

Finance (No. 2) Bill 2021 – Clause 31
Covid-19 support scheme: working households receiving tax credits
Briefing from the Low Incomes Tax Reform Group (LITRG)

1 Executive summary

- 1.1 This measure relates to the £500 one-off payment for certain working households receiving tax credits, announced at the March 2021 Budget. It ensures that the payment is not taxable, which is welcome.
- 1.2 The clause also applies paragraph 8 of Schedule 16 to Finance Act 2020¹ to the payment. This means that an income tax charge, equivalent to 100% of the payment not subsequently repaid, arises where a person receives a payment that they were not actually entitled to under the scheme rules².
- 1.3 We have two concerns with the clause as currently drafted:
- As the payment is made automatically by HMRC, without requiring a claim from the individual, if HMRC mistakenly make a payment to someone who is not entitled under the Direction and it is not subsequently repaid, it appears that the tax credit claimant will automatically be subject to a tax charge under Finance Act 2020. This

¹ <https://www.legislation.gov.uk/ukpga/2020/14/schedule/16/paragraph/8/enacted>

² <https://www.gov.uk/government/publications/treasury-direction-made-under-section-76-of-the-coronavirus-act-2020>

triggers notification requirements for the individual, assessing powers for HMRC and potential penalties.

- How HMRC will define/determine what counts as fraudulent activity in order to determine who the tax charge might apply to

1.4 We suggest that the first of these issues could be dealt with by an amendment to 31(3) such that paragraph 8 of Schedule 16 to FA 2020 will only apply in a case where a payment is made to someone who falls under Paragraph 5 of the Treasury Direction¹ (where the tax credit award or the payment was obtained as a result of fraudulent activity). That would prevent a tax charge applying where HMRC make a payment in error in non-fraudulent cases.

1.5 On the second point, we seek a ministerial commitment that HMRC will set the bar high in terms of what constitutes fraud and that it will be limited to those people who fall under Section 35 of the Tax Credits Act 2002² in relation to their underlying tax credit award.

2 About Us

2.1 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 Background to the measure

¹ <https://www.gov.uk/government/publications/treasury-direction-made-under-section-76-of-the-coronavirus-act-2020> which states 'A person is not a qualifying person if the person, or either member of a couple of which that person is a member, received a current award as a result of knowingly being concerned in fraudulent activity undertaken with a view to obtaining a current award or a support payment'

² Section 35 Tax Credits Act 2002 sets out the offence of fraud in relation to tax credits.

- 3.1 As part of the Government's coronavirus response, a temporary £20 a week increase was given to working tax credit (WTC) and universal credit (UC) claimants. For WTC, this meant an increase to the basic element of working tax credit from the planned £1,995 to £3,040 for the tax year 2020/21.
- 3.2 At the March 2021 Budget, the Government announced that they would extend the £20 temporary uplift in UC for a further 6 months until the end of September 2021. However, as tax credits are calculated on an annual basis and the IT system programmed with this in mind, we understand it was not possible to increase the basic element of WTC for only 6 months.
- 3.3 Instead, the Government announced a one-off £500 payment for certain working households receiving tax credits. The explanatory memorandum to the Finance (No.2) Bill 2021 states that the payment is being made to cover the 6-month period from 6 April 2021 to 30 September 2021 to continue government support.
- 3.4 This not a payment of tax credits; it is an entirely separate payment. As with the other coronavirus support schemes introduced in the last year, the speed at which it has been designed and delivered means there are some 'rough edges' to the payment.
- 3.5 These 'rough edges' relate to the fact that although the payment is to cover the 6-month period from April to September 2021, qualification for the payment is based on the tax credit award in place on 2 March 2021. This means that some people, who may go on to receive relevant payments of tax credits from April to September (or part of that period), may not qualify for the one-off payment because they have not yet updated HMRC with their actual income figures for 2020-2021. Tax credit awards are provisional during the tax year. Once the tax year ends, HMRC begin the 'renewals' process which finalises the award for the year just ended and acts as a claim for the new tax year. There is no requirement to notify HMRC of income changes before that finalisation exercise takes place.
- 3.6 However, the opposite is also true. There will be some people who will qualify for the one-off payment, but who won't be awarded tax credits between April and September (or part of that period) once they report their actual income to HMRC or because their circumstances have changed.
- 3.7 HMRC will make the £500 payment automatically to those who are 'qualifying persons' under the Treasury Direction setting out the conditions for the scheme. No claim by the individual will be required.
- 3.8 As a result, it appears the only scenarios in which it is possible that a tax credit claimant will receive a payment to which they are not actually entitled is if:
- HMRC make the payment in error (for example due to an IT error) to someone who is not a qualifying person; or
 - HMRC make the payment to someone who has a relevant award of tax credits in place on 2 March 2021, but they received that award *'as a result of knowingly being*

concerned in fraudulent activity undertaken with a view to obtaining a current award or a support payment'

4 Potential issues with the Clause

- 4.1 Clause 31(2) states that no liability to income tax arises in respect of the payment, however 31(3) goes on to say that this does not prevent the application of paragraph 8 of Schedule 16 to Finance Act 2020.
- 4.2 Paragraph 8 of Schedule 16 to Finance Act 2020 states that a recipient of an amount of a coronavirus support payment, in this case the £500 one-off payment, is liable to an income tax charge if they are not entitled to the amount in accordance with the scheme rules under which the payment was made and it is not wholly repaid to the person (in this case, HMRC) making the payment. The individual then has 90 days to notify HMRC of chargeability and HMRC have powers to assess the charge. There are also potential penalties linked to the tax charge.
- 4.3 As explained in paragraph 3.8, it appears there are only two situations where someone might receive this payment where they are not entitled to it.

Error by HMRC

- 4.4 The first is where HMRC make the payment in error (for example due to an IT error). This payment is being made automatically to those considered by HMRC to be qualifying people (as defined in the Treasury Direction), without the need for any separate claim or action on the part of the tax credit claimant. This is different to the other coronavirus support payments administered by HMRC which require claims to be made. It is possible that HMRC's systems may make a payment by mistake to someone who is not a qualifying person.
- 4.5 We obviously hope that HMRC's systems are robust enough that this will not happen, however it is a possibility given the speed at which the scheme has been set-up and the fact it relies on data from the tax credit IT system.
- 4.6 Given that this is an automatic payment made by HMRC, without any claim or action by the claimant, we do not think that HMRC should recover any payments made in error. Given the complexity of the tax credit annual system and the subtle differences between entitlement, awards and payments, we think it would be unreasonable to expect people who receive a payment to independently verify that they are in fact entitled.
- 4.7 To ensure the tax charge in Finance Act 2020 does not apply to a payment made in error by HMRC, we think Clause 31(3) should be amended so that Paragraph 8 of Schedule 16 Finance Act 2020 only applies to those not entitled to the payment due to underlying fraud (that is, those who fall under paragraph 5 of the Treasury direction).
- 4.8 If that amendment is not made, we seek public reassurance from the Minister that HMRC will not seek to recover payments made by them in error to non-qualifying people, **and** that

they will not subsequently assess a tax charge or penalty which arises as a result of Schedule 16 of Finance Act 2020.

Underlying fraud

- 4.9 The Treasury Direction states that a person who has a relevant tax credit award is not a qualifying person if they received that award as a result of 'knowingly being concerned in fraudulent activity undertaken with a view to obtaining a current award or a support payment'.
- 4.10 We are of course supportive of the need for HMRC to have a way to recover a payment that has been obtained due to underlying fraud (whether relating to the payment itself or the award of tax credits on which the payment is based).
- 4.11 The wording in the direction is similar to that in Section 35 Tax Credits Act which sets out the offence of fraud in relation to tax credits. However, HMRC also use the term 'fraudulent' in other areas of tax credit compliance, where the classification demands a less stringent threshold of proof and does not necessarily lead to prosecution.
- 4.12 We hope that HMRC will only deny entitlement to the one-off payment in cases of clear fraud, as opposed to those where the person made a mistake, failed to take reasonable care or where it was not obvious what the status of their claim should have been. In other words, the bar should be set high and limited to those people who fall under Section 35 of the Tax Credits Act in relation to their underlying tax credit award or the support payment.

LITRG
4 May 2021