Work and Pensions Committee – Universal Credit rollout inquiry
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to respond to this additional call for evidence. We do so as tax specialists with interest and expertise in the tax and related welfare problems of those on low incomes, particularly the self-employed.

1.2 This submission supplements the detailed paper we submitted to the Committee in response to their inquiry on self-employment and the gig economy.[1]

1.3 We remain concerned about the current structure of universal credit (UC) for the self-employed and if major changes are not made there is a risk that those who are already self-employed will be forced to give up their businesses in order to access adequate state support and it is likely to deter people from starting self-employment.

1.4 At present, the Minimum Income Floor (MIF) fails to strike the right balance between protecting public funds on the one hand and supporting self-employed businesses on the other. The MIF is a poorly targeted measure and we believe it is possible to make changes to the existing system in order to restore this balance and remove some of the harsh consequences of the MIF for those who do have viable, profitable businesses. Our October 2017 report *Self-employed claimants of universal credit: lifting the burdens* sets out one

[1] https://www.litrg.org.uk/sites/default/files/files/170116-LITRG-response-WPC-self-employment-FINAL.pdf

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possible model that could be used to address the current areas of concern within the system.[1]

1.5 We also comment briefly on free school meals, passported benefits and work incentives in response to the Committee's published questions.

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 Self-employment

3.1 *What effect has UC had on self-employed people?*

3.1.1 At present, there are only a few thousand self-employed claimants within the UC system which makes it difficult to fully assess the effect. Many of these existing UC claimants are likely to be newly self-employed after a period of unemployment and therefore within their 12-month start-up period so that the MIF does not apply.

3.1.2 The monthly UC statistics[2] do not show the number of self-employed claimants in the system as a separate category. This is a flaw in the current statistics that should be addressed as soon as possible. It would also be helpful if DWP reported how many self-employed claimants are subject to the MIF each month.

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[1] https://www.litrg.org.uk/sites/default/files/Self%20Employment%20report%20FINAL%20for%20release.pdf

[2] https://www.gov.uk/government/collections/universal-credit-statistics#latest-release

3.1.3 We have had a small number of enquirers to our various websites who are currently in receipt of UC. One person wrote to us saying:

'I'm self-employed on Universal Credit. I will now be better off unemployed. I explained how my business operates and had problem sorted out in February. Now someone decided to go into my account and increase MIF. I don't seem to be getting anywhere with UC to resolve problem. If I continue working i have to decide whether to feed my family and face eviction or pay my rent and not eat. Any help or advice would be very much appreciated.'

3.1.4 Others report problems with what counts as income/expenses for self-employed UC claimants and we have come across some people who claim to have to 'negotiated' a lower MIF amount[1] suggesting that there may be some inconsistency in its application. By far the largest amount of contact we get is from people within the tax credits system who are concerned about their future under UC and there is often confusion about whether the MIF applies to tax credits.

3.1.5 However, the numbers remain small and until more self-employed claimants are in the system the full impact of the self-employed rules within UC will not be known. The Department for Work and Pensions (DWP) have made various commitments to monitor the impact of the MIF and it is important that detailed evaluation is carried out of the MIF as well as other aspects of the system as it relates to self-employed claimants.

3.2 ***How can the Department best balance protecting public funds with supporting self-employed people in UC? Does the MIF achieve this balance?***

3.2.1 In 2015, during a Parliamentary debate, Lord Freud explained the purpose of the MIF:

'Universal credit is there to support those on low incomes and ensure that work always pays. It supports self-employment where it is a realistic route to financial self-sufficiency, alongside other support available to help businesses. However, the welfare system is not there to prop up unproductive or loss-making businesses. The minimum income floor is there to incentivise individuals to increase their earnings from their self-employment……the other thing that the minimum income floor does is to address a loop-hole in the tax credits system whereby individuals can report little or zero income but still receive full financial support, which is neither a desirable or sustainable situation to maintain.'[2]

3.2.2 Arguably, the MIF does address the concerns raised by Lord Freud in this paragraph – it removes state support from people in long term, unproductive businesses and it incentivises people to increase their earnings from their self-employment because that is the only way they will see an increase in their overall household income. However, the MIF is a broad-brush policy and as a result it is poorly targeted meaning that it has several negative

[1] Our understanding of the current rules is that this is not possible unless the claimant has a physical or mental impairment or caring responsibilities.

[2] https://publications.parliament.uk/pa/ld201516/ldhansrd/text/151214-0003.htm

consequences for self-employed UC claimants who are in productive, profit-making businesses – as we show in 3.2.4.

3.2.3 We understand some of the concerns about people who are more likely to be classed as hobby traders claiming state support for long periods of time. We also acknowledge that there has to be a balance between protecting public funds on the one hand and supporting self-employed UC claimants on the other – but the MIF does not achieve this balance as it has tipped too far towards protecting public funds at the expense of providing proper support to self-employed claimants.

3.2.4 As explained in detail in our previous submission and October 2017 report, the MIF is problematic because:[1]

1. *It applies independently each month – negatively impacting those with fluctuating earnings*

   Fluctuations can occur for any number of reasons – the seasonal nature of the trade, the timing of payments from clients, sickness and holidays, the type of trade (for example farming) – and is a very common feature of self-employment.

   This leads to a situation where a self-employed UC claimant who earns above the MIF level[2] when viewed over 12 months receives significantly less UC than an employed person earning the same amount – this is because the self-employed earnings fluctuate from month-to-month, but the MIF is applied inflexibly month-by-month.

Example[3] Fiona is a single parent with three children and runs a self-employed business with fluctuating profits across the year.

[1] The MIF only applies to those in the all-work requirements group, claimants in other conditionality groups will not be subject to the MIF.

[2] For any month in which the self-employed claimant's profits fall below the MIF, the claimant's UC award is assessed as if he/she had profits at least equal to the MIF. The level of the MIF is equal to the National Minimum Wage (NMW) for the claimant's age group, assuming they worked their expected number of hours each week (i.e. the National Living Wage (NLW) rate for those aged 25 or over). For most people, the expected number of hours will be 35 hours a week, although it may be less for example if the claimant has caring responsibilities, is responsible for a child under the age of 13, or has a physical or mental impairment.

[3] This example is based on an example used in an earlier submission to the Committee and in our report and uses 2016/17 rates.

> Gregory is a single parent with three children who works 35 hours a week and earns £7.20 an hour as an employee.
>
> Over 12 months, from April 2016 to March 2017 Fiona's self-employed income for UC purposes is £12,077 and Gregory's employment income for UC purposes is also £12,077.
>
> Fiona will receive a total of £5,333.43 in UC payments over those 12 months while Gregory will receive £7,944.96.
>
> Gregory receives £2,611.53 more UC than Fiona because of the variable pattern of earnings that Fiona has in her business even though over the year both earn the same amount.
>
> (See Appendix 2, Example 1 page 31[1] of our report for the full example)

If Fiona's self-employed earnings accrued at an equal amount each month – she would receive the same UC as Gregory. However, Fiona is penalised by the MIF by having fluctuating income/expenses even though she is in a profitable trade and earning annually as much as she would if she worked for 35 hours each week in employment. This has a particular impact on those in seasonal trades as discussed below in Section 3.3.

2. *It does not take account of one-off large business expenses*

   Self-employed people have to pay for their expenses. Whereas an employee will be provided with 'tools' needed by their employer, a self-employed person must provide their own tools. Although the current UC rules allow most expenses to be deducted when working out a self-employed claimant's earnings, the subsequent application of the MIF can mean large expenses are not in reality taken into account. The following example again shows someone who, in 11 months of the year, has earnings well above the MIF level and is in a profitable, long term business but who has a large annual business expense to pay. She receives £600 less UC over the year than she would if she could pay that expense monthly instead of annually.

1 https://www.litrg.org.uk/sites/default/files/Self%20Employment%20report%20FINAL%20for%20release.pdf

Example[1]
Alyssa runs a wedding photography business. Alyssa's self-employed income is above the MIF every month of the year except one (Month 5). This is because in that month she has to pay her annual insurance premium (covering her public liability indemnity and equipment insurance). Due to her previous credit rating she is unable to take advantage of a monthly payment plan.
Alyssa's UC for a 12-month period will be £12,769.89. If she was able to pay her premium monthly instead, she would receive nearly £600 more in UC over the year.
This is because when she pays her premium of £1,200 in month 5, her income in that month is reduced to £100. The MIF then applies and she is treated as earning £1,006.49 that month and so most of the expense of the premium is in effect disallowed for UC.
(See Appendix 2, Example 3[2] of our report for the full example)

3. *It fails to take account of pension contributions for those under or near the MIF level*

UC is paid based on a claimant's net income – after the deduction of tax, National Insurance (NI) and certain pension contributions. An employed claimant who pays into a qualifying pension scheme will have their net income for UC purposes reduced £1 for each £1 paid into the pension. However, a self-employed UC claimant who has earnings at or below the level of the MIF will not see any such increase in their UC if they make pension contributions. There does not seem to be any justification for this unfairness.

Example[3]
Aaron is a self-employed builder – his self-employed income for January 2017 is £1,092. His notional tax and NI will be £85.51. Derek works in a call centre for 35 hours a week earning the NLW (£7.20 at the time). His monthly income is also £1,092 and he has deductions of tax and NI of £85.51 in that assessment period.

[1] This example is based on an example used in an earlier submission to the Committee and in our report and uses 2016/17 rates.

[2] https://www.litrg.org.uk/sites/default/files/Self%20Employment%20report%20FINAL%20for%20release.pdf

[3] This example is based on an example used in an earlier submission to the Committee and in our report and uses 2016/17 rates.

Aaron and Derek will both receive the same amount of UC in January 2017, assuming their circumstances are both the same.

In February 2017, Aaron and Derek both decide to pay £75 a month into a private pension. Derek will have his UC calculated on his new net income of £931.49 (£1,092 gross less tax and NI of £85.51 and pension contributions £75) whereas Aaron will have his UC calculated on £1,006.49.

This is because Aaron's actual income of £931.49 is lower than the MIF of £1,006.49. This means that Derek will receive nearly £50 a month more UC than Aaron despite them having the same earnings each month and making the same pension contributions. Aaron is therefore not given any recognition for his pension contributions

4. *It only applies to people who are gainfully self-employed*

The MIF currently only applies to those who are considered 'gainfully self-employed' by DWP. This means that DWP have determined that:

- They are carrying on a trade, profession or vocation
- They are carrying on their activity as their main employment
- Their earnings from it are self-employed earnings
- It is organised, developed, regular and carried out in expectation of profit

DWP guidance[1] states that in determining whether a business is organised, developed, regular and carried on in expectation of profit, the following factors should be considered:

- whether the activity is undertaken for financial gain
- the number of hours spent each week on the work
- any business plan or steps taken to increase income from the activity
- how HMRC regard the activity
- how much work is in the pipeline
- whether the claimant is actively marketing or advertising for work

In our view it is unlikely that 'hobby traders' would pass the gainful self-employment test in many cases, particularly where they are receiving little or no income (as with the 'tax credit loophole' referred to by Lord Freud). Therefore only those who are doing all of the things expected in genuine self-employment will be subject to the

[1] H4050 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661668/admh4.pdf

MIF, those who fail the gainful self-employment test will not be subject to it and instead will face conditionality requirements.

3.3 ***Are any groups of self-employed people particularly likely to be affected by the MIF?***

3.3.1 It is worth repeating that the MIF only applies to those who are in the all work requirements conditionality group and even then, the level of the MIF depends on the 'expected hours' placed on the individual. For many that will be 35 hours a week, but the legislation allows that to be reduced in some cases. The MIF does not apply in the first 12 months of a new business.

3.3.2 Once within scope of the MIF any self-employed claimant with fluctuating earnings, one-off large business expenses or who has a lower income and makes pension contributions may potentially be adversely affected by the MIF.

3.3.3 Some trades are more likely to encounter fluctuations in income because it is a hallmark of that specific trade – for example farmers, B&B owners, market traders, those engaged in creative work such as actors, writers and artists. Other business are also affected by seasonal factors such as gardeners, ice-cream van owners, bricklayers and wedding photographers. It is reasonable to expect an established business to be sufficiently robust as to sustain certain fluctuations in income but where those fluctuations incur application of the MIF, there can be an inherent unfairness resulting in less UC support by comparison with a business or employed claimant with steady income even though the earned income over the whole year is the same.

3.3.4 Those who piece together a living by working in the 'gig economy' are likely to have fluctuating income and low earnings, meaning they will be more likely to be caught by the MIF – see para 3.7.[1]

3.3.5 Many people are attracted to self-employment because it offers more independence and freedom which can be appealing for people with young children, caring responsibilities and disabilities or health issues as the work can often fit around life requirements. However, with the benefits of self-employment comes some significant disadvantages including long hours, sole responsibility and unpredictable finances. Running costs must be paid even if income disappears for a period of time.

3.3.6 This puts self-employed claimants at risk if they hit an unforeseen problem – for example a gardening business who loses a major client or a childminder who has a child withdrawn and

[1] See page 8, 9 of SMF report, *A tough gig*: 'around a fifth (19%) of families with an individual whose main job is self-employment are claiming in-work benefits such as tax credits and housing benefit that will be replaced by Universal Credit. We estimate that of this 19%, around 39% (or over 190,000 families) have earnings below the minimum income floor, and so are likely to be worse off under Universal Credit': http://www.smf.co.uk/wp-content/uploads/2016/10/Social-Market-Foundation-SMF-Tough-Gig-Tackling-low-paid-self-employment-in-London-and-the-UK-October-2016.pdf

cannot immediately find a replacement. Once they are within scope of the MIF, there is no recognition for these events if there is a temporary fall in income.

3.3.7 The majority of self-employed people rely on payments from clients of their business to be paid on-time. However, they cannot control when these payments will be made and the timing of payments is very important when considering the impact of the MIF as the following example shows. Due to the timing of payments from his clients, John (a painter and decorator) loses £659 of UC because of the effect of the MIF.

Example

John is a painter and decorator.

Month 1 – He paints a whole house for one client which takes him three weeks (Job 1) and then does some work for another client which takes just over a week (Job 2).

Month 2 – He paints the upstairs of a house which takes him one week (Job 3) and then paints some new offices which takes him three weeks (Job 4).

Scenario 1

Month 1 – The clients for Job 1 and 2 pay him within this assessment period. His net income from self-employment is £1,500 which is above his MIF level. His UC is calculated based on income of £1,500. He receives £1,055 of UC.[1]

Month 2 – The clients from Job 3 and 4 pay him within this assessment period. His net income from self-employment is £1,400 which is above his MIF level. His UC is calculated based on income of £1,400. He receives £1,118 of UC.

Total income in assessment periods 1 and 2 = £2,900

Total UC in assessment periods 1 and 2 = £2,173

Income + UC in assessment periods 1 and 2 = £5,073

Scenario 2

Month 1 – The clients for Job 1 and 2 do not pay him within the assessment period. He has no income from self-employment and so the MIF is applied. His UC is calculated based on income of £1,046.81.[2] He receives £1,341 of UC.

Month 2 – He receives payment from all four jobs in this assessment period and his net income from self-employment is £2,900. He receives £173 of UC.

[1] Assume a max UC amount of £2,000

[2] £7.50 x 35 = £262.50 x 52/12 = £1,137.50 less notional tax and NIC £90.69 = £1,046.81

Total income in assessment periods 1 and 2 = £2,900
Total UC in assessment periods 1 and 2 = £1,514
Income + UC in assessment periods 1 and 2 = £4,414

3.4 ***What are the options for reforming the MIF, and what are their cost implications?***

3.4.1 In our October 2017 report[1] we set-out changes that could be made to the current system to address some of the problems including:

- Extending the start-up period to a minimum of two years.
- Introduction of a general anti-abuse provision to ensure people cannot manipulate their income in order to claim UC or more UC. This would apply to both employed and self-employed claimants and remove the need for complex surplus earnings rules.
- Allow self-employed claimants with fluctuating income or profits to be given an option of averaging their income over a period of up to one year.
- Alignment of rules with HMRC cash accounting rules.
- Reporting of self-employed earnings so that it would follow the period over which earnings are averaged.
- Three months 'grace' period from the MIF each year and the ability of DWP staff to dis-apply the MIF on application from the claimant.

3.4.2 There are other options for reform. The purpose of the MIF, as discussed in paragraph 3.2.1, was to stop state support for people running unsustainable businesses and incentivise those in self-employment to reach a certain level (35 hours x NMW of income). If that is truly the goal of the MIF, there are other ways that those same outcomes can be achieved without the unintended consequences on self-employed claimants who do run sustainable businesses and who do achieve earnings in excess of the NMW over the year as a whole.

3.4.3 One possibility would be to amend the 'gainful self-employment' test and remove the MIF. We believe most 'hobby traders' would fail the gainful self-employment test as it is, but it could be further amended to ensure that only people in viable, profitable long term self-employment pass the test. Those who fail the test would be subject to conditionality and there would be no further need for the MIF.

3.4.4 In the early debates on the Welfare Reform Act 2012 and the subsequent legislation, it appeared that self-employed claimants would have an option to avoid the MIF by opting for conditionality but DWP changed direction on this and that no longer appears a possibility unless you can persuade a work coach that you are no longer gainfully self-employed.

[1] https://www.litrg.org.uk/latest-news/reports/171030-self-employed-claimants-universal-credit-%E2%80%93-lifting-burdens

Allowing this as part of reforming the gainful self-employment test might also be worthy of further consideration.

3.4.5 In terms of cost, in March 2017, the Office of Budget Responsibility forecast that the introduction of the MIF would reduce UC spending by £1.5 billion relative to where it would have been by 2021/22. However, by November 2017,[1] the OBR revised their estimate of the MIF savings down to £1.1 billion and said:

'This 30 per cent drop illustrates the volatility of an estimate that is based on just over 350 sample cases in the FRS. The losses per family – as high as £6,000 on average for young single parents with school aged children – are so large that there are bound to be knock-on effects that are not yet captured in the modelling.'[2]

3.4.6 We are not aware of any other published figures that estimate the cost of removing the MIF. Nor is there any data available that shows how much of the MIF cost savings come from those at whom the measure is targeted (those in long term, unsustainable self-employment) as against those who are caught by the MIF due to its failure to reflect the realities of self-employment. We would encourage the Committee to call on DWP to produce such analysis and figures.

3.5 ***Is the existing start-up period for newly self-employed UC claimants appropriate? If not, what changes should be made and how much would these cost?***

3.5.1 We agree that the concept of a start-up period is crucial for those starting out in self-employment, however we do not think that the current start-up period is long enough to allow businesses to reach their initial potential.

3.5.2 Research by the RSA, referenced by Citizens Advice,[3] shows that on average it will take three years for a self-employed person to be earning the equivalent of the NMW from their business. Having a shortened start-up period means that some claimants, who could go on to have strong, profitable business that reduce their need for state support in the future may not be able to continue their self-employment due to the harsh effects of the MIF after 12 months.

3.5.3 We recommend extending the start-up period to three years, with a minimum of two years. We do not have enough data to help provide a costing of this – but any cost needs to be balanced against the additional costs associated with providing support to people giving up self-employment that could, given another year or two, be profitable.

[1] http://cdn.budgetresponsibility.org.uk/Nov2017EFOwebversion-2.pdf

[2] P.160 http://cdn.budgetresponsibility.org.uk/Nov2017EFOwebversion-2.pdf

[3] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Work%20Publications/GoingSolo.pdf

3.6 ***To what extent will UC surplus earnings rules offset the impact of the MIF?***

3.6.1 The surplus earnings rules are some of the most complex we have seen and we cannot see how they will be administered or explained by DWP. We believe there are other, less complex, ways to deal with the risks perceived by the DWP with regards to potential manipulation of income.

3.6.2 In terms of the impact of the surplus earnings rules for self-employed claimants, we cannot see that they will offset the impact of the MIF in any situation. At the time the surplus earnings rules were introduced, similar loss relief rules were also introduced which mean self-employed claimants who make a loss in the previous 11 assessment periods can carry that loss forward to reduce their income in the current assessment period. However, the rules only allow losses to reduce income down to the level of the MIF, not below it. So while the loss relief aspect is better than the current situation, it does not in any way relieve the situation with regards to the MIF nor does it alleviate any of the other problems with the MIF relating to fluctuating incomes and one-off expenses.

3.6.3 In fact, the surplus earning rules can make a self-employed person even worse off. This is because the incentive to manipulate income in order to maximise UC is already addressed by the MIF for the self-employed. In paragraph 3.2.4 above, we gave an example of Gregory and Fiona where Gregory, as an employed person, received £2,611.53 more UC over 12 months than Fiona. This was due to Fiona's fluctuating earnings.

3.6.4 If the surplus earning rules are applied to that example, Fiona loses a further £455 of UC making her £3,066.53 worse off compared to Gregory.

3.7 ***How should 'gainful self-employment' be defined under UC? For example, should 'gig economy' workers be eligible to claim UC as self-employed?***

3.7.1 It is not entirely clear how gig economy workers will be classified in the UC system. If a certain type of work within the gig economy is their main job, for example they are a full-time delivery driver, our understanding is that they will be treated as self-employed for UC purposes and will most likely be found to be gainfully self-employed and be subject to the MIF. It is not so clear cut where someone does lots of different things within the gig economy as it could be said that they are not carrying on a trade, profession or vocation.

3.7.2 Gig economy workers are, in our experience, more likely to have lower levels of education and literacy/numeracy skills or are more likely to be migrant workers with limited English. This presents a challenge given the monthly reporting and admin requirements of the UC system in relation to self-employment. A recent HMRC report[1] suggests that many people who have earned income from the gig economy do not consider it as taxable due to lack of understanding of the rules – this does not bode well for UC.

[1] https://www.gov.uk/government/publications/sharing-economy-user-characteristics-and-tax-reporting-behaviour

3.7.3 It is also the case that gig economy workers are far more likely to have fluctuating income and low earnings, meaning they will be caught by the MIF. Often such workers have very high expenses (for example the cost of leasing a car for UBER drivers) which may not be fully recognised because of the MIF.

3.7.4 Finally, there has been some reporting of an increased number of gig economy workers forming limited companies. Under the tax credit system, people working for their own limited company fall into a separate category whereas under UC our understanding is that DWP will, in some cases, 'look-through' the limited company structure and treat the person as self-employed for UC purposes making them also subject to the MIF. This adds further complexity to the system.

4 Free school meals and passported benefits

4.1 *How should eligibility for free school meals in UC be determined?*

4.1.1 The Department for Education in England are currently consulting on the criteria for passporting from UC to free school meals. Their proposal is an annual net earnings threshold. Although not clear from the consultation document, we assume this annual figure will be divided by 12 to produce a monthly figure which will be compared to the claimant's monthly assessed net earnings from UC or the monthly net earnings from UC will be grossed up and compared with the annual threshold.

4.1.2 The problem with any fixed threshold for free school meals is that it creates a cliff-edge and does not reflect the number of a children in a family.

4.1.3 A family with income just over the threshold who have four children will not get any help with free school meals, whereas a family with one child with income just under the threshold will be entitled to free school meals. The more children a family has, the less disposable income they have available to pay for costs, including school meals.

4.1.4 The cliff edge created means that working an extra hour, or earning a few pence an hour more, could leave the person considerably financially worse off, thereby further negating the principle that work will always pay under UC. If the proposed threshold goes ahead, we recommend further thought is given to a run-on or other alternatives that can alleviate the harshness of the cliff edge.

4.1.5 There are also some interactions with the UC definition of 'net earned income' that may cause potential problems: for example, those subject to the MIF would seem to lose their passported benefits as a result even though they do not actually have any income, further worsening their position. We recommend that the threshold be applied to actual earnings rather than those imposed by the MIF.

4.2 *Other passported benefits*

4.2.1 Passported benefits have, for many years, been a subject of interest for LITRG. Free school meals, and other passported benefits, are extremely important for low-income families. In the Government's response to the Social Security Advisory Committee's 2012 report on passported benefits, it was noted that the introduction of UC presents not only a challenge for the Departments with responsibility for passported benefits, but also a unique opportunity to consider more fundamental reform to simplify and streamline some passported benefits in the future.

4.2.2 It is therefore disappointing that the opportunity has not been taken to implement a coherent passporting benefit strategy across Government. Instead we have a number of passported benefits linked to UC that have different thresholds and in some cases the same benefits with different thresholds in each part of the UK. This creates a complex landscape and numerous cliff edges which will be difficult to understand for claimants and those who seek to advise them.

5 Work incentives and universal credit

5.1 *What would be the impact of adjusting a) the taper rate or b) UC work allowances on employment incentives in UC? Which option for reform would be most cost-effective?*

5.1.1 The personal allowance has been increasing steadily over the last few years. Each time a further rise is announced, we highlight that while a welcome announcement for many, it does little to help those on the lowest incomes. Those already earning under the personal allowance gain nothing from any increase and those earning above it may benefit, but by how much depends on whether they receive means-tested benefits such as UC. If they do, as the amount of tax they pay reduces, their UC award also reduces by 63% and so they only gain by 37% of the benefit of any increase in the personal allowance.

5.1.2 If the Government want to help those on the lowest incomes, increasing/restoring work allowances in universal credit (and the first income threshold in working tax credit) would provide a valuable work incentive for those on the lowest incomes.

5.2 *How can the Department help UC claimants better understand the impact on their incomes of moving into work or taking on more hours?*

5.2.1 In his post-Budget statement on UC, the Rt Hon David Gauke MP said that UC 'is a modern welfare system which – through one simple monthly payment – ensures that work always pays'. 'Making work pay' has become somewhat of a strapline for UC – but what does it actually refer to? It most likely refers to the taper rate in UC which means that for each £1 of extra earnings, claimants will only lose 63p of their UC and will keep 37p. However to conclude that UC always ensures that work pays based on the taper rate alone would be incorrect.

5.2.2 Most people care about the amount of cash they have available each week to pay their bills. So when considering whether taking a certain job will leave them better off or whether working extra hours are worth it, a whole range of factors needs to be considered. Some of these are within the UC system and others are outside such as tax and NI, council tax reduction, loss of passported benefits, costs of travelling to work, extra childcare costs (UC covers 85% but claimants still need to find the additional 15%).

5.2.3 Only once all of these factors have been accounted for is it possible to say if someone will be better off in work or increasing their hours and if so, by how much. DWP must provide support to people to understand their financial position when considering work, but they must also be realistic about other costs.

5.2.4 Arguably any support needs to also go wider and consider what other help a person may be entitled to once they move into work, for example if the earnings are enough to take them off UC, might they be entitled to Tax-Free Childcare (TFC) and who is going to help them decide whether to claim help through UC or move to TFC instead?

5.2.5 There are other factors that are also relevant to decisions about taking on more hours or moving into work – for example the current waiting period for help with mortgage interest is 39 weeks. If a claimant takes temporary work, they will have to start the waiting period again when the temporary work ends. Similarly, once the surplus earning regulations are in place from April 2018, anyone earning more in an assessment period or moving into work will need to be warned that they must budget carefully in the next six months in case they need to come back to UC – the surplus earning calculations do not take into account any of the increased costs a person might have when moving into work, yet they are expected to continue living at UC levels just in case they need to return to the benefit.

5.2.6 All of these factors makes providing support challenging for the Department. However, if the Department continues to introduce complex rules, it is their responsibility to ensure that these rules and their consequences are adequately explained to claimants and that their advisers have the tools needed to provide claimants with a full picture of what will happen if they increase their hours or enter work. Calculators can go some way to helping with this task, but it also needs a great deal of knowledge of the wider factors by DWP staff if they are to provide reliable and accurate advice.

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