

A credit to the Revenue?

Tax credits, aimed both at increasing family incomes and returns from work, are crucial to tackling child poverty. The programme is large – in 2004/05 £15.8 billion was spent – and encompasses most families, and this serious investment in children has been welcomed by those keen to see the Government meet its child poverty targets. Yet early problems with both its structure and the quality of the administration have dogged the scheme and threatened its success. Eliza Buckley and Paul Dornan examine some of these and the Government's action plan for reform.

The first two years

Concerns with the operation of the tax credit system are not new and arise from a combination of poor administration and structural issues, especially the use of an annual system of assessment (in line with the tax year, but out of line with Department for Work and Pensions practice). In 2004, CPAG published a study analysing the experience of the scheme after its first year of operation. This examined each area of operation and highlighted potential problems: assessing and reporting income and changes; overpayments; underpayments; relationships with other benefits; and childcare. Much of the concern raised at the time and subsequently has been on the impact of the recovery of overpayments. Statistics released at the end of the first year of operation show the extent of these: 1.9 million (one third) claimants had been overpaid (at an average of £1,028) and 713,000 claimants (13 per cent) had been underpaid (at an average of £651). These figures are only for the end of the year and so underestimate the true extent of under- and overpayments (those found within the year are not covered). The distinction between 'in-year' and 'end-of year' overpayments is particularly important since the mechanism of recovery adopted has been different. In the former case,



Jackie Chapman/Photofusion

the computing system currently attempts to pay the family the correct amount for the year and, consequently, a large overpayment discovered late in the year might wipe out an ongoing entitlement and leave the family with little or no ongoing payments. Overpayments discovered at the end of the year have been dealt with by fixed percentage deductions from ongoing awards and so reflect a gentler approach to recovery and do not precipitate such large swings in income.

In summer 2005 CPAG interviewed families who had been receiving tax credits and who had experienced problems. In general, the families we spoke to agreed with the principle of the scheme, but had faced serious difficulties with its operation. The problems reported were mainly with the quality of administration, including getting through to the helpline, obtaining effective action from the helpline, being given wrong or misleading advice and reporting changes which were then not acted upon. We found families who were budgeting carefully and for whom falls and instability in income caused serious hardship.

Recipients found the system complex to understand, not helped by incomprehensible award notices and found accurate information difficult to access.

I don't know my exact entitlement... I've no clue about how they actually work it out.

Sarah, an employed lone parent with a young son.

You can't work it out easily for yourself. You're not given any information as to how to

work it out. It should be fairly simple the way they make it sound, but it's not.

Eve, who works part time and is a lone parent with one daughter.

The helpline is a primary channel through which claimants engage with the system, such as to report changes of circumstances.

[I] tried the helpline but it was a nightmare. Nobody could get through so I actually went down to...the Revenue with my contract and all the information I needed.

Lydia, a part-time worker who is a lone parent bringing up three daughters.

One young chap said "I'll put it in the system now" and I heard it being done, you know tapping away on the keyboard. He said that's all done but when I phoned up for something else I just asked if it had been changed and it hadn't.

Anna, who works part time and is bringing up a son and daughter with her partner.

Both the complexity of the system and the impact of recovery mechanisms lead to swings in income and a lack of control.

I feel like I've lost control, now I've worked out my finances without that money but if that comes in it throws all my financial budget out so I don't know what to do.

Rachel, a lone parent with two sons, employed but on long-term sickness leave.

It kept going up and changing so I called up and asked them. They said "no, no, no that's fine, you're entitled to it". Every time I called to check they'd say it was right. Then they stopped my money completely without even telling me why. I had nothing after October 2004 until February 2005.

Alison, a lone parent with two daughters.

Most concerning was the impact of, often sudden, income falls on families and children following the discovery of an overpayment.

At the moment for me something's got to give. This month I've not got enough to pay my electricity, gas and food.

Alison

When we realised it was stopping for long term we had to start living to what means we had then; we started paying our bills weekly. We cut down on everything, school dinners – the kids had to have pack lunches. We just went without for ages until about now when we are starting to get back on our feet again.

Bronwyn, who works part time (her partner works full time) and is bringing up three daughters.

May 2005 action plan

In May 2005, responding to high profile criticism from both Citizens Advice and the Parliamentary Ombudsman and a public apology from the Prime Minister, the Government announced six steps towards improving the operation of the tax credit system.¹

- 1 Review the effectiveness of information provided to claimants and reduce the number of cases where people receive unnecessary duplication of award notices.
- 2 Test new methods of reminding claimants of the importance of providing up-to-date in-year information on changes in income and circumstances.
- 3 Develop options to improve the quality of the helpline service.
- 4 Identify IT system problems and process errors more quickly.
- 5 Work more closely with the voluntary sector to target more active support for vulnerable families.
- 6 Review the operation of the code of practice on overpayments, so that recovery can be suspended in cases of genuine hardship while a disputed overpayment is resolved.

The intention behind the announcement was to improve the operation of the current system – not to challenge its fundamentals. A key stumbling block, both to administrative and policy reform, remains the IT system. The system, referred to as 'potentially fragile'² by Sir David Varney, Head of HM Revenue and Customs (HMRC), has been prone to error in the past and change, where agreed, is desperately slow.

Plans for a clearer award notice in April 2006 and future plans for improved written communication are welcome, but seem unlikely to get over the inherent complexity of the scheme. Managing this complexity shows the need for effective support and communication alongside the notices. Since claimants need information that fits their needs there should be no 'one size fits all' model. The helpline remains the key channel for responding to claimants' questions and the emphasis on ensuring that this works much better in the future is welcome. Progress is difficult to judge, but there are access and quality of service questions. Claimants have, for instance, reported the script used by HMRC staff as quite fixed and not good at solving complex questions. This suggests staff need to have both a good script and either better training for parts of the law not well covered by this

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I'm not entirely sure I have even been overpaid. They give you a big wad of paper and stuff but it's so difficult to work anything out from that.

or the ability to signpost. To this end, a 'hard cases' team has been set up to respond to more complex circumstances and, presumably, take more of a casework approach with ownership taken of particular cases. This team, currently only able to deal with a small minority of cases, needs to be increased to ensure the call centre model works more effectively for claimants. Alongside telephone contact there is a continual need for face-to-face advice.

HMRC now suspends recovery following a dispute of an overpayment pending its result. This is very welcome, but only occurs if an overpayment is challenged and so leaves the onus to do so with the claimant. Since the scheme currently often denies claimants access to the quality of information needed to instigate a challenge, this hardly seems reasonable. There is no break currently between a decision to recover and the process that reduces an award (although the Paymaster General has signaled an interest in exploring this).

The Pre-Budget Report 2005
The December 2005 Pre-Budget Report went further than the administrative reforms and engaged with two key problems: the extent of overpayments and the process of recovery. The changes proposed were as follows.³

- From April 2006, an increase in the disregard for income increases from £2,500 to £25,000.
- From November 2006, the same limits will apply to the recovery of in-year overpayments as to the recovery of end-of-year overpayments.
- From April 2007, underpaid awards will be adjusted to the correct entitlement, but any lump sum will be held over until the renewal point.
- There will be stricter rules on reporting changes of circumstances (from April 2006 more changes must be reported and from April 2007 there will be a shorter time period in which to do so).
- From summer 2006, the deadline for returning end-of-year information will be brought forward from September to August.
- From 2007, HMRC will be more proactive at contacting key groups of tax credit recipients to collect up-to-date income information before the start of the new tax year.

These changes are, in most cases, very welcome – particularly, the harmonisation of recovery rates between in-year and end-of-year

recoveries – and should reduce the scope of overpayments and the impact of in-year recovery, a major cause of hardship. The official expectation is that the totality of the changes will, in future, reduce the extent of overpayments (by value, rather than the numbers affected) by one third and in doing so create a saving for the Government. The strategy to reduce overpayments is to increase reporting responsibilities and to shorten the 'renewals window' – the point after the year end but before an award has been confirmed, which the Government believes is a key period in which overpayments are likely. The substantial rise in the disregard for income increase will capture most typical income changes (for example, a partner going into work). That such significant changes are only expected to reduce the extent of overpayment by one third indicates that overpayments are not usually the result of income increase but changes of circumstances.

Alongside the positive change, there are concerns. Firstly, lump sums, which are currently paid after an underpayment is discovered, will be held back until the year end to offset any subsequent overpayment. Although this may reduce debt to the Government and subsequent recovery, families who may have urgent spending needs or debt following an underpayment will not receive a lump sum at the point an award is adjusted. By increasing the mandatory requirements HMRC intends to improve clarity around reporting. This may be sensible, but the key here should be to encourage reporting, not to punish those who may have good cause for not having done so. There is a question about how aggressively HMRC will pursue those who do not comply (even when they may have very good reasons perhaps following a relationship breakdown or bereavement). Since HMRC will be able to recover any overpayments there is a strong case for a lenient approach. Finally, since the income disregard applies between the assessment and the current year, it does not apply to those whose incomes have been reassessed within the year and so does not offer the same protection to claimants whose income goes down and never rises above the level of the previous year's income (for example, after maternity leave).

What more is needed?

Tax credits are crucial if the Government is to deliver on its pledge to reduce (and eradicate) child poverty. The experience of the first two years has been distinctly rocky, but recent proposed changes provide good hope that the system will be made to work more in the interests of claimants than it has done to date.

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It is worth reiterating, however, the slow speed of the implementation of the changes. The constraint here looks IT-related, rather than political, but before changes have been fully implemented many families will continue to suffer the impact of the problems. Policy makers need to push as hard as possible to make changes quickly, either as an automated process or, as has been done in the case of overpayments, manually. A 'streamlined' formula has been introduced to deal with the backlog of disputed overpayments, which has led to some overpayments being written off and, therefore, presumably a more generous system. The length of time before the changes are fully implemented also suggests the need for a more generous approach to overpayment decisions, and that there may continue to be a role for a process such as the streamlined formula.

If this is not possible, more extensive efforts to increase the use of the additional payment system are required to soften recovery. Take up of additional payments seems extremely low. Compared with the 1.9 million end-of-year overpayments in 2003/04, only 32,500 claimants received an additional payment in 2003/04 and just 10,000 in 2004/05. Part of this decrease may result from groups being excluded from payments in the later year. The Paymaster General has stated 'HMRC will consider how they might raise claimants' awareness of the availability of additional payments'⁴ and it appears to be doing so to some extent, but the onus remains on claimants to access these payments and not all can do so. Take up could be improved, for instance, by automatically paying people on income support or jobseeker's allowance.

Improvements need to be made to enable claimants to challenge decisions more effectively. There is currently no independent right of appeal against the existence or recovery of an overpayment and this must be established. Such a right of appeal is, however, only meaningful if information is provided in a manner that enables individuals to know how to challenge.

Turning to the recovery process, the Paymaster General recently stated that she is considering what might be done to 'alert claimants about the recovery of an overpayment before HMRC starts to collect it'.⁵ This pause is vital – to allow claimants to understand what has happened, to challenge where appropriate and to adapt to a different level of future income. The proposed harmonisation of in-year and end-of-year recovery rates should protect families from substantial income swings, but the jump between

different rates (currently 100 per cent, 25 per cent and 10 per cent of awards depending on entitlement) can result in large differences in repayment rates that are not proportionate to household income.

Alongside these, there are under-explored issues affecting the provision of childcare through working tax credit. Take up of this element is low, ill targeted on the poorest and subject to significant variation in level, which itself may well lead to overpayments. Although not well examined in research or policy documents, there are significant relationships between tax credits and social security benefits. There is confusion about the availability of passported benefits and tax credit entitlement, and poor communication between different departments may inhibit take up of other important elements of support such as the Sure Start maternity grant or milk tokens. There is a need for careful monitoring and improved data on how individuals and groups of claimants are faring under the new system. Notably those with fluctuating incomes are difficult to cater for – with both over and underpayment likely – and the impact of the new scheme needs to be examined with this in mind.

Finally, tax credits are required to help meet the challenge of 'halving the number of children in relative low-income households between 1998/99 and 2010/11, on the way to eradicating child poverty by 2020'.⁶ Hitting the 2004/05 target of reducing income poverty by a quarter will be reported on in March 2006. Moving beyond this, towards 2010/11, means much more investment in tax credits, alongside more efforts to increase the financial gains from paid work. Take up of child tax credit has been estimated at 80 per cent, although more detailed analysis is needed to examine the effectiveness of its different elements and of working tax credit. If the halfway target is to be met, the gains from work must be improved, resources must be invested in child benefit and child tax credit, and the tax credits system must be made to work effectively. ■

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1 House of Commons *Hansard*, 26 May 2005, 23WS. Text paraphrased in National Audit Office report, October 2005

2 In oral evidence to Treasury Select Committee, 12 October 2005

3 Paymaster General's Written Statement, 5 December 2005

4 Letter to Ann Abraham, Parliamentary and Health Services

Ombudsman, from Dawn Primarolo, 29 July 2005

5 See note 3

6 HM Treasury, *Child Poverty Review*, 2004