



Low Incomes
Tax Reform
Group

A voice for the unrepresented

14 January 2021

The Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A

Submitted online via: <https://www.smartsurvey.co.uk/s/Budget2021StakeholderRepresentations/>

Dear Sirs,

2021 Budget Representation – High Income Child Benefit Charge

The Low Incomes Tax Reform Group (LITRG), an initiative of the Chartered Institute of Taxation, recognises that the 2021 Budget will be of critical importance as the country continues to tackle the economic and public health impact of the Covid-19 pandemic. There is much speculation that tax rises will be required in order to shore up public finances, though the extent and timing of such rises require a careful balance with the financial stability and resilience of individuals, businesses and the economy in general. We explored some of these issues in our submission to the Treasury Committee's call for evidence on *Tax after coronavirus*.¹

Whatever else the 2021 Budget might contain as regards tax rises for individuals, we urge the government to take the opportunity to reconsider one particular tax rise which occurs each year as a result of fiscal drag: the High Income Child Benefit Charge (HICBC). We highlight three key recommendations:

1. that the current £50,000 threshold is updated to at least £60,000;
2. that the point at which child benefit is fully withdrawn should be increased from £60,000 to at least £75,000; and
3. that changes are made to ensure that low-income taxpayers do not lose out on National Insurance credits as a result of not claiming child benefit where the charge is applicable.

¹ <https://committees.parliament.uk/writtenevidence/11719/pdf/>

CHARTERED INSTITUTE OF TAXATION
30 Monck Street, Westminster, London,
SW1P 2AP

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
E-mail: litrg@ciot.org.uk

Web: www.litrg.org.uk



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In the Spending Review on 25 November 2020, it was confirmed that the government will increase the 2021/22 personal allowance and higher-rate threshold in line with the September 2020 CPI figure. As a result, the higher-rate threshold for 2021/22 is set to be £50,270. This means that basic-rate taxpayers, for the first time, will be affected by the HICBC (with effect from 2021/22), given the existing £50,000 threshold. This is directly contrary to the original policy intent of the HICBC announced in the Spending Review ten years earlier, which stated that the charge should only affect families with a higher-rate taxpayer.

We therefore take the opportunity to re-submit our 2020 representation on recommended changes to the HICBC, as its contents are even more relevant than they were last year. Assuming the charge continues in its current structure, in particular and **at an absolute minimum**, the £50,000 threshold must be updated. To compensate for seven years of fiscal drag, and in order for the charge to continue to meet its original policy intent, we recommend it is raised to at least £60,000.

Our 2020 submission also recommended that the point at which child benefit is fully withdrawn should be increased from £60,000 to at least £75,000. This is because the greater the number of children for whom child benefit is claimed, the greater the impact on the effective marginal rate of a taxpayer between the applicable thresholds. Accordingly, the structure of the charge appears to discriminate against larger families.

Finally, changes should be made to ensure that low-income taxpayers do not lose out on National Insurance credits as a result of not claiming child benefit where the charge is applicable. We believe that this particular issue is storing up problems for low-income taxpayers which will only come to light when they claim their state pension. By this point it may be too late to plug the gaps in their National Insurance record.

Yours faithfully



Victoria Todd
Head of LITRG Team

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Low Incomes Tax Reform Group (LITRG)

Budget 2020 representation – High Income Child Benefit Charge (HICBC)

1 Executive Summary

- 1.1 The HICBC was introduced in January 2013, imposing an income tax charge to claw back child benefit where the claimant or their partner has adjusted net income in excess of £50,000.
- 1.2 Despite its name and the fact that the charge itself applies to the partner with the higher adjusted net income, the way the HICBC operates has consequences for the whole household, including the partner with the lower income and the child. For this reason, it is within scope of our remit to represent low-income and unrepresented taxpayers.
- 1.3 The HICBC has been a controversial policy since its introduction. Questions have been raised about the fairness of the policy and whether it is cost-effective. For these reasons, we think it is sensible for a review of the policy to be carried out to assess if it is working as intended and whether it meets its original objectives. This rest of this submission assumes HICBC continues to exist in its current format.
- 1.4 First, some families affected think that making a child benefit claim is not worthwhile if it will be clawed back in full (or even in part) via the tax charge, especially given the fact that liability to the HICBC requires the completion of a Self Assessment tax return. Based upon the general level of confusion surrounding the charge, expressed by enquirers to our website, households may easily be led to this conclusion.
- 1.5 But not to claim the child benefit in this scenario carries unforeseen consequences for the would-be claimant, as they might miss out on National Insurance (NI) credits for up to 12 years (or potentially longer if there is more than one child in respect of whom child benefit may be claimed). This could have a serious impact on their future state pension entitlement. Even if the claimant were to realise their mistake, under current rules they can only backdate a claim to child benefit for three months. However, it is likely that people will not

realise their mistake until many years later and perhaps only when they see their state pension forecast for the first time.

- 1.6 The above issue must be resolved before it causes problems for the claimant when they reach UK state pension age. Accordingly, LITRG endorses the following recommendations made by the Office of Tax Simplification in their report, *Taxation and life events*:

1. The government should review the administrative arrangements linked to the operation of Child Benefit, making clear the consequences of not claiming the benefit, with a view to ensuring that people cannot lose out on national insurance entitlements.

2. The government should consider the potential for enabling national insurance credits to be restored to those people who have lost out through not claiming Child Benefit.^{1,2}

- 1.7 In this representation we recommend that the Government should allow a claim for NI credits for years where the person (or their partner) would have been entitled to child benefit and they (or their partner) had adjusted net income over the HICBC threshold. There should be no time limit on this for the reasons set out in paragraph 1.5 – some further thought will need to be given about the evidence that may be required to support such a claim but we suggest this be fairly basic.

- 1.8 Second, given that the £50,000 threshold has remained static since the charge was introduced in 2013, the HICBC is affecting an increasing number of families. We therefore suggest that **the £50,000 threshold should be uprated to £60,000** in order to minimise the impact of the charge and to ensure the policy works in the way originally intended. Thereafter, the threshold should be reviewed regularly, or preferably provision made to automatically uprate it annually in line with inflation.

- 1.9 Third, there is a particular issue which affects families in which child benefit is claimed where the higher-income partner has adjusted net income of between £50,000 and £60,000 a year: the effective marginal rate applicable to that person. This is exacerbated when there are large numbers of children involved, which is not uncommon in families of certain origin, and so may be said to be discriminatory. For these families, finances are already likely to be stretched. Accordingly, we recommend that **the point at which child benefit is fully withdrawn should be increased from £60,000 to at least £75,000**. Alternatively, the child benefit could be withdrawn instead by a fixed amount for each £100 above the initial threshold, rather than a percentage of the total child benefit received.

¹ <https://www.gov.uk/government/publications/ots-life-events-review-simplifying-tax-for-individuals>, October 2019, p23

² For sake of clarity, the ability for NI credits to be restored should be available to those who have *and will have* lost out through not claiming child benefit. In other words, this should be a rolling facility and not just a one-off resolution for those who have missed out up to a certain point of time.

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 cannot afford to pay for advice. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Ability to backdate NI credits

- 3.1 Child benefit claimants are entitled to NI credits for the first 12 years of a child's life. These are crucial to preserving the claimant's entitlement to a state pension – which requires 35 'qualifying' years for the full amount – where they do not otherwise work (earning above the Lower Earnings Limit), or receive NI credits on some other basis.
- 3.2 At present, HMRC advise that to preserve entitlement to NI credits individuals have the option to claim child benefit but opt out of receiving payments.¹ This is done by ticking a box on the child benefit claim form, or if the child benefit is already in payment, by completing a separate form. However, such an 'opt-in then opt-out' process is not intuitive, despite the guidance issued on the face of the claim form. Indeed, many would-be claimants might not even go so far as to obtain a copy of the claim form, or not bother to read the form and its accompanying guidance even if they have been given it (for example, on the birth of a child), having already decided not to claim.²

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/807955/CH2_online.pdf

² Unfortunately, data does not seem to be available on the number of families who have chosen not to claim child benefit due to the introduction of the HICBC (see pages 2-3, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691948/Child_Benefit_Commentary_August_2017.pdf).

- 3.3 In addition, if people do see the HICBC threshold on the form or are aware of it from elsewhere, they may not even make a claim for HICBC in the first place and therefore may not be aware of the potential to lose out on credits.
- 3.4 As a consequence, the individual potentially misses out on 12 qualifying years that would otherwise have counted towards their state pension entitlement. Indeed, this issue could affect more than 12 years if more than one child, born at different times, is involved. To illustrate the financial impact of this, the current maximum state pension is £168.60 per week.¹ This is achieved by having 35 qualifying years. Thus, an individual with only 23 qualifying years (assuming they do not make up any of the ‘lost’ credit years in the rest of their working life and do not qualify for other credits for the same period) will only receive £110.79 a week (missing out on £3,006.12 annually).²
- 3.5 Under existing rules, an individual who becomes aware of having missed out on these NI credits may only backdate the claim to child benefit for *three months*. This is unlikely to have much impact on whether or not a year is treated as qualifying for state pension purposes.
- 3.6 Thus, it seems appropriate, to allow individuals to make a claim claim for NI credits for years where they would have been entitled to child benefit and they (or their partner) had adjusted net income over the HICBC threshold. There should be no time limit on this for the reasons set out in paragraph 1.5 – some further thought will need to be given about the evidence that may be required to support such a claim but we suggest this be fairly basic.
- 3.7 This should be accompanied by some effort on HMRC’s part to identify would-be claimants who have missed out and to contact them to invite them to claim the credits they have missed out on. Other government initiatives, such as Pensions Dashboards (within which it is intended to show people’s full pension savings, including state provision), could be used to communicate to people the potential for having missed out on NI credits and prompt them to claim.
- 3.8 In addition, HMRC must ensure that their process is robust to ensure people understand the options open to them and hopefully do not need to rely on a later credit claim.

4 The £50,000 threshold

- 4.1 The ‘trap’ resulting from the present inability to backdate NI credits, into which families are driven because of the design of the HICBC, is one of a number of issues which are faced by families in scope of the charge. As well as the obvious financial cost of the charge (which in practice could affect the whole household, not just the person liable), these include:

- if child benefit is not claimed at all as a result, the child does not receive an NI number automatically when they turn 16, which may mean that they would have to attend a face-to-

¹ <https://www.gov.uk/new-state-pension/what-youll-get>

² $£168.60 \times 23/35 = £110.79$; $(£168.60 - £110.79) \times 52 = £3,006.12$

face interview in order to apply for one,¹

- lack of awareness of the charge leading to a large tax debt accruing and failure to notify penalties,²
- ambiguity over precisely when two people become (and cease to be) ‘partners’ and consequential imprecision over when liability to the charge begins and ends,³
- perceived unfairness of the charge as it can affect a couple earning the same amount in total as another couple (not liable to the charge) whose earnings are more evenly split between them,
- high marginal rates of tax in the range of income where the charge applies,⁴
- difficulties when couples wish to retain financial independence and confidentiality, and
- cases where the HICBC-liable partner exercises coercive financial control over their partner as a result of the charge.⁵

4.2 In this submission we do not consider these issues further (other than the high marginal rates of tax), but we argue that together they strengthen the case for the £50,000 threshold to be raised as it defines which families are affected. We set out the principal argument for raising the threshold below, beginning with a brief overview of the background to the threshold.

¹ On this point the OTS recommended that ‘the government should consider how to ease the process of enabling children of those who have not claimed Child Benefit to receive their National Insurance number’ (*Taxation and Life Events*, October 2019) – a view we support.

² HMRC conducted a review into the failure to notify cases and retrospectively granted a ‘reasonable excuse’ in limited circumstances (see <https://www.gov.uk/government/news/review-for-high-income-child-benefit-charge-penalty-cases-concludes>) but this only applied to tax years from 2013/14 to 2015/16 and in any case the HICBC itself remained payable.

³ See <https://www.litrg.org.uk/latest-news/reports/150511-couples-tax-and-related-welfare-systems--call-greater-clarity> for our detailed report, *Couples in the tax and related welfare systems – a call for greater clarity* (May 2015) for further discussion.

⁴ See Section 5 for a full discussion.

⁵ These issues were discussed in a parliamentary debate held in September 2019: <https://hansard.parliament.uk/Commons/2019-09-03/debates/CEE5563C-B89E-4849-BE95-ABA947935179/HighIncomeChildBenefitCharge>

- 4.3 Nearly ten years ago in the 2010 Spending Review, it was proposed to withdraw child benefit from families with a higher-rate taxpayer, from January 2013.¹ The mechanism for this was then announced in the 2012 Budget: an income tax charge would apply where a household had someone with an adjusted net income of more than £50,000 a year, with the charge equal to the amount of child benefit received for households which had someone with an adjusted net income of £60,000 or more.²
- 4.4 In the 2012/13 tax year, an individual would be liable to the higher rate of tax once they had taxable income exceeding £42,475,³ so the £50,000 threshold actually reduced the scope of the charge from the original proposal. Given that the HICBC effectively introduced an increased marginal rate of tax for incomes between £50,000 and £60,000, this meant that an individual did not suffer a ‘double-hike’ in marginal rates once the higher-rate threshold was reached.
- 4.5 More importantly, at the time it was anticipated that 90% of all families would still receive some or all of their child benefit.⁴ This fact was used to justify the introduction of the charge when it was debated in Parliament – but it no longer applies.⁵
- 4.6 The charge was introduced by Finance Act 2012, s 8 and Sch 1, including a new section 681F to the Income Tax (Earnings and Pensions) Act 2003 which provides for the £50,000 threshold to be changed by Treasury Order.
- 4.7 Owing to increases in the personal allowance and the basic rate band over the recent years, the higher-rate threshold has now caught up with the £50,000 HICBC threshold.⁶ This means that an individual becomes liable to the higher rate of tax at the same time as the HICBC – precisely the effect which was deliberately avoided in 2012/13.

¹ <https://www.gov.uk/government/publications/spending-review-2010>

² <https://www.gov.uk/government/publications/budget-2012>

³ Assuming the individual was entitled to the standard personal allowance in 2012/13 of £8,105.

⁴

<https://webarchive.nationalarchives.gov.uk/20141007023213/http://www.hmrc.gov.uk/budget2012/tiin-0620.pdf>

⁵ The then Exchequer Secretary to the Treasury, David Gauke, said the following in the Finance Bill debate: “The only benefit received by those in the top 10% of earners, which includes all of us, is child benefit, if they have children. That is the only benefit that we receive, so it is the only one that can be reduced or withdrawn. That is why we have this approach. It is perfectly fair that steps are taken to remove child benefit from those households that contain people in the top 10%.” (Column 615 – 616) (<https://publications.parliament.uk/pa/cm201212/cmhansrd/cm120419/debtext/120419-0004.htm>)

⁶ In England, Wales and Northern Ireland. The higher rate threshold is lower in Scotland (£43,430 for 2019/20).

4.8 At the same time, the proportion of families affected by the charge has increased as a result of rising wages and the effect of fiscal drag.¹ A year ago, the Institute for Fiscal Studies (IFS) estimated ‘around 36%, or 370,000, more families will lose some child benefit in 2019/20 than in 2013/14’.² It also pointed out that continuing the freeze would mean that, from April 2021, significant numbers of families who do not contain a higher-rate taxpayer will begin to lose some of their child benefit for the first time, and by 2022 more than one in five families with children would be set to lose at least some of their child benefit, up from one in eight when the policy was introduced.

4.9 The IFS makes the point quite plainly:

‘...what cannot be justified is to have an ever-increasing proportion of families exposed to the policy over time, with the increase determined by the rise in prices since 2013. If £50,000 was the right number in 2013, then it will not be the right number in 2023, and vice versa.’³

4.10 It concludes by pointing out that this is just one example of many cases where lack of indexation in the tax system leads to tax increases by stealth, stating:

‘...the government is not even attempting to take a principled view of exactly which families should be keeping all of their Child Benefit, who should be paying higher rates of tax, and so on. Instead, it is simply allowing these choices to be buffeted around arbitrarily each year by inflation. Meanwhile, the cumulative impact it has in raising taxes or reducing benefits by stealth can do nothing for trust in government.’⁴

4.11 We do recognise, however, that there might be some advantage of having a clear figure which the government can use to publicise the charge. However, notwithstanding this clear £50,000 ‘hook’, LITRG has encountered a number of examples where individuals have been unaware of the obligation to notify to HMRC their liability to the charge, with the result that large debts have accrued as a result of the HICBC being unpaid for several years. So

¹ Data at <https://www.gov.uk/government/publications/high-income-child-benefit-charge-data/high-income-child-benefit-charge#paying-the-charge> shows that the combined number of people either paying the HICBC or opting out of child benefit payments has increased from 2013/14 to 2017/18.

² <https://www.ifs.org.uk/publications/13791>

³ <https://www.ifs.org.uk/publications/13791>

⁴ <https://www.ifs.org.uk/publications/13791>

fundamentally, it is not the amount that is important – the key point is that people need to be aware of the amount and their obligations.¹

- 4.12 We are also concerned at the lack of clarity about what income the £50,000 threshold actually relates to. People are only affected by the charge if their *adjusted net income* is over £50,000. Adjusted net income allows certain deductions to be made from taxable income which means that potentially some people who may think they are caught by the charge are in fact not. However, most of the letters we have seen from HMRC continue to refer to income over £50,000. Going forward, it is important that whatever the threshold is set at, there is clear communication about what income this actually refers to.
- 4.13 A one-off increase in the threshold would be a good opportunity to underscore the importance of public awareness of the charge, so a clear figure on which to base the message would be helpful. We therefore suggest that a £10,000 increase to the threshold would be appropriate, bringing the threshold to £60,000.² Increases in the threshold should be reviewed on a regular basis (we suggest every five years at a minimum), although preferably future increases could be done annually, with uprating automatically pegged to the Consumer Price Index.

5 The £60,000 limit

- 5.1 Where a family unit includes a child benefit claimant and the higher-income partner has adjusted net income of between £50,000 and £60,000, he or she faces a withdrawal of the child benefit claimed through the HICBC. This is in addition to income tax at the higher rate, currently 40%, and NI of 2% (class 1 if employed, or class 4 if self-employed). Unlike the rates of tax and NI, which are fixed, the amount of additional tax suffered as a result of the HICBC will depend on the amount of child benefit claimed.
- 5.2 For example, a claimant with two children will be entitled to receive a total of £1,788.80 a year in child benefit.³ This is withdrawn via the HICBC at a rate of 1% for each £100 of income above the £50,000 threshold. Therefore, on an additional £100 of income within the £50,000 to £60,000 range, the partner with the high adjusted net income in such a family suffers £17.89 of HICBC, £40 of tax and £2 of NI: a marginal rate of 59.9%.

¹ As this is a Budget Representation and therefore confined to tax policy rather than specifically about its administration, we do not comment in detail about how the administration of the charge could be improved. However, we would point out that whatever the amount of the threshold, it should be within HMRC's capability to warn people whose income begins to exceed £50,000 in a tax year that they should consider whether they need to notify liability to the HICBC.

² Had HICBC rules kept pace with inflation, the threshold would now be about £56,000, per the Bank of England inflation calculator, using CPI averaging 2.4% a year.

³ Child benefit is currently paid at a rate of £20.70 a week for the eldest child and £13.70 a week for each additional child. The total figure of £1,788.80 assumes a 52-week benefit year.

- 5.3 For those claiming child benefit for more children, the marginal rate is even higher, as shown in the following table:

Number of children	Effective marginal rate
3	67.0%
4	74.1%
5	81.3%
6	88.4%
7	95.5%
8	102.6%

- 5.4 The above effect might be considered to be discriminatory against families with large numbers of children, which can be disproportionately represented within certain ethnic groups.¹
- 5.5 For example, an ONS report (using 2011 Census data) on total fertility rates (TFRs) by country of birth identified particularly high TFRs for Somali-born (4.19) and Afghan-born (4.25) women in England and Wales in 2011; both were more than twice the England and Wales average. Women born in Pakistan and Bangladesh also had significantly high TFRs (3.82 and 3.25 respectively).²
- 5.6 Such families will already be facing additional financial strain as a result of the number of children involved, with the result that the increased marginal deductions have an especially harmful impact. For example, in the extreme case, a family of 8 or more children whose high-income partner earns a salary of £50,000 will not be financially incentivised to accept a new role on £60,000 as to do so would leave him or her worse off. This is surely a perverse and unintended consequence of the policy and must be corrected.
- 5.7 LITRG proposes two possible solutions. The first, in order to preserve the basic structure of the charge, the £60,000 ‘run-out’ point could be increased to at least £75,000. If the starting threshold for becoming liable to the charge is increased to £60,000, this would be equivalent to withdrawing child benefit through the HICBC at a rate of 1% for each £150 above the threshold, rather than for each £100.
- 5.8 Alternatively, an arguably fairer solution would be to equalise the impact of the increased marginal rates among those families affected. This could be achieved by having a clawback rate of, say, £15 for each £100 earned above the threshold. This would mean that the increased marginal rate for those liable to a part-withdrawal of child benefit through the

¹ This could leave the policy open to challenge under the equality law.

² See ‘Babies born in England and Wales to non-UK born mothers infographic’, 4 February 2014: <https://webarchive.nationalarchives.gov.uk/20160107141650/http://www.ons.gov.uk/ons/rel/fertility-analysis/childbearing-of-uk-and-non-uk-born-women-living-in-the-uk/2011-census-data/info-mother-s-country-of-birth.html>

HICBC is the same for all individuals affected, regardless of the number of children for whom child benefit is claimed.

LITRG
7 February 2020