

## Call for evidence by the Social Security Advisory Committee: Localisation

### Response from the Low Incomes Tax Reform Group (LITRG)

#### 1 Executive Summary

- 1.1 Whilst LITRG is generally supportive of localisation to the extent that it means people are better served by authorities being able to flex benefits and services to local needs, we are concerned that this creates potential for serious confusion. This confusion arises both in terms of people's understanding of to whom they turn for guidance (is it a national, devolved or local authority – or perhaps a combination?) and of what power exists to change things in their community.
- 1.2 We therefore believe that localisation should be approached with considerable caution, limiting differences to those considered essential to meet local need. Efforts should be made to share best practice between authorities so that service standards are consistent, and to minimise any 'postcode lottery'.
- 1.3 Turning to our particular interest in the interaction between tax and benefits, we raise concerns about the understanding of tax matters at a local level – particular examples being the different definition of income for the self-employed in terms of tax, tax credits and benefits (both at national and local level), and how the infrequent tax payments payable under self assessment are treated for benefits purposes. Guidance for claimants on these matters is also very poor (appendix 2 gives an example). LITRG is willing to help develop best practice protocols for local authorities on successful delivery of public guidance where tax and benefits interact.

- 1.4 We also raise concerns about how decisions taken at one level of government or administration can cause displacement of costs to another level, and we note the closure of HM Revenue & Customs (HMRC) Enquiry Centres as one example of this.
- 1.5 A further consideration is the tax status of a benefit if a local authority wishes to put in place a scheme tailored to its community. As illustrated in appendix 1, we can find no global exemption in tax law permitting a local authority to introduce such a scheme, and we strongly recommend that the government consider putting something in place to allow flexibility if there is to be further localisation. Similar consideration must also be given to the tax credits treatment of local benefits, and their impact on universal credit entitlement.
- 1.6 LITRG has a unique ability to consider tax, tax credits and benefits interactions, but our efforts – for example in reviewing and helping to improve guidance for the public – can be hampered by the proliferation of information on different government and local authority websites. In the past, when a national tax change was announced, we could immediately analyse the impact on individuals and households by understanding what the impact on net income would be for benefits purposes (including local impacts such as council tax benefit). With increased localisation (the move to individual council tax support schemes), we are no longer able to make such global comment and of course this means it is also more difficult for central government to understand the impact of national changes on individuals at a local level.
- 1.7 Nevertheless, we are willing to share our tax and benefits interaction expertise so that we reach individuals across the country. If it is helpful to discuss any aspect of this response in more detail, then we are always happy to lend support.

## **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 on low incomes. 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 Introduction and general comments

- 3.1 Given LITRG's focus, as outlined in section 2, our interest in this call for evidence extends to tax credits, tax reliefs for social purposes and a general interest in the interactions between the tax and benefits systems. We have a keen interest in areas where HMRC and the Department for Work and Pensions (DWP) should work together to offer the best help to customers common to both departments. The cooperative working we would like to see (but often find lacking) should extend to working with local authorities and voluntary sector organisations operating at a local level as necessary.
- 3.2 Also relevant is that HMRC have cut their local presence in the last year with their programme of Enquiry Centre closure. Whilst HMRC still have the capability to provide some local services to those who 'need extra support', this is a less flexible system. It limits people's ability to approach HMRC, as the 'extra support' service is only accessible by telephone initially.<sup>1</sup>
- 3.3 It also means that HMRC's 'local knowledge' has been lost in the new, centralised offering. Communities that have specific local needs and differences are not therefore immediately apparent. For this reason, when they were developing the 'Needs Extra Support' service, we encouraged HMRC to link up with local authorities and voluntary sector organisations to understand properly particular issues and needs at a local level.
- 3.4 We are concerned that decisions such as this, taken at one level (central administration) have impacts and displace costs elsewhere (to local level). In past evidence to the Treasury Committee<sup>2</sup>, we noted a direct correlation between the closure of HMRC Enquiry Centres and increased demand for Tax Help for Older People's services – the need had not gone away, it was simply that the means of satisfying the need had changed. A further example of such displacement might be that when housing benefit is cut, local authorities either pick up the tab with discretionary grants, or homelessness increases.

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<sup>1</sup> Unless it is accessed via another voluntary sector or community organisation with which the individual has made face-to-face contact. See this announcement on 24 November 2014 extending the availability of the Needs Extra Support service to more voluntary organisations:

<https://www.gov.uk/government/publications/voluntary-and-community-sector-organisations-needs-extra-support-service/voluntary-and-community-sector-organisations-needs-extra-support-service>

<sup>2</sup> See paragraph 2.3 of the joint submission by the Chartered Institute of Taxation, Association of Taxation Technicians and the Low Incomes Tax Reform Group, 25 January 2012:

[http://www.tax.org.uk/Resources/CIOT/Documents/2012/02/120126\\_TreasComm\\_CD\\_CIOT\\_ATT\\_LITRG.pdf](http://www.tax.org.uk/Resources/CIOT/Documents/2012/02/120126_TreasComm_CD_CIOT_ATT_LITRG.pdf)

- 3.5 LITRG does not in itself give advice to the public and does not have a ‘local’ presence (except to the extent that our websites<sup>1</sup> have broad geographical reach and we therefore reach the UK as a whole, and receive enquiries from around the country). We do, however, liaise with other voluntary sector organisations across the UK that operate at a local level – examples include those dealing with single-parent families, and migrant agencies. Via our project work<sup>2</sup>, we have also had contact with local authorities around the country – in particular their staff who deal with direct payments to those with care needs<sup>3</sup> and those dealing with migrants.
- 3.6 We have set out the main body of this submission by answering the questions posed in the call for evidence paper, but have only answered those questions where we have a contribution to offer.

#### **4 Question 1: What is understood by the term ‘localisation’?**

- 4.1 ***Can ‘localisation’ be distinguished from devolution, decentralisation, deconcentration or subsidiarity?***
- 4.1.1 We think that localisation can be distinguished from devolution. We would interpret localisation as delivery of services and benefits at a much more local level than devolution – the latter being about control being passed from UK central government to the national authorities of the constituency countries of the UK (the Scottish Parliament, the Northern Ireland Assembly and the Welsh Assembly). There is still further localisation within the devolved administrations. The term devolution might seem least applicable to the people of England, for whom there is no such ‘separate’ governmental body.
- 4.1.2 There are, however, cross-overs between these terms and areas for potential confusion. People might be confused about whom to approach for help and advice in a particular situation, given the range of options – local authorities, local offices of government departments (principally JobCentre Plus), or national bodies. As we note in answer to question 3 below, this confusion is likely to be compounded with mixed messages as to where to find information online – with central Government promoting GOV.UK as a ‘one stop shop’ but also at the same time new websites are being created in devolved parts of the UK, as well as local authorities continuing to provide information on their own websites.

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<sup>1</sup> [www.litrg.org.uk](http://www.litrg.org.uk), [www.taxguideforstudents.org.uk](http://www.taxguideforstudents.org.uk), [www.revenuebenefits.org.uk](http://www.revenuebenefits.org.uk) and [www.disabilitytaxguide.org.uk](http://www.disabilitytaxguide.org.uk)

<sup>2</sup> ‘Disability Tax Guide’, and ‘Tax Guide for Migrants’.

<sup>3</sup> See our project website – [www.disabilitytaxguide.org.uk](http://www.disabilitytaxguide.org.uk)

4.2 ***What is the rationale for having some benefits/entitlements configured and accessed on a national basis and some on a sub-national or local basis?***

- 4.2.1 We can see the rationale for having some benefits/entitlements configured on a local basis where local authorities might need to address particular needs in their area. They need to take into account local demographics and other factors – for example the average age of their population, the prevalence of families with young children, housing supply, housing costs and constituents' ethnic origins. There are also differences in the cost of living across the country which are not factored into national benefits – for example, the living wage outside of London is estimated to be £7.85 an hour, rising to £9.15 an hour for all Boroughs in Greater London<sup>1</sup>. This true 'living wage' no doubt also has subtle regional variations.
- 4.2.2 One example of a tax relief for social purposes operating on different bases at a sub-national level is the Blind Person's Allowance (BPA)<sup>2</sup>. This has different qualifying criteria for England and Wales (registration of blindness on the local authority register) to Scotland and Northern Ireland (based upon eyesight being required to work). There seems little rationale for these differing criteria in tax law, particularly now that the Universal Credit Regulations define someone as 'blind' if they are 'certified as severely sight impaired or blind by a consultant ophthalmologist'<sup>3</sup>.
- 4.2.3 We would have thought that it would make for a more sensible and simple system if local differences were only introduced where there is an identifiable local need or demographic variation, rather than seemingly arbitrary (though probably in legal or administrative terms soundly based) differences such as in the case of the BPA.<sup>4</sup>

4.3 ***What have been the dominant trends over recent years?***

- 4.3.1 In Scotland, we have picked up on a general feeling that although there is devolution to the Scottish Parliament, there is not enough 'devolution' to the regions (ie insufficient 'localisation'). It seems that whilst people welcome the trend towards greater national devolution in the cases of Scotland, Wales and Northern Ireland, they feel there is more centralisation in terms of what happens thereafter. This could be a misconception and that there is in fact more localisation than people realise – for example, it may be that people are not aware of the localisation of council tax. This does though serve to illustrate the potential

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<sup>1</sup> See <http://www.livingwage.org.uk/calculation>

<sup>2</sup> Section 38 Income Tax Act 2007

<sup>3</sup> Regulation 3, The Universal Credit and Miscellaneous Amendments (No.2) Regulations 2014, SI2014/2888: <http://www.legislation.gov.uk/uksi/2014/2888/regulation/3/made>

<sup>4</sup> Though prior to making any changes to the BPA, the government would need to consult further with interested stakeholders such as ourselves and other organisations representing people with impaired sight.

for confusion between the various terms and people’s understanding of what is controlled at local, devolved, UK national and perhaps even European levels.

## **5 Question 2: What has been the impact of ‘localisation’ on particular benefits and services?**

### **5.1 *Independent Living Fund closure***

5.1.1 One of the subject areas listed under this question is closure of the Independent Living Fund. Elsewhere in this response, we comment on certain ‘central government versus localisation’ issues for users of direct payments administered by local authorities. We do not repeat those comments here, but stress that our experience has all too often shown that tax and benefits interactions, together with central government and local interactions, are usually overlooked or side-lined in favour of driving through a particular policy.

### **5.2 *The ‘postcode lottery’ and the need for best practice***

5.2.1 One of the potential pitfalls with localisation is that there will be different practices by those administering benefits and services at a local level – essentially creating a ‘postcode lottery’. This is all very well where that difference is justified (that is, where a service or benefit is tailored to meet a community’s particular needs); but the aim should be to deliver a consistently high level of service across the country where there is no justification for deviation from a central protocol. A good example of this is council tax debt collection practice across the country. This is an area where Citizens Advice and the Local Government Association have worked together to identify good practice and set out a protocol<sup>1</sup> to which local authorities are encouraged to sign up with the aim of achieving consistency.

## **6 Question 3: What is working well and what is not – and why?**

### **6.1 *Do you have experience of co-commissioning or co-location of advice services?***

6.1.1 Yes. LITRG set up Tax Help for Older People, which has been run since 2004 by a separate charity, Tax Volunteers<sup>2</sup>. This service originated (and still operates to a large extent) by working with other voluntary sector organisations, for example holding tax ‘surgeries’ in other organisations’ local venues to achieve a geographic spread around the country.

### **6.2 *Are there examples of local authorities seeking to change or better coordinate their own services to meet the needs of social security claimants?***

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<sup>1</sup> See ‘Council tax arrears – good practice protocol’:

[http://www.citizensadvice.org.uk/index/campaigns/current\\_campaigns/recent\\_campaigns/council-tax-arrears.htm](http://www.citizensadvice.org.uk/index/campaigns/current_campaigns/recent_campaigns/council-tax-arrears.htm)

<sup>2</sup> See [www.taxvol.org.uk](http://www.taxvol.org.uk)

- 6.2.1 Our work with local authorities on various projects, as described above, has shown that they are keen to improve and coordinate their services. Whilst one benefit might be to serve the needs of social security claimants, the authorities might also have regard to the cost efficiencies that coordination can bring. Problems may stem, however, from having sufficient resources to invest in coordination which might deliver longer term savings.
- 6.3 ***Is there an adequate consideration of how the ‘tax system’ interacts with the ‘benefits system’ at the local level?***
- 6.3.1 We do not believe there is currently adequate consideration of these interactions. Tax is a complex subject and LITRG has come across instances of where it has not been considered (or not considered thoroughly) when rolling out benefits initiatives. These examples include:
- 6.3.1.1 Drives to get people into work, which may include promoting self-employment as an option. We have found that low-income benefits claimants have been advised (by local JobCentre Plus offices, and others) to consider self-employment as a means of earning a living, or as a stepping stone to get back into the employed workplace. But this has been done without any or adequate warning of the impacts from an HMRC perspective – both for tax credits (where the claimant has to demonstrate sufficient working hours and the need to be in ‘qualifying remunerative work’), and for tax (where there are obligations on the individual to notify HMRC of self-employment and complete self assessment tax returns each year).
- 6.3.1.2 Direct payments made to those with personal care needs, and the tax implications of becoming an ‘employer’ of care workers. In a 2008 report<sup>1</sup>, LITRG identified inadequacies in the information provided to direct payments users. This is something we have ourselves then attempted to rectify through our ‘Disability and Tax – A Guide’ project<sup>2</sup>. We have found that local authorities are keen to understand more about the tax interactions and consequently to deliver a better service to direct payments users, though constraints on their resources and budgetary restraints are limiting factors.
- 6.3.1.3 Disabled people being provided in-work or back-to-work support through the Access to Work programme, but without guidance as to the tax treatment of grants paid under that scheme.

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<sup>1</sup> ‘Independent living, direct payments and the tax system’ - see <http://www.litrg.org.uk/reports/2008/independent-living-direct-payments-and-the-tax-system>

<sup>2</sup> See [www.disabilitytaxguide.org.uk](http://www.disabilitytaxguide.org.uk) – this LITRG project was funded via the HMRC Grant in Aid programme.

- 6.3.1.4 The localisation of council tax support. This has created particular confusion for the self-employed and those paying tax under self assessment<sup>1</sup>. The measurement of income for the self-employed is different for tax and benefits purposes, creating confusion for council tax support and housing benefit claimants. In summary, there is both a lack of guidance for the public (see appendix 2 for one example) and a lack of understanding at a local level of the tax issues involved.
- 6.3.2 As noted above, we do not think this situation is helped as there are confusing messages about where people should seek information. On the one hand, the Government Digital Service is working to merge various other public websites into the global GOV.UK and promoting this as a single source of information. Yet on the other hand, new websites are being created in the devolved administrations (such as for Revenue Scotland – [www.revenue.scot](http://www.revenue.scot)), and there is a vast array of different information in different formats on local authorities' websites. On the advice of LITRG and others, the Revenue Scotland website includes a page on what they 'don't do' and where to go for other information that visitors to the site might be seeking<sup>2</sup>. Such clarity and signposting is essential.
- 6.3.3 Even if people are made aware that there may be tax and benefits interaction issues, there is often a lack of information to be had as to what those issues are and what to do about them – both at national and local level. Our experience shows that it is difficult enough to get HMRC and DWP to join together to provide cohesive advice: a problem that is compounded exponentially when adding in the dimensions of devolved administrations and local authorities.
- 6.3.4 Localisation in terms of benefits also makes it very difficult for stakeholders to input into consultation, to consider all tax and benefits interactions, and to review information for the public. For instance, the move from a general Council Tax Benefit to local Council Tax Reduction Schemes<sup>3</sup> has produced challenges for ourselves in terms of what information we can provide on our websites to assist the public with this important tax. The existence of different schemes means that we can no longer provide a simple overview of the system and how this interacts with other tax and benefits matters. This makes for confusion and uncertainty.
- 6.4 ***Will increased 'localisation' change any aspect of the relationship between tax and social security?***

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<sup>1</sup> This may be in a single lump sum, on 31 January after the end of the tax year; or as two payments on account on 31 January and 31 July followed by a balancing payment on 31 January after the end of the tax year.

<sup>2</sup> See <https://www.revenue.scot/who-we-are/what-we-dont-do>

<sup>3</sup> In addition to which a person might apply for discretionary relief under the Local Government Finance Act 1992 Section 13A – as summarised in this case report: *SC v East Riding of Yorkshire Council* [2014] EW Misc B46 (VT) (27 May 2014), <http://www.bailii.org/ew/cases/Misc/2014/B46.html>



- 6.4.1 There is a question over how easily local authorities can flex the system to meet local needs. For instance, we recently received an enquiry about a local authority wishing to recognise the burden of childcare costs faced by parents in its area, asking whether or not this was achievable or if it would open up a range of complex issues.
- 6.4.2 We have appended this question and our response to it to this document (appendix 1), as it provides a good summary of the issues that would need to be considered and addressed – for tax and tax credits purposes – before a local authority could take what would seem to be a simple step towards helping its constituents.
- 6.4.3 We would conclude from the issues outlined in the appendix that the government should consider some form of generic exemption for income tax (and for the assessment of means-tested benefits income) of payments made under local authority schemes to help meet the needs of their constituents.
- 6.4.4 Further, as we have said in our comments on devolution<sup>1</sup>, one key aspect of a tax system (and indeed arguably the benefits system) should be certainty. Increased localisation of benefits is a double-edged sword from that viewpoint:
- 6.4.4.1 On the one hand, local delivery of services provides an ideal opportunity to interact with taxpayers and benefits claimants on a personal level and ensure they are provided with information and engaged with the system at that time (subject to capitalising on that opportunity, but which increased digitisation of services might threaten). This can be used to provide them with certainty.
- 6.4.4.2 On the other hand, the availability of different benefits in different areas, subject to local discretion moves away from certainty of entitlement and could be prejudicial to fairness. This may be particularly noticeable for those living on or near authority boundaries (further exacerbated for those on the borders of the devolved administrations). It may also serve to influence behaviour in unintended or unexpected ways, such as a desire to move to a different area that provides a particular benefit. It also might create uncertainties in treatment for tax and other benefits if there is no clear, global exemption as suggested above.
- 6.4.5 We would also point out that short-term measures are generally unhelpful as they can cause confusion and changes in behaviour that are unsustainable. What individuals require is a stable system so that they can plan ahead. But increased localisation could mean more frequent changes and undesirable or unintended consequences, particularly if authorities do not consult with each other.

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<sup>1</sup> See for example our evidence to the Finance Committee of the Scottish Parliament (inquiry into devolution): <http://www.litrg.org.uk/submissions/2014/141112-Smith-devolution-fiscal-LITRG>

6.5 ***Is there evidence that Welfare Reform is displacing costs from central to local government? Detailed examples will be very useful, including experiences from the current DWP-sponsored pilot projects.***

6.5.1 No comment.

**7 Question 4: In the context of ‘localisation’ of social security are there particular claimant groups/categories whose circumstances place them at particular risk?**

**7.1 *Direct payments and personal budgets users***

7.1.1 Those people with disabilities who apply for, and are awarded, direct payments to cover their care needs may be at risk from national or devolved administration changes in tax law and other policy. If there is a change in their care costs as a result of a change in the law, users may be able to apply to the local authority for an increase in their direct payments entitlement to compensate for the additional cost. But if the user is subject to their care costs having been capped, they will not be able to do so and have to fund the additional cost through other means (or alternatively reduce the level of care they receive).

7.1.2 Examples of this could be where:

7.1.2.1 There is a national increase (or devolved administration increase) in the level of class 1 secondary National Insurance that an employer has to pay for its staff. Notably, employers of personal assistants are not currently eligible for the ‘Employment Allowance’ offered to businesses employing staff to reduce their class 1 secondary National Insurance liability<sup>1</sup>.

7.1.2.2 There is a new requirement to pay something else on behalf of staff – such as the employer of a personal assistant being staged into auto enrolment and have to make pension contributions for their staff.

7.1.3 LITRG has found that such national/local interactions are often overlooked, to the detriment of individual taxpayers and claimants.

LITRG  
12 December 2014

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<sup>1</sup> Though it will be extended to them from April 2015, in a welcome move announced in the Chancellor’s Autumn Statement on 3 December 2014 – see para 1.234 of the full document: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/382327/44695\\_Accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382327/44695_Accessible.pdf) (and as campaigned for by LITRG, see <http://www.litrg.org.uk/News/2014/141203-PR-IDPD-NIC-EA>).

## **Appendix 1 – Enquiry to LITRG and reply, October 2014**

### ***Enquiry***

“I was hoping to get some advice on how a council could support low income workers with childcare costs without a payment being clawed back through the resident being taxed more or receiving less in tax credits. They are aware that paying at least 30% childcare costs is a major disincentive to work for many parents, and want to pilot whether more parents start work if the council make up this payment. I understand that this would involve changing regs for both tax credits and taxation. Is that right? Are there any possible work arounds? Eg council making payment directly to childcare provider.”

### ***LITRG’s reply***

“Your query raises a number of points for consideration.

As far as income tax is concerned for payment of a benefit from the local authority to parents (whether ‘in kind’ to the childcare provider direct, or as cash to the parents which they use to pay for childcare), I can’t see anything in the current income tax provisions that would allow this to be tax exempt. The state benefits currently payable as tax-exempt are listed within Section 677 of the Income Tax (Earnings and Pensions) Act 2003, so any local authority payment would have to be made under those regulations provided for as tax-exempt benefits; or otherwise the main statute would need to be amended to include another benefit as tax exempt. Whilst Section 151 of the Finance Act 1996 gives the Treasury power to make regulations to exempt from tax charge ‘benefits under pilot schemes’, this does seem only to be benefits piloted by central government, rather than locally. Presumably any regulations exempting a local pilot scheme would therefore have to go through the full Parliamentary process of approval, rather than short-cut via the Treasury.

The slightly odd thing about the income tax legislation in the context of benefits is that equally, however, a local authority pilot scheme/new benefit would not seem immediately to fall to tax as ‘taxable social security income’, as there is a list of benefits that are specifically taxable as defined in Section 660 of the same Act. There is no apparent ‘catch all’ clause for anything else within that section of ITEPA. We can only assume therefore that it would fall to tax as ‘other income’ within the provisions of the Income Tax (Trading and Other Income) Act 2005, which does have an ‘anything else not taxed elsewhere’ provision (Part 5, Miscellaneous Income, of that act).

So in conclusion, we think that a payment from a local authority to parents for childcare purposes would be taxable as other income, and I can’t see a way around that even if the payment were made direct to the childcare provider.

Generally it follows that income that is taxable is also assessable as income for tax credits purposes. Here, we need to turn to SI 2002/2006 Tax Credits (Definition and Calculation of Income) Regulations. If we assume that any benefit provided by the local authority is taxable as ‘miscellaneous income’ within the ITTOIA 2005 provisions as noted above, it falls that the

amount would also be income for tax credits purposes, as in Regulation 3 (referring to Regulation 18).

So this could increase income for tax credits purposes and reduce the award accordingly.

To compound the tax credits problem, however, HMRC are also likely to infer (if the local authority pays the childcare provider direct, or providers vouchers for that purpose) that the claimant no longer incurs that cost and so they would only get 70% of the amount they actually pay. So it wouldn't achieve their objective, ie an amount covered by the local authority directly to the childcare provider wouldn't be classed as part of the 'costs incurred' by the claimant or the amount 'paid by the person...'. So if the childcare fees are £120 p/week and the local authority covers £36 of that charge by paying to the childcare provider, then the claimant is incurring fees of £84 and can only get up to 70% of that £84 via tax credits.

It is interesting to note that HMRC actually did something similar themselves – a 100% childcare pilot as part of a series of other childcare pilots: [http://dera.ioe.ac.uk/3599/1/3599\\_DFE-RR117.pdf](http://dera.ioe.ac.uk/3599/1/3599_DFE-RR117.pdf). But of course, the difference with that is that HMRC did it by increasing the childcare percentage for tax credits which obviously eliminated the issues above.

We also note that a scheme was run in Scotland a couple of years back – working for families. The evaluation report seems to talk about the childcare aspects of the scheme at some length – <http://www.scotland.gov.uk/Resource/Doc/269769/0080320.pdf>

Under this programme, we believe they ran several options to subsidise childcare costs which no doubt supplemented the childcare element of tax credits by effectively covering part of all of the remaining balance or sometimes covering the up-front deposit asked by childcare providers. We think the risk of HMRC challenge that the childcare costs have not been 'incurred' is lower if cash is paid to the parent which they then use to pay for childcare, ie if the claimant pays over £120 and gets £84 through tax credits, then the local authority may find a way to give them back the other £36. However, if any payment made to a claimant is stipulated to be for childcare, then there is a risk that HMRC would say that the claimant is not 'incurring' the costs and so only cover 70% of the amount of childcare they claimant actually pays (as outlined above). It might be worth approaching HMRC to get confirmation of how they would treat the costs once the model is decided upon. Whilst we don't have any specific detail, we think under the old Scottish scheme it was possibly referred to as some kind of work-incentive grant (and was tax-free, presumably fitting within the in-work credit benefit definition within the tax-exempt table set out in S677 ITEPA) but it appeared to achieve the programme's objective.

... In summary:

- 1) Yes, you are right that there may well have to be a change in regulations for tax purposes to get a local authority childcare support payment out of income tax

charge, unless it could be framed within one of the benefits already tax exempt under Section 677 ITEPA.

- 2) For social security income purposes, the tax credits income regulations don't follow tax provisions directly. Therefore, there might also need to be a specific disregard included in Regulation 7 for such a benefit, unless it could be fit into one of those benefits already disregarded.
- 3) For the best tax credits result, the payment would need to be made to the parent, who then pays for the childcare. If the payment is made direct from the local authority to the childcare provider, HMRC are likely to say that the tax credits claimant has not incurred the full cost of childcare and therefore only award tax credits based on 70% of the amount the claimant has actually paid themselves."

## Appendix 2 – Council tax guidance for the self-employed

Example of guidance on self-employed earnings for council tax support on the West Norfolk online benefits calculator tool<sup>1</sup>:

### ‘Self Employed: Allowable Expenses

Self-employed people’s gross earnings are worked out as the gross profit of the business less certain **allowable expenses**.

Allowable expenses **include**:

- repayments of capital on loans used to replace or repair equipment needed for the business
- the cost of replacing or repairing equipment needed for the business
- Interest paid on business loans
- VAT paid in excess of VAT received
- expenses paid for the purposes of the business
- bad debts that have been defaulted on.

They **don’t include**:

- money spent on new equipment or to set up or expand the business
- amounts for depreciation or write-offs
- domestic or personal expenses not essential to the business
- money spent on business entertainments or meals

Any losses you make during the period you are receiving benefits will be counted as nil income.

You can enter your gross self-employed earnings (less the amounts shown on your accounts for allowable expenses) and let the calculator work out your net self-employed earnings automatically. Alternatively you can directly enter your net self-employed earnings.’

Notes/LITRG brief commentary on the above:

1. There was no direct link to the above guidance from the tool – we had to find it via the ‘earnings from employment’ help page.
2. The guidance is sorely inadequate. For example, it mentions nothing about the basis period to use, nor whether the claimant is to report figures on an accruals basis or ‘cash’ basis and how that is defined. Further it refers to ‘the amounts shown on your accounts for allowable expenses’, thus presupposing that expenses shown as

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<sup>1</sup> <http://www.west-norfolkcalc.entitledto.co.uk/help/viewhelp.aspx?sid=65&CTYLAUA=33UE&ePage=EarningsDiffNetEarnings&helpfile=benefitselfemployed>

allowable in a person's accounts (even if they are able to afford the services of an accountant to prepare them) equate to allowable expenses for benefits purposes, which is not necessarily the case.

3. The calculator itself asks the user to enter 'income tax paid', but gives no additional help link when making that entry. Thus, a self-employed user will not know what figure is expected from them.