should, on the one hand, acknowledge that the world is now a much different place where marriage and relationships have changed greatly (page 17), yet states that consideration of extending bereavement support to families where cohabiting partners are not married or in a civil partnership is 'out of scope'.
- 4.12.4. This seems illogical on a number of fronts.
- 4.12.5. First, it fails to address the fact that the survivor of what we might term a 'de facto' couple could well be in just the same position as the survivor of a 'de jure' married couple or civil partnership on

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<sup>1</sup> See HM Treasury and HM Revenue and Customs 'Integrating the operation of income tax and National Insurance contributions: Next Steps' – November 2011

[http://www.hm-treasury.gov.uk/d/condoc\\_integration\\_it\\_nics\\_contributions.pdf](http://www.hm-treasury.gov.uk/d/condoc_integration_it_nics_contributions.pdf)

losing their partner. Indeed, they might be financially worse off if they are not entitled to death benefits or pensions from their late partner as a result of their 'informal' partnership. Failure of the state to offer bereavement support in such circumstances therefore seems anachronistic in the modern age. This seems particularly unfair for the children of unmarried or same sex couples who have not registered their partnership, and would seem to us to be a contributing factor in child poverty.

- 4.12.6. Moreover, it also does not follow that couples always have the choice to get married or register a civil partnership in order to provide security for their family. For example, if you are separated from someone who is unwilling to divorce you, you have to wait five years from the date of separation before you can unilaterally divorce, and that can then take another few months, or longer if the application is contended.
- 4.12.7. Finally, it seems inconsistent with other '21<sup>st</sup> Century' thinking on benefits generally. Both tax credits and, in due course, Universal Credit, are based upon household/couple family units, whether married or in a civil partnership, or cohabiting partners. If working age benefits are therefore to be calculated on that basis, it seems only logical to operate the same principle unilaterally and extend entitlement to bereavement benefits to household units.

LITRG

1 March 2012