Low Incomes
Tax Reform
Group
A voice for the unrepresented

Treasury Committee, Assessment of Tax Measures in the Autumn Statement 2016
Comments from the Low Incomes Tax Reform Group (LITRG),
a Committee of the Chartered Institute of Taxation

1 Executive Summary

1.1 Given the focus of LITRG's work, we comment solely on measures affecting those on low incomes, judged against the principles of tax policy set by the Treasury Committee.

1.2 We do not intend to score the tax measures in the 2016 Autumn Statement numerically – rather, we have simply commented on those which concern us and outlined how we think they stand against the principles, including comments on how the measures could be adjusted such that they score more highly.

1.3 LITRG welcomes a number of the announcements in the Autumn Statement, including the fact that the Government will be reverting to a single annual fiscal event, as tax change is a major cause of tax complexity.

1.4 We give a cautious welcome to the package of measures designed to help low earners. While headline increases in the personal allowance do not generally benefit the lower paid as much as the higher paid, the higher benefit awards, reductions in marginal deduction rates and increases in the living wage also announced make the package of changes as a whole more attractive to the lowest earners.

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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

3.1 The principles set by the Treasury Committee are that tax policy should:

1) be fair;
2) support growth and encourage competition;
3) provide certainty without regular recourse to the courts – which in turn requires legal clarity, simplicity and targeting (so that taxpayers are clear whether or not they are liable for particular types of charges to tax);
4) provide stability, with minimal change unless there is a justifiable economic or social basis;
5) be practicable, meaning that a person's tax liability should be easy to calculate and straightforward and cheap to collect; and
6) be coherent, with new provisions complementing the existing system rather than conflicting with it.

3.2 We comment on a number of tax measures in the 2016 Autumn Statement as compared to the above principles.

4 Increases to the personal allowance and changes to National Insurance thresholds

4.1 It was confirmed that the personal allowance will be £11,500 for 2017/18 and it was restated that this will increase to £12,500 by the end of the current Parliament (2020).

4.2 While welcome in general, increases to the personal allowance produce mixed results for those on low incomes. To gauge the impact on any individual, interactions with means-tested benefits need to be considered.

4.3 Recipients of means-tested benefits (where entitlement to those benefits is assessed on net rather than gross income) such as universal credit gain less than those not entitled to such benefits. This is because their benefit is withdrawn as their net income increases. So a basic rate taxpayer who does not claim means-tested benefits will be £100 better off in 2017/18 as compared with 2016/17. Meanwhile, a basic rate taxpayer who is also a universal credit claimant will gain by only £37, because in 2017/18 universal credit will be withdrawn from claimants by 63p in every £1 by which the claimant's income exceeds the work allowance.

4.4 Perhaps more importantly, increasing the personal allowance does not benefit those on the lowest incomes at all – that is those who have income of less than the current personal allowance.

4.5 It is a logical consequence of a progressive tax system that any relief or exemption from tax is apt to be regressive in the sense that it benefits the wealthier taxpayer (who pays more tax) more than it benefits the less wealthy (who pays less). Conversely, those who pay no tax at all because their income is lower than the personal allowance at its current level see no benefit at all from any increase in that threshold. If then the policy behind raising the personal allowance is to enable people to keep more of what they earn, it is less effective for those on lower incomes, therefore arguably less fair than a measure or series of measures which taken together would benefit all workers equally. It is also incoherent to the extent that the clawback of means-tested benefits detracts still further from any advantages experienced by those who receive those benefits. Nevertheless, two other measures announced in this Autumn Statement – the increase in the national living wage and the lowering of the universal credit taper – do mitigate those two factors to some extent, while reversing some of the Government's earlier cuts to the universal credit work allowance would have gone further towards restoring the equilibrium.

4.6 Further, the measure could also be related to the National Insurance contributions (NIC) Primary Threshold for employees. The Autumn Statement aligned this to the Secondary Threshold (for employers) from 6 April 2017 at £157 a week. Annualised, this amounts to £8,164 – a difference of some £3,336 when compared to the personal allowance (£11,500 for 2017/18). Contributory benefit entitlement would be unaffected by a substantial increase in the primary threshold, provided that the lower earnings limit was left substantially unchanged.

4.7 Scores of fairness, certainty and simplicity, practicability and coherence would be greatly improved if the NIC Primary Threshold and personal allowance were themselves aligned (or if moves were made towards doing so). This would help many more people, mainly women, who work part-time in schools, supermarkets, catering, etc. to support the family income while raising the children and who receive no benefit from increases in the personal allowance; but they may be subject to Class 1 Primary NIC. As many such women might otherwise be entitled to National Insurance Credits[1] if they did not work, payment of NICs is effectively an additional tax charge.

5 Tax credits – child disability element payments

5.1 Child tax credit (CTC) is paid to people who are responsible for a child or qualifying young person. A higher rate of the child element of CTC is paid to families who are responsible for a disabled child or young person. The most common way to qualify for these higher payments is through receipt of a disability benefit such as disability living allowance or personal independence payment.

5.2 Although it is the claimant's responsibility to tell HMRC that they receive a disability benefit for their child, HMRC have historically received information directly from the Department for Work and Pensions (DWP) about these disability benefits. This has allowed HMRC to update the tax credits award automatically with the extra child disability amounts, even where claimants have not directly notified them about the benefit.

5.3 There was a gap in the data feed between DWP and HMRC from 2011 to 2014 which meant that HMRC could not automatically update awards. The result has been that around 28,000 families in 2016/17 are not receiving the higher level of CTC that they could be entitled to because of their child's disability.

5.4 The announcement in the Autumn Statement confirms that, where the qualifying disability benefit is being paid by DWP, HMRC will award the extra child disability elements from 6 April 2016 without claimants needing to contact them.

5.5 While reinstatement of the missing payments from 6 April 2016 is welcome, the affected families might have lost considerable sums for several years. HMRC and the Treasury point out, correctly, that it is the responsibility of claimants to make a claim, or notify a change of circumstances, otherwise entitlement to tax credits, or extra tax credits, does not arise. But given the complexity of the tax credits system, we think that more could have been done to support those who have missed out – particularly considering that they are likely to be families in difficult circumstances such that understanding the intricacies of the tax credits system is unlikely to be practicable for them. In terms of fairness, HMRC have done what they can, within the existing legal framework, to compensate those families, but this episode raises serious questions about how practicable that framework is, given the vulnerability of many claimants.

[1] See https://www.gov.uk/national-insurance-credits/eligibility – for example, claimants of Child Benefit for a child under 12 are eligible for National Insurance Credits.

6 Salary sacrifice changes

6.1 The tax and National Insurance advantages of salary sacrifice schemes are to be removed from April 2017, except for certain arrangements that the Government want to promote such as childcare vouchers. Salary sacrifice arrangements often result in beneficial tax and National Insurance treatment under the rules applying to employer-provided benefits. The government have expressed concern about the growth in such arrangements and recently held a consultation on the issue.

6.2 In the Autumn Statement, the Chancellor made clear he will take action to remove the advantages of salary sacrifice except for arrangements related to pensions, childcare, Cycle to Work and ultra-low emission cars. Employees will be able to continue to enjoy favourable tax and National Insurance treatment in respect of these benefits in kind at a reduced cost at the expense of the Exchequer.

6.3 This move does not attempt to deal with another salary sacrifice-related issue – the fact that those on low pay are currently stopped from benefitting from such arrangements. This is because employees with earnings at or near the National Minimum Wage (NMW) cannot participate, since their cash earnings cannot be reduced below the NMW rates. This leaves them at a significant disadvantage in comparison to say, a colleague doing generally the same work but with slightly higher earnings.

6.4 If this is a measure designed to achieve fairness and coherence for employees, it fails to do so for those on the lowest incomes. Ideally the NMW Regulations need to be rethought to allow those on the minimum wage to salary sacrifice.

7 Changes to National Insurance contributions for the self-employed

7.1 The Chancellor confirmed that NIC will change for the self-employed with some transitional protection for those on lower incomes. The self-employed do not get sick pay or automatic enrolment into a pension scheme. Payment of NIC helps to secure the state pension and other state benefits for them.

7.2 Currently all self-employed people are liable to pay Class 2 and Class 4 NIC, depending on their level of profits. Class 2 contributions go towards providing state pension, maternity allowance, bereavement benefits and contributory Employment and Support Allowance, while Class 4 contributions provide no such entitlement to state benefits.

7.3 Class 2 National Insurance is currently payable at the rate of £2.80 per week (£2.85 per week for 2017/18) for those earning more than £5,965 in the year (£6,025 per year for 2017/18). Those who earn less than that sum are able to voluntarily pay Class 2 contributions to secure those state benefits.

7.4 From April 2018, the government intends that entitlement to these state benefits will be accessed through paying Class 3 and Class 4 NIC – they will go ahead with the proposed abolition of Class 2 NIC from that date.

7.5 Class 3 contributions are currently £14.10 per week (£14.25 for 2017/18), very significantly more expensive than Class 2 NIC. While the 2018/19 rates have not been announced, the fact that the Chancellor announced a transitional measure to support self-employed individuals with low profits implies that the cost of Class 3 NIC will be significantly higher than the cost of Class 2 NIC.

7.6 Interestingly, the Chancellor's letter to the Office of Tax Simplification dated 23 November 2016 contains the following sentence:

> "Following the abolition of Class 2, the structure of Class 4 NICs for benefit entitlement will largely be aligned with the structure of employee NICs."[1]

7.7 If this is indeed the case, such that the self-employed accrue benefits entitlement at the same or very similar cost as employees, it would indeed be a measure that creates more fairness across the system. A proper assessment cannot, however, be made until we understand the detail of the proposals. The fact remains that unless the new structure restores the ability for self-employed individuals on low profits to contribute at a much lower rate than that currently payable under Class 3, the state retirement pension and other contributory benefits will be put out of their cost range at precisely the time that inadequate pension arrangements for the self-employed are coming under the policy spotlight.

8 Foreign pensions

8.1 The Autumn Statement documents included a note that the tax treatment of foreign pensions will be changed so that it is more closely aligned with the UK's domestic pension tax regime. The detail is unclear, but we know that this will include bringing foreign pensions and lump sums fully into tax for UK residents, to the same extent as domestic ones.

8.2 This could mean a significant change for some pensioners, as – at present – only 90% of the amount of foreign pension received is generally subject to UK tax. The proposed alignment in treatment between foreign and UK pensions may mean that those in receipt of a foreign pension will in future pay tax on 100% of the income received.

8.3 Again, we do not yet have a detailed understanding of the proposals. While at face value it may be fair to expect recipients of foreign pensions to pay tax on 100% of that income, the measure seems likely to come at a cost to existing recipients of foreign pensions accustomed

[1] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571265/OTS_NICS_CX__letter.pdf

to paying income tax on only 90% of that income. At the very least, there will need to be clear communications to those affected in order to score highly on against the measure of 'certainty'. As it stands, such pensions now face a period of uncertainty until the rules are more clearly understood.

8.4 We would hope that this measure will be accompanied by a review of HMRC's rules which currently force all of those in receipt of a foreign pension to fill in a self assessment tax return each year.[1] Currently this presents an annual cost (particularly if they have to engage an agent for assistance) to those in receipt of foreign pensions, and puts them out of step – seemingly unnecessarily – with those receiving only UK pensions.

8.5 It also presents an unnecessary cost to HMRC, particularly if the effect of processing a tax return is that nil tax is collected. Unlike other sources of foreign income – dividends, rental income, etc. – pensions are pretty stable, predictable and likely to be lifelong. So once in payment, there is no reason why they cannot be included in a simple assessment where tax is due, or just ignored where there is no tax liability at all (we are familiar with cases where the pensioner is completing a self assessment tax return solely because of receipt of a foreign pension even though there is not, and never has been, a liability). Where the pension is level, collection can be straightforward and accurate; where it is indexed or there is a fluctuation in exchange rate, then there will probably be a need for an end of year adjustment. But if the pensioner also has, as in many instances, a UK source of pension income, collection of any small underpayment could be dealt with under PAYE – by adjusting the code on the UK source.

8.6 Addressing these points would ensure that the measure meets fairness, practicability and coherence criteria for tax policy making.

9 Pensions – Money purchase allowance

9.1 As part of the Autumn Statement, the Government has published a consultation on reducing the pensions 'money purchase annual allowance' from £10,000 to £4,000. Under the proposals contained in the document, people who have drawn money from their pension pot will not be able to put more than £4,000 a year back into a pension from April 2017 onwards.

9.2 This could catch out people who have taken advantage of the pension flexibility rules, which took effect in April 2015 and allow people to take their money purchase pension savings in full as a lump sum, or in stages, rather than purchasing a lifetime annuity. In contrast, the

[1] See self assessment criteria - https://www.gov.uk/self-assessment-tax-returns/who-must-send-a-tax-return

current money purchase annual allowance of £10,000 is unlikely to catch out too many people who might do this.

9.3 The measure is aimed at deterring people from manipulating the pension flexibility rules to engage in 'tax-free cash recycling', which might mean that people seek to get further tax relief on money they have just taken out of a pension.

9.4 This is clearly a measure based on fairness. But we are concerned that some people may unwittingly get caught out, if they decide to take money out of their pension (currently allowed at age 55) – for example, to pay off their mortgage or other debts. Paying off such debts could result in surplus disposable income, which they may then wish to put back into pensions but may only do so subject to the new, lower, annual allowance.

9.5 The measure may score low against the measure of coherence, especially when viewed in the longer term. We might, for example, compare the individual who has saved into a pension against another person in otherwise similar circumstances who has saved up in a Lifetime ISA and received the 'government bonus' on those savings. If the latter person cash in the Lifetime ISA at age 60, they would be permitted to put however much they like into a pension plan and receive tax relief on their contribution. But the former saver would be capped at £4,000 a year of new pension saving. In addition to being incoherent, this example demonstrates a lack of fairness between taxpayers in comparable positions.

10 Life insurance policies

10.1 As announced at Budget 2016 and following consultation, the government will legislate in Finance Bill 2017 regarding the very large and the hugely unfair tax charges that arise in certain circumstances from life insurance policy part-surrenders and part-assignments. This will allow taxpayers to ask HMRC to recalculate the gain on a 'just and reasonable' basis. This will lead to fairer outcomes for policyholders. The changes will take effect from 6 April 2017.

10.2 We welcome this change, although we would have preferred a more clear-cut measure to tackle the problem. As it stands, much depends on how these new rules will be communicated to people. Many unanswered questions remain, such as: if someone is unrepresented and fills in their return with gain details and then notes the resulting large tax bill, what will prompt them to ask for it to be recalculated on a just and reasonable basis? Furthermore – assuming they get that far – how will they know if the revised calculation is actually just and reasonable? Will gains in fact be prepopulated into individuals' digital tax accounts under the Making Tax Digital proposals? If so, will the online system prompt people very clearly to there being a possible alternative means of calculation?

10.3 Our support for these changes is also predicated on there being a full right of appeal to the tax tribunal.

10.4 HMRC will need to issue very clear guidance to the public. This in itself raises a serious and legitimate concern that in fact HMRC do not now have full control over tax guidance made available to the public, given that the Government Digital Service has editorial oversight of GOV.UK. We have seen instances where the ethos of that website (which we understand to be to meet the needs of the majority) means that points such as this are not covered at all as they are likely to be viewed as esoteric, thus depriving those who do need to know of essential guidance. Considerable effort therefore needs to be invested in making this new legislation work, and we are willing to work with HMRC so we hope they will consult on these matters in due course.

10.5 In summary, while this measure introduces a fair and coherent solution to a legislative problem that has caused gross unfairness to some taxpayers, we have concerns in respect of two of the tax policy measures: certainty for the taxpayer, and practicability of application, whereas two of the three other options on which HMRC consulted would not have given rise to such concerns. Fairness of the measure is also significantly compromised if there is no right of appeal to the tax tribunal.

10.6 We would also note that the measure finally adopted here was not one of the options formally consulted on by HMRC,[1] thus potentially limiting the opportunity for interested parties to comment on it.

11 Digital measures – tax credits

11.1 The announcement that new claims for tax credits can be made from digital devices from April 2017 is a welcome development. This will mark substantial progress in tax credits since HMRC were forced to withdraw their first attempt at online tax credit claims in the early days of days tax credits, now over ten years ago. The digital agenda is now firmly underway and, providing the new claims service is easy-to-use, quick and accurate, this will be welcomed by many.

11.2 This measure therefore scores highly in terms of practicability and coherence. Our only concern is that it will be important that HMRC keep to their pledge to ensure that those not digitally enabled for whatever reason, and who will inevitably continue to rely on paper-based or telephone claims, do not receive a second rate service by comparison.

LITRG
8 December 2016

[1] See consultation document published 20 April 2016: https://www.gov.uk/government/consultations/part-surrenders-and-part-assignments-of-life-insurance-policies