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Tax Credits Bill

Bill 9 of 1998-9

This Bill which is due to receive its Second Reading Debate on 27 January 1999 would replace the current in-work benefits Family Credit and Disability Working Allowance with two new tax credits. These will be known as Working Families Tax Credit and Disabled Person's Tax Credit and are planned to be introduced from October 1999. The Bill provides for the transfer of functions from the Department of Social Security to the Inland Revenue and the payment of the tax credits by employers through the pay packet from April 2000.

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Summary of main points

The *Tax Credits Bill* provides for the creation of Working Families Tax Credit and Disabled Person's Tax Credit. The current in-work benefits, Family Credit and Disability Working Allowance will be replaced. The detailed rules of the new tax credits will be contained in regulations. The Bill provides for:

- the administration of the tax credits by the Inland Revenue
- the introduction of the tax credits in October 1999
- the payment of the credits by employers through the pay packet from April 2000
- the protection of employees against unfair dismissal on the grounds of receiving or applying for a tax credit
- appeals by claimants of tax credits to be made to the unified appeal tribunals established by the *Social Security Act 1998*
- the exchange of information between the Department of Social Security and the Inland Revenue to enable assessments to be made
- the introduction of penalties for claimants and employers in respect of fraudulent claims or the failure to comply with the Inland Revenue
- the transfer of regulation making powers in Family Credit and Disability Working Allowance legislation from the DSS to the Board of the Inland Revenue and the Treasury
- a change to the eligibility criteria for Disabled Person's Tax Credit from that which currently applies to Disability Working Allowance

This Paper also discusses the issues raised by the recent report by the Social Security Select Committee on Tax Credits and the publication by the Inland Revenue that contains the detailed proposals for the new tax credit system. These issues are:

- the timetable for implementation of the tax credits
- the administrative burden on employers
- fraud
- the potential transfer of payments from women to men
- the impact of the new childcare tax credit on childcare arrangements

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I Introduction

The *Tax Credits Bill 1998-9* was laid before Parliament on 10 December 1998. It provides for Family Credit (FC) and Disability Working Allowance (DWA) to be replaced by Working Families Tax Credit (WFTC) and Disabled Person's Tax Credit (DPTC) and transfers the administration of these benefits from the Benefits Agency and the Department of Social Security to the Board of the Inland Revenue and the Treasury. These changes will take effect from 5 October 1999. The section of the Bill which provides for payment of tax credits by employers through the wage packet will take effect from 6 April 2000. Much of the Bill transfers existing regulation making powers under social security legislation to the Inland Revenue and the Treasury, and applies existing tax legislation to the credits. New measures provide for penalties to be imposed on claimants and employers for failing to disclose information, failing to pay credits as authorised by the Inland Revenue and providing false information in order to make a fraudulent claim. The Bill also makes one change to the eligibility criteria for DPTC from that which existed under DWA.

The present Bill was foreshadowed by the *Tax Credits (Initial Expenditure) Act 1998* which received Royal Assent on 21 May 1998. This allowed the Inland Revenue and Department of Social Security to spend money on preparing for the introduction of the tax credits. The financial memorandum to the *Tax Credits (Initial Expenditure) Bill* estimated this expenditure at around £15-20 million.

The detail of the new tax credits will be contained in secondary legislation. Some of this detail, such as the level of the payments and the rate at which they will be withdrawn, has been announced previously and is contained in the Explanatory Notes to the Bill. Other details, such as how the credits will be paid when a claimant has more than one employer and the arrangements for payments by employers, have recently been published in a booklet by the Inland Revenue.

This paper should be read in conjunction with Research Paper 98/46, *Working Families Tax Credit and Family Credit*, which contains the background to the introduction of tax credits and discusses the main issues. Research Paper 98/45, *The 1998 Budget and Work Incentives*, considers the impact on work incentives of the WFTC and changes to National Insurance Contributions announced in the March 1998 Budget. This paper outlines the current legislative framework and updates the issues raised in the earlier papers, in particular, those raised by the Social Security Select Committee in its recent report on tax credits. It also raises specific issues arising from the content of the Bill. A detailed explanation of the clauses is contained in the Explanatory Notes to the Bill and these should be read in conjunction with the brief outline of the Bill's provisions contained in Section V.

The debate on Second Reading is scheduled for 27 January 1999.

II Background

A. The current legislative position

Family Credit was introduced in April 1988 by the *Social Security Act 1986*. It is a benefit for low paid families in work. Disability Working Allowance (DWA) was introduced in April 1992 by the *Disability Living Allowance and Disability Working Allowance Act 1991*. This is a benefit for low paid disabled people in work. In the case of both benefits the main provisions were subsequently consolidated into the *Social Security Contributions and Benefits Act 1992*. Regulations containing the detailed eligibility rules and operation of the benefits are made under this Act and section 5 of the *Social Security Administration Act 1992*.

Therefore, the main rules for each benefit are provided for by secondary legislation. These are contained in the *Family Credit (General) Regulations* SI 1987/1973 and the *Disability Working Allowance (General) Regulations* SI 1991/2887. As the *Tax Credits Bill* transfers the regulation making powers in social security legislation to the Inland Revenue and the Treasury, the detail of the tax credits will also be contained in regulation. In its recent report on tax and benefits, the Social Security Select Committee commented on the lack of parliamentary scrutiny such arrangements would afford while acknowledging the commitment of the Inland Revenue to consult on regulations:

> 6. The Government plans to introduce a Bill in the current session of Parliament which will allow WFTC and DPTC to be introduced from October 1999. In the past, there has been a tendency in primary social security legislation to produce 'skeleton' Bills, which set out the broad framework of what is proposed but little of the detail. This makes Parliamentary scrutiny at that stage very difficult. The detailed rules are contained in statutory instruments made later; although at that point there is no practical opportunity for Parliament to comment substantively, or to amend. The Inland Revenue told us:
>
> "If there were to be secondary legislation on any of this, it has become our custom in recent years, certainly on things like employer legislation, to publish the detail in advance and to give people the opportunity to comment on that. An example of that is self-assessment where we published draft regulations. If there were any secondary legislation that is what we would intend to do."
>
> 7. We welcome the Inland Revenue's intention to consult on secondary legislation. **We recommend that the main draft regulations on WFTC and DPTC should be published and made publicly available so that all interested parties have the opportunity to comment on the detail of the measures proposed.**
>
> 8. The Inland Revenue's willingness to consult with organisations regarding the detail of secondary legislation does not address the more fundamental issue of adequate Parliamentary scrutiny of major change. Even if the affirmative procedure is used (under which a Minister may make an Order only after both

> Houses have approved a draft), this is a 'take it or leave it' process which is one of debate, not detailed examination; and, again, amendment is not possible.
>
> 9. We therefore note the recommendation of the Procedure Committee in the last Parliament in its Report on Delegated Legislation, that there should be a new category of 'super-affirmative' instruments, whose complexity and political importance warranted their detailed investigation. No progress appears to have been made on this recommendation.[1]

The Government has confirmed that the draft regulations outlining the detailed design of the scheme will be published "in time for the detailed debates on the primary legislation".[2] This is likely to refer to the Committee stage of the Bill.

B. The current in-work benefit system

1. Family Credit

Family Credit was introduced in 1988. Its predecessor, Family Income Supplement (FIS) had originally been brought in as a stopgap measure in 1971, in anticipation of a tax credit scheme, which was never actually introduced.[3]

Family Credit is a weekly benefit paid to lone parents and couples with children on low incomes. In order to qualify, the lone parent, or in couples at least one of the couple, must be working full-time (defined as more than 16 hours per week). The amount of benefit payable is calculated by taking into account the numbers and ages of children in the family, and the income and capital of the family. If the family's income is below or at a set figure, known as the 'applicable amount', the family will receive the maximum amount of Family Credit. For those on incomes above the 'applicable amount', the amount payable is the maximum amount of Family Credit reduced by 70% of the difference between their income and the applicable amount. Certain childcare costs of up to £60 per week can be deducted from income before calculating Family Credit entitlement. The main rules for claiming Family Credit are compared to the proposed structure for WFTC on page 12.

In May 1998, there were 767,000 families receiving Family Credit of which 377,000 were lone parent families.[4] Take up by case load is estimated to be 72% of all families eligible and this is estimated to be 84% if measured by the level of expenditure.[5]

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1 Social Security Select Committee, *Tax and Benefits: implementation of tax credits*, 2 December 1998, HC 29 1998-9, p viii

2 *Tax Credits Bill, Explanatory Notes*, p 29

3 a brief history and background to the introduction of Family Credit is contained in Research Paper 98/46

4 HC Deb 14 December 1998 cc 372-4W

5 HC Deb 16 November 1998 c 601

2. Disability Working Allowance

DWA was introduced in April 1992 as an in-work means-tested benefit for people with a disability or long-term illness and it operates in a similar way to Family Credit. A person's net income is compared with an 'applicable amount'. For those on incomes at or below the applicable amount, maximum DWA is payable. For those earning above the applicable amount, the amount payable is the maximum amount of DWA reduced by 70% of the difference between net earnings and the applicable amount. DWA is compared to the proposed DPTC on page 13.

The White Paper which introduced proposals for DWA set out for it the objective that it would encourage people to return to or take up work. The assumption was that about 50,000 people would be entitled and that the savings from disabled people moving off out-of-work benefits would broadly offset the new expenditure.[6]

The success of the benefit in achieving these objectives was assessed in 1996 by a PSI report commissioned by the DSS.[7] On the objective of helping previously unemployed disabled people into work, the report concluded that it had not been a success:

> Helping disabled people move into work is probably the key aim of DWA but the benefit has not been very successful in achieving it. Between the spring of 1992 and the autumn of 1995, only two per cent (30, 000) of the 1.5 million working-age recipients of one of the main incapacity benefits (ISdp IVB, SDA) moved off these benefits and into full-time work. And virtually all of these made the transition from benefits to work without the help of DWA. Only 200 of these claiming DWA in October 1993 had been directly encouraged into work by the benefit. There are some signs that the incentive effect is increasing - in the first half of 1994, approximately 500 people took a job because of DWA. But this is still a very small figure - DWA has not been successful in encouraging many people into work ...
>
> To sum up, DWA has only helped a handful of disabled people into work. This is for a number of reasons: many disabled people felt unable and had very low expectations of working again; those who could or wished to work wanted to move into full-time 'proper' jobs; there were many important barriers to work including the overall lack of jobs, employers' attitudes and impairments; jobs were unattractive because of low pay and so there was some disincentive to work, but jobs were also unattractive because they were part-time and low status - pay was only part of the problem; awareness of DWA was low; and even those aware of DWA did not take it into account because they wanted to be independent of the state when they moved into work.[8]

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6 DSS, *The Way Ahead: Benefits for Disabled People*, Cm 917, 1990, paras 5.12 and 5.17

7 Rowlingson and Berthoud, *Disability, Benefits and Employment*, DSS Research Report No 54, 1996

8 *Ibid*, pp 203 and 207

On the question of the incentive to stay in work for people who had already been in work for some time when they claimed DWA, the report found that on average, DWA recipients had higher average net incomes after housing costs than non-working disability benefits recipients. However there were some who were slightly worse off. It concluded:

> One of the reasons for providing assistance to disabled people who are already in work is to help them stay in work. And the benefit does seem to have helped some people stay in work. Two-thirds of all those who first claimed DWA early in 1993 were still in work two and a half year later. Some of these may have stayed in work without DWA but two-fifths of those who were still in work said they would not still be in a job without DWA.[9]

On the financial objective, the report noted that because the numbers claiming DWA were low, it did not cost much. It could break even if a large enough proportion of claimants left incapacity benefits.

The general conclusions of the report were that the research "casts some doubt on the extent to which a means-tested in-work benefit can provide an incentive to take a job."[10] It explained the differences between the success of Family Credit, in terms of the numbers of people claiming it, and DWA as follows:

> Given all the reasons why DWA has not been a success, it may seem strange that FC has made such an impact - with over half a million claimants in 1994. Of course there has been an in-work benefit for families for over 20 years but when FIS as first introduced it reached its first peak of 200,000 recipients after only two years. The differing levels of success of FC and DWA might be explained by the difference between the two claimant groups. About half of those on FC are lone mothers who are particularly keen to work less than a full working week and will therefore be prepared to take the fairly low-paid service sector jobs which are available. There is no similarly large group of disabled people who want such jobs. But although FC has been a success in terms of caseload, there is little evidence (apart from, perhaps, lone parents) that the benefit has encouraged people into work … It may help people stay in work by cushioning the blow of a drop in wages, but there is little hard evidence of an incentive effect.[11]

The most recent statistics for Disability Working Allowance state that there are 15,875 in receipt of the benefit and the average award is £58.64 per week.[12]

The Government expects the case load of DPTC to increase by 10-15% from the numbers claiming DWA as a result of the structural changes brought about under the new tax

9 *Ibid*, p 209
10 *Ibid*, p 210
11 *Ibid*, p 211
12 DSS, *Disability Working Allowance Statistics: Quarterly Enquiry*, July 1998

credit.[13] This compares with the anticipated 27% increase in claimants of WFTC as compared to Family Credit.[14]

3. Comparison of the benefits with the proposed tax credits

The main differences between Family Credit and WFTC are the method of payment and the amount that will be payable. The following table compares the two.

Family Credit	Working Families Tax Credit
• Administered and assessed by Benefits Agency's Family Credit Unit in Preston	• Administered and assessed by Inland Revenue. Existing staff in the Family Credit Unit will be transferred to the Inland Revenue
• Claimed by woman in couple	• Claimed by man or woman according to couple's choice
• Paid by order book, or direct debit to account of claimant's choice	• Paid through wage packet by employer or direct from the Inland Revenue to nominated partner
• Main earner must be working 16 hours per week or more	• Main earner must be working 16 hours per week or more
• Extra credit for those working 30 hours per week or more	• Extra credit for those working 30 hours per week or more
• Paid over six month period after which claim can be renewed	• Paid over six month period after which claim can be renewed
• Starts to be withdrawn once net income reaches £80.65 (from April 1999). One adult credit paid per family plus additional, age-related credits for children	• Starts to be withdrawn once net income reaches £90. One adult credit paid per family plus additional, age-related credits for children. These credits will be at the same rate as under Family Credit
• Reduced at rate of 70p for each extra £1 earned over threshold	• Reduced at rate of 55p for each extra £1 earned over threshold

13 HC Deb 2 April 1998 c 617W

14 HM Treasury, Financial Statement and Budget Report, *New ambitions for Britain*, HC 620, March 1998, p 47

• One adult credit per household, plus age related credit for each child	• One adult credit per household, plus age related credit for each child
• Certain childcare costs up to £60 per week are deducted from income when calculating entitlement. This applies to costs in respect of children up to the age of 11.	• More generous help with childcare costs through a childcare tax credit. Up to 70% will be paid on eligible childcare costs of up to £100 per week for 1 child and £150 for two or more. This will apply to costs in respect of children up to the age of 14 (age 16 if disabled)
• Capital over £8,000 disqualifies from benefit; capital between £3,000 and £8,000 reduces benefit	• Capital over £8,000 disqualifies from benefit; capital between £3,000 and £8,000 reduces benefit

The following features are common to both DWA and Family Credit:

- administration
- payment method
- hours rule
- 30 hour credit
- payment period
- help with childcare
- withdrawal rate

Where these are to be changed for WFTC as described in the table above, the same changes will apply for DPTC.

The following features apply to DWA and DPTC only:

Disability Working Allowance	**Disabled Person's Tax Credit**
• Claimants must have been receiving an eligible disability benefit within **56** days of a claim for DWA • Starts to be withdrawn once net income reaches £60.50 for a single person and £80.65 for lone parents and couples (amounts quoted to take effect from April 1999)	• Claimants must have been receiving an eligible disability benefit within **182** days of a claim for DWA • Starts to be withdrawn once net income reaches £70 for a single person and £90 for a couple/lone parents
• Capital over £16,000 disqualifies from benefit; capital between £3,000 and £16,000 reduces benefit	• Capital over £16,000 disqualifies from benefit; capital between £3,000 and £16,000 reduces benefit

On the introduction of WFTC, the Pre-Budget Report published by HM Treasury in November 1998 stated that it:

- will provide a guaranteed minimum income of £190 for families with one member in full-time work earning the national minimum wage; and
- will reduce the tax burden on families so that those with earnings of less than £220 a week, half male average wages, will no longer pay any net tax.[15]

On DPTC, the report stated that it:

> will provide a guaranteed minimum income of at least £150 a week for a single disabled person who moves from benefits to full-time work earning the National Minimum Wage, and £220 for a couple with one earner and one child.[16]

A discussion of the effect of the credits on work incentives and model calculations are included in Research Paper 98/46.

C. Government support for disabled people in work

The introduction of the DPTC is part of the Government's initiative to help people who are sick and disabled move into employment. Other initiatives in this area include changes to the benefit system, support from the Employment Service and other agencies to help people find employment, and an increase in the support for disabled people once they are in work. These measures are seen by the Government as interdependent strands of its policy towards the disabled.[17]

There have been three such measures to date and these are set out below.

1. The linking rule for claimants of Incapacity Benefit, Severe Disablement Allowance, and the disability and higher pensioner premiums in Income Support, Income-based Jobseeker's Allowance, Housing Benefit and Council Tax Benefit has been extended to 52 weeks. This means that claimants who leave these benefits for paid employment can return to their previous rate of benefit if they subsequently leave their job within 52 weeks. This took effect from 5 October 1998. The previous linking rule for Incapacity Benefit was 8 weeks.[18]

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15 HM Treasury, *Pre-Budget Report: steering a stable course for lasting prosperity*, Cm 4076, November 1998, para 4.41

16 *Ibid*, para 4.45

17 HC Deb 23 March 1998 c 6

18 This change was introduced by the *Social Security (Welfare to Work) Regulations* SI 1998/2231

2. The 16 hours per week maximum of voluntary work for people on Incapacity Benefit has been removed.[19]

3. The New Deal for Disabled People was announced by Gordon Brown in his July 1997 Budget. The two main elements to this programme are a range of local and national schemes to help disabled people obtain and retain work, and a new personal adviser service for disabled people. Further details of the New Deal for Disabled People are contained in Research Paper 98/111, *Employment and Training Programmes for the Unemployed.*

Future developments in this area include:

- pilot initiatives to be introduced from April 1999. These will allow people on incapacity benefits to earn up to £15, or test out a job for a trial period, whilst remaining on benefit. Other pilots will provide a range of new grants and subsidies to disabled people in work.[20]

- an expansion of specialist disability services, such as the Access to Work scheme and the Job Introduction Scheme. Details of this expansion were provided in a press release on the day of the Welfare Reform statement last October.[21]

D. Announcement of tax credits

The Labour Party Manifesto for the 1997 General Election stated:

> We will also examine the interaction of the tax and benefit systems so that they can be streamlined and modernised, so as to fulfil our objectives of promoting work incentives, reducing poverty and welfare dependency, and strengthening community and family life.[22]

After the General Election, the Chancellor, Gordon Brown, set up a task force under Martin Taylor, then chief executive of Barclays Bank, to review the tax and benefit system, and examine the capacity for increased integration. Taylor's final report was published on the same day as the March 1998 Budget statement. In it he concluded:

> I believe the Government should replace Family Credit with a tax credit. A tax credit will associate the payment in the recipient's mind with the fact of working, a potentially valuable psychological change. I believe that a payment through the tax system associated with the recipient's work, is likely to prove more acceptable to society at large. And the establishment of a tax credit system is likely to come

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19 Also introduced by SI 1998/2331
20 DSS, *A new contract for welfare: support for disabled people*, Cm 4103, October 1998, p 42
21 DfEE Press Release, *New £30 million fund helps disabled people into work*, 28 October 1998
22 Labour Party, *New Labour: because Britain deserves better*, April 1997, p 13

> in useful in future as a broader delivery mechanism eventually allowing closer integration between the benefit system and conventional income tax.[23]

Although the report did not address the specific issue of a tax credit for disabled people in work, the DPTC can be seen as representing the next stage of such "closer integration". The Taylor report is discussed in more detail in Section II of Research Paper 98/46.

In his Budget statement on 17 March 1998 Gordon Brown announced plans to introduce the new credits:

> Under the present system of family credit there is, quite simply, a ceiling on aspirations for women and men wanting to work their way up. In Britain today there are nearly three quarters of a million working families who are held back by marginal tax rates in excess of 70 per cent. There are nearly half a million working families, with children, whose pay is so low that they receive in-work benefits and yet still are required to pay income tax.
>
> From October 1999, the working families tax credit will not only be a tax cut for hundreds of thousands of working men and women with children, but will abolish the grotesque distortion where some low-paid employees have had to pay back more than £1 for every extra £1 they earn.
>
> Instead of the state paying out benefit through the social security system to working families on lower incomes, in future they will receive cash directly through the tax system. Families will be able to choose to whom the credit is paid--either directly or through the pay packet.
>
> By tackling the unemployment trap and increasing the help available to families, the working families tax credit ensures that work will always pay more than benefits and by tackling the poverty trap--through cutting the rate at which help is withdrawn as incomes rise, the working families tax credit ensures that the more you earn, the more you take home …
>
> I have one further tax and benefit integration to announce. For decades, thousands of disabled people have been denied a basic right--the right to work--and the tax and benefit system is one of the barriers that have denied them opportunity.
>
> As a Government, we will never compel to work disabled men and women who cannot work, and for those who want to work we will systematically remove the obstacles that, at present, prevent them from achieving their potential.
>
> So, alongside the working families tax credit, the Government will introduce a new tax credit for disabled people in work, paid through the wage packet, and a

[23] HM Treasury, *The Modernisation of Britain's tax and benefit system Number Two - work incentives: a report by Martin Taylor*, March 1998, p 8

> new 12-month linking rule to improve the incentives for those on long-term benefits to take a job. Together, these measures will ensure higher rewards for disabled men and women if they choose to enter work, making work pay.[24]

Gordon Brown announced the childcare tax credit later in the same statement:

> For too many parents, the cost of child care has meant that parents either cannot afford to work or find themselves paying out most of their wages on the cost of child care. So we will introduce a new child care tax credit as part of the working families tax credit, and put high quality child care within the reach of people who have never been able to afford it. For spending on child care of up to £100 a week for the first child and £150 for two or more children, the tax credit will cover up to as much as 70 per cent of the cost.
>
> The rules that we draw up, which will be reviewed after two years of experience, will be designed to ensure that parents have access to high quality child care: child minders, day nurseries and out-of-school clubs. That is a change that today makes a reality of choice for hard-working families previously denied it. Child care will from now on be affordable for the many and not just the few.[25]

Although, it was announced separately and is sometimes discussed as though it is a separate initiative, the childcare tax credit is part of the WFTC and DPTC and will operate under the rules for these credits.

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[24] HC Deb 17 March 1998 c 1105

[25] HC Deb 17 March 1998 c 1106

III The Social Security Select Committee Report

The Social Security Select Committee published its report on the implementation of tax credits on 2 December 1998.[26] This followed two reports in the previous session on the integration of tax and benefits.[27]

The Committee welcomed the stated policy aim of the Labour Government to improve work incentives for low paid workers. However, the report raised a number of concerns about the administration of the new tax credits and much of the accompanying press coverage saw it as highly critical of the Government's plans.[28] The following discusses the Committee's comments on these issues and subsequent recommendations.

A. Implementation timetable

The Committee expressed doubts as to whether the developmental work required to move the staff and systems from the Benefits Agency to the Inland Revenue could be completed successfully in time for the start of WFTC in October 1999. It also highlighted potential problems with the deadline of April 2000 for the payment of tax credits by employers.

The start of WFTC in October 1999 is likely to result in a large increase in the volume of claims because the new tax credit is more generous and therefore larger numbers of claimants will be eligible. In addition to this, October is generally one of the two peak months of the year for assessing Family Credit claims. This is because of the renewal cycle following the introduction of Family Credit in April 1988. As Family Credit is awarded for six months, claims need to be renewed at the end of this period. The Committee were told by staff at the Family Credit Unit in Preston that this results in a surge of work every April and October from repeat claimants.

The Committee made the following comments on this issue:

> 17. Officials from the Inland Revenue identified two main strategies to handle both the increase in volume of work and the likely surge of claims at what were already peak periods. The first was to use publicity to specifically target families who were likely to be eligible. The second was to draw on the existing experience of the Family Credit Unit:
>
> "We are working extremely closely with the Family Credit Unit. They are used to dealing with these volumes of claims because Family Credit was introduced in a similar sort of way, on a particular date, and over a similar time period. They

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26 Social Security Select Committee, *Tax and Benefits: implementation of tax credits*, 2 December 1998, HC 29 1998-9

27 Social Security Select Committee, *Tax and Benefits: an interim report*, HC 283 1997-8, and *Tax and Benefits: pre-Budget report*, HC 423 1997-8

28 see for example, "MPs and employers attack family tax credit", *Financial Times*, 3 December 1998 and "Tax credit 'unworkable'", *Independent*, 3 December 1998

> are used to dealing in peaks and troughs of work in that way. We shall be combining the experience that we have had in both departments to tackle the peak of work that we shall get with the introduction of tax credits".
>
> 18. The Committee is not wholly satisfied by these reassurances. Our Report on the introduction of Disability Living Allowance and Disability Working Allowance in 1993 gives a dreadful warning of the debacle which can occur when officials underestimate the surge in demand when a new benefit is introduced. Even the best targeted publicity will still result in an extra 400,000 claims. Moreover, since the introduction of Family Credit in 1988, the Family Credit Unit has never experienced such a large surge in claims. **We recommend that during the first three months of WFTC only, provision should be made for new awards of Family Credit to last seven months (or 30 weeks) so that, in the future, work can be distributed more evenly throughout the year.**[29]

The second deadline to be met by the Inland Revenue is 6 April 2000 which is the proposed date in the Bill for the provisions that allow WFTC and DPTC to be paid through the wage packet **(clause 5(4))**. Employers' organisations have expressed reservations about the potential burden resulting from the implementation of tax credits and it is difficult to separate these concerns from the more specific issue of the implementation timetable. The Committee concluded:

> 13. The inability of officials to give answers on such key questions at this stage gives ground for concern about the timetable for delivery. Most of the difficult questions concern aspects of the most fundamental change in the Government's reforms: the decision to pay WFTC and DPTC through the wage packet rather than as a cash social security benefit. Employer organisations have raised concerns about the proposed April 2000 starting date for such payments. The Federation of Small Businesses described the timescale as "far too quick":
>
> "...we have asked the Government to step back a bit, but they actually say that the timetable is longer than they wished it to be"
>
> The Institute of Directors thought the timetable "extremely tight", a view echoed by the Confederation of British Industry which added that employers would need clear guidance on their responsibilities at least six months before April 2000 to enable the necessary changes to be made to payroll systems. **We recommend that the Inland Revenue should work with employers' organisations to ensure that employers are fully aware of the practical implications for them as the details of the WFTC and DPTC are finalised.**
>
> 14. The Government set considerable store by the decision to pay WFTC and DPTC through the wage packet:

[29] Social Security Select Committee, HC 29 1998-9, paras 17-18

"Its clear link with employment should demonstrate the rewards of work over welfare and help ensure that people move off welfare into work".

Unless payment of the new tax credits through the wage packet is successful from the start, the new system runs the risk of being discredited at an early stage. **The concerns of employers, coupled with the difficult questions which still have to be resolved, lead us to propose that the Inland Revenue should address with some urgency the practical difficulties of implementation within the currently proposed timetable.**[30]

B. Administrative burden on employers

The Committee noted the potential problems faced by employers in having to make payments of tax credits and reclaiming this money from the Inland Revenue. It took evidence from organisations representing employers on this issue and examined the potential administrative burden that the Government's proposals may cause. The Committee recommended that the Inland Revenue should make advance payments to employers with cash-flow problems and reimburse small employers their administrative costs.

Representatives of employers welcomed the fact that employers will not be involved in the calculation of entitlement and the gathering of personal information. However, they remain fundamentally opposed to the introduction of tax credits paid through the pay packet, as they were in 1987 when such a proposal was included with the introduction of Family Credit. This opposition is best summarised by the comment in the Institute of Directors' evidence to the Select Committee:

It is in principle not the job of employers to administer the benefits system.[31]

Employers argue that a system of tax credits paid through the wage packet would impose costs on businesses and that this may result in a disincentive to employ people who would be likely to be eligible for a credit.[32] The main cause of the costs to business is the cash flow problems the system is likely to create. This is explained by the Institute of Directors as follows:

32. There is also a cash-flow point. At the moment employers pay net wages at (say) the end of a month, but only pay the income tax and national insurance contributions on the 19th of the following month. If net pay is increased and total tax and national insurance payable correspondingly decreased, the cash-flow position of employers will be worsened. The cash-flow position of the Crown will be correspondingly improved: employers will effectively be lending the

30 *Ibid*, paras 13-14
31 *Ibid*, p 13
32 *Ibid*, p 27

> Crown the money to pay benefits, with each loan outstanding for between two and six weeks depending on the pattern of wage payments.[33]

The Federation of Small Businesses reiterates these fears and, in particular, argues that the system will have a disproportionate effect on small firms:

> Employers are already the unpaid tax collectors on behalf of government for NICs and PAYE and employers also fund such benefits as Statutory Sick Pay, Statutory Maternity Pay and redundancy pay. Large businesses have extensive personnel departments to deal with such responsibilities - in the small firm it is more often than not the owner manager performing the calculations on the kitchen table.[34]

The Institute for Fiscal Studies also raised the issue of cash flow problems for firms with large numbers of tax credit recipients and few non-recipients. The Inland Revenue's decision to allow firms to apply for advance payments where they pay out more in tax credits than their tax and NI liability can be seen, in part, as a response to such criticism. The Committee made the following comments and recommendations on this issue:

> 26. We welcome the Inland Revenue's recognition of the potential cashflow problems WFTC and DPTC might bring to some employers. Advance funds should be made available promptly on request to employers with a cashflow problem caused by the obligation to pay WFTC or DPTC. **We recommend that the performance of the Inland Revenue in making prompt payments of advance WFTC or DPTC to employers should be measured against clear targets, and that details should be recorded of the number of employers who request such funds and the sums paid out by the Inland Revenue as a result. We recommend that the new payroll service for new small businesses being developed by the Inland Revenue should incorporate systems which take account of WFTC and DPTC. We recommend that small employers who administer WFTC should be awarded reimbursement of their costs similar to that which currently applies in relation to Statutory Maternity Pay, whereby small employers are entitled to an additional payment of 7 per cent of the payment of SMP.**[35]

There has been no indication from the Government that they intend to accept this final recommendation and pay the administrative costs of small firms as is currently the case under Statutory Maternity Pay.

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33 *Ibid*, p 16
34 *Ibid*, p 17
35 *Ibid*, para 26

C. 'Purse to wallet'

Under the present system of Family Credit, payment is usually made to the mother. If payments are made through the pay packet under WFTC, this will make it more likely that, in couples where there is only one earner, the money will go to the male partner. This has become known as the 'purse to wallet issue'. Since the Government first announced that it was considering the introduction of a WFTC payable through the pay packet, there has been concern that this would mean that money would be transferred from women to men in the family. Evidence suggests that the result of this is that less money would be spent on the children.[36] This issue was also controversial at the time of the proposals for Family Credit and criticism of its effect led, in part, to the decision by the Conservative Government to abandon its initial proposal to pay the benefit through the pay packet.[37]

The Government has confirmed that couples will be able to choose which partner should receive the payment of the new tax credits. The Select Committee welcomed this decision but continued to express concern that this choice is presented in a "positive way":

> 58. It is crucial that the option of payment to the non-wage earner in a couple (usually the mother) should be actively presented in a positive way. There is otherwise a risk that, in a couple with a single male breadwinner, the automatic presumption will be that the in-work assistance should go to the man earning the wage. The Inland Revenue advised the Committee that it was working on the design of the claim form "to see how the choice might be presented". It is important that the claim form for WFTC is designed to encourage proper consideration of payment of the tax credit to the partner at home. This could be done by making payment to the partner at home the 'default' position, barring an active choice by the couple to opt for payment through the wage packet. **We recommend that the claim form for WFTC should indicate that payment will normally be to the partner at home in recognition of their responsibility for meeting the everyday needs of the children; but that, if both partners prefer, payment can be made through the earner's pay packet by ticking a special box.**[38]

The Government does not appear to have accepted the recommendation to make payment to the partner at home the default position.[39] It has attached importance to the policy of paying the new credit through the pay packet arguing that "as a tax credit, it will demonstrate more clearly the rewards of work over welfare and reinforce the minimum

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[36] The most recent research on this subject is: Goode et al, *Purse or wallet? Gender inequalities and income distribution within families on benefit*, Policy Studies Institute, 1998. This issue is discussed in more detail in Research Paper 98/46

[37] For debate see SC D Deb 18 March 1986 cc 933-85

[38] Social Security Select Committee, HC 29 1998-9

[39] Inland Revenue, *Working Families Tax Credit and Disabled Person's Tax Credit*, 1998, p 8

wage in making work pay".[40] Commentators have noted that the Government may see default payment to the caring partner as weakening the WFTC's role in promoting work incentives.[41] It appears that this consideration led to the decision to reject the Committee's recommendation. Furthermore, payment through the pay packet is the main change from Family Credit and as such is the main purpose of the Bill. Many of the proposed changes to the structure of the new credits would not require primary legislation. For example, making the benefit more generous by increasing the threshold of the applicable amount and reducing the taper could be achieved by secondary legislation under Family Credit.[42] Similarly, the new credits will remain a separate addition to net pay rather than an adjustment of PAYE. Payment through the pay packet therefore remains central to the Government's stated policy intentions and the legislation implementing the tax credits.

D. Fraud

In its report, the Committee said that in their evidence Government officials had not attached sufficient importance to the potential for fraud in the proposed tax credit system. The Committee expressed concern that the potential for fraud could increase if priority was placed on prompt payment at the expense of rigorous checking of eligibility:

> 73. A balance has to be struck between ensuring that working people on low incomes are supported in taking up employment by having swift access to in-work financial assistance, and meticulous checking of every last detail of their claim for possible fraud. We are concerned that not enough weight appears to be being given by staff charged with the task of implementing WFTC and DPTC to the Government's desire to integrate an anti-fraud culture into all aspects of the welfare system. For example, the Inland Revenue referred to 'Process Now Check Later', a system it has been moving towards with self-assessment for income tax.
>
> 74. The price of longer 'front-end' checks is likely to be greater delays in paying WFTC and DPTC. Whilst helping people move off benefits and into work should be a priority, it is equally important that the proper checks are carried out to verify all the information provided in support of a claim. **We recommend that the Government should give consideration to extending payment of Income Support or Jobseeker's Allowance to people who have claimed WFTC or DPTC for up to 14 days after commencement of employment in order that claims for in-work financial support can be properly verified before payment is made.**[43]

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40 HM Treasury, Financial Statement and Budget Report, HC 620, March 1998, p 47

41 see Professor Ruth Lister's evidence to the Social Security Select Committee, HC 29 1998-9, Appendix 1, p 72

42 HC Deb 3 December 1998 c 176W

43 Social Security Select Committee, HC 29 1998-9

Reducing benefit fraud is a key part of the Government's approach to social security policy. The Labour Party manifesto for the 1997 General Election contained a commitment to reducing fraud in the social security system.[44] Subsequently, in July 1998, the Government published a Green Paper that outlined its strategy to combat benefit fraud.[45]

However, since the announcement of the Government's plans to introduce tax credits to replace in-work benefits for families and disabled people, critics have expressed concern that the new system will be more susceptible to fraud. Shortly after leaving the Government, Frank Field described the potential problems with the new system as follows:

> If operated honestly, the working family tax credit will offer important support, and ensure that those with children who work are better off than if they remained on benefit.
>
> But the whole of the working family tax credit is fraught with great dangers.
>
> - It offers huge bonuses for dishonesty for both employers and workers.
> - It strengthens the employers hold over people - "these are the conditions: cheat and both of us will be better off".
> - It thereby pulls employers into a spider's web of corruption.
> - It rewards employers paying low wages
>
> It takes pressure off improving productivity and thereby the scope for increasing real wages.[46]

Critics also point to the experience of the Earned Income Tax Credit in the USA. An article in *Fiscal Studies* based its criticism on a study by the Internal Revenue Service (IRS) released in early 1997 which found that taxpayers claimed $4.4 billion more in EITC refunds than they were eligible to receive.[47] However, as the UK proposals have been developed it has become clear that the WFTC and DPTC will be more closely aligned with the current UK in-work benefit system than the tax credit system in the USA. For example, eligibility for the EITC was originally checked only after awards had been made in line with the policy on tax measures. The IRS have now moved to verifying eligibility prior to payment but such a process is already built into the UK proposals as they build on existing structures for in-work benefits.[48]

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44 Labour Party, April 1997, p 19

45 DSS, *Beating fraud is everyone's business: securing the future*, Cm 4012, July 1998

46 Frank Field, "Gordon's fatal floor" *Guardian*, 7 August 1998

47 Robert Walker and Michael Wiseman, "The possibility of a British EITC", *Fiscal Studies 4*, 1997, pp 418-9

48 see Jeffrey Liebman, *Lessons about tax-benefit integration from the US earned income tax credit experience*, Joseph Rowntree Foundation, 1997 and Appendix II of Research Paper 98/46

However, the Select Committee remained concerned that the increased generosity of the tax credits could exacerbate existing problems of fraud and the transfer of functions to the Inland Revenue would create potential problems. The Committee criticised the decision to drop the benefit review on Family Credit:

> 70. In 1997 the Benefits Agency carried out a pilot review of Family Credit, in preparation for a full review of the benefit to estimate the level of fraud. The pilot was intended to give information on methodology and indications of types of fraud. The Secretary of State agreed to give us a copy of the report on 29 October 1998. The paper had still not been received by the time we came to consider this Report.
>
> 71. We accept that the pilot study was not intended to produce statistically robust results. Nevertheless, we understand that the results indicated sufficient areas for concern to have warranted a full study being undertaken as soon as possible. It is therefore surprising that, in the words of the Chief Executive of the Benefits Agency, "work on the main Benefit Review of FC has been suspended for the present following the decision to move to a Working Families Tax Credit next year". **We regret the fact that work on the main Benefit Review of Family Credit was dropped by the Benefits Agency following the decision to transfer the benefit to the Inland Revenue, when the lessons to be learned from such a review would have been of particular importance in assisting the Inland Revenue to minimise the scope for fraud in the design of the new tax credit system. We recommend that the Inland Revenue should take over and complete the investigation started by the Benefits Agency.**[49]

The Government argues that the Inland Revenue's experience of detecting and preventing collusive fraud will help limit the amount of fraud in the new system.[50] The provisions for combating fraudulent claims and collusion between employers and employees are contained in **clause 8** of the Bill and are discussed in Section V. These provisions would introduce new and stricter penalties than currently exist in social security legislation.

E. The childcare tax credit

The childcare tax credit is an integral part of both WFTC and DPTC. Whereas the current in-work benefit system allows certain childcare costs to be deducted from income before benefit is calculated, under the proposed tax credits claimants may be paid a proportion of their childcare costs. The Committee welcomed the introduction of the tax credit as an improvement on the existing support for childcare. Its Report also acknowledges that the recent announcement that the credit will apply to children up to the

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49 Social Security Select Committee, HC 29 1998-9
50 HC Deb 9 November 1998 c 103W

age of 14, and aged 16 if they have a disability, is likely to alleviate the concerns of some of the disability organisations that gave evidence to the Committee.[51]

The Government has confirmed that, as under Family Credit, financial help will only be provided for what is described as 'eligible childcare'.[52] The regulations governing eligible childcare costs for Family Credit specify that up to £60 a week of child care costs can be disregarded when working out a person's income for Family Credit purposes. These costs can only be taken into account where the child is being looked after by a childminder registered under section 71 of the *Children Act 1989* or in other specified circumstances.[53] Because of the 70% taper, this means that the maximum amount by which the Family Credit award can be increased is £42 per week. Under the Childcare Tax Credit, the maximum amount payable will be £70 per week for one child and £105 per week for two or more children.

It is difficult to estimate the effect that the new credit will have on individual family's childcare arrangements. Currently, only 40,000 people receive the childcare disregard under Family Credit.[54] This represents approximately one in ten of those claimant families where both parents are in work or the family is headed by a lone parent.[55] Taking all families with working parents (ie not only those on Family Credit), there are approximately 700,000 families with childcare costs.[56] This represents roughly seven in ten of all families where both parents are in work or the family is headed by a lone parent.[57] Some of these families will currently earn too much to be eligible for Family Credit but may become eligible to the more generous WFTC. Others may have childcare costs which are not eligible for help through the benefit system but may alter their arrangements to attract the new credit. However, it is not possible to accurately predict the numbers involved.

The increased generosity of the credit will potentially create a situation in which parents will have a clear financial incentive to obtain registered childcare rather than rely on informal networks such as friends and relatives. The IFS' £4bn estimate of the final cost of the childcare credit was based on the assumption that people currently offering informal childcare would register as childminders.[58] However, it remains unclear how feasible this would be. The wording of the section 71 of the *Children Act 1989* would appear to prevent relatives from registering as childminders:

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51 Social Security Select Committee, HC 29 1998-9, para 66
52 HM Treasury, *The Modernisation of Britain's tax and benefit system, number 3: the Working Families Tax Credit and work incentives*, 1998, para 3.06
53 Regulation 13A(2)(a) of the *Family Credit (General) Regulations 1987*, No 1973, as amended
54 DSS, *Family Credit statistics: quarterly enquiry*, May 1998
55 *Ibid*
56 DSS, *Family resources survey*, 1996/7 and ONS, *Labour Force Survey*, spring 1998
57 *Ibid*
58 "Row brews over cost of childcare credit scheme", *Financial Times*, 19 March 1998

(4) A person who -

(a) is the parent, or a relative of a child;
(b) has parental responsibility for a child; or
(c) is a foster parent of a child,

does not act as a childminder for the purposes of this Act when looking after that child.

Yet in its evidence to the Select Committee, Inland Revenue officials suggested that it was possible for relatives to register, presumably on the basis that the *Children Act* does not require registration in these circumstances but may not prevent it. During questioning from Julie Kirkbride MP, Tony Orhnial, Assistant Director of the Personal Tax Division at the Inland Revenue, made the following comments about take up of the childcare tax credit:

355. What did you mean by the behavioural effect?
(Mr Orhnial) Well, that is the behavioural effect.

356. Just that they would take it up?
(Mr Orhnial) Yes.

357. Not that they would arrange their living standards in order to take it up or perhaps ask mum to become a registered child-minder?
(Mr Orhnial) That is certainly an option. There is nothing——

358. There is nothing to stop mum becoming a registered child-minder?
(Mr Orhnial) There is nothing to stop anyone, if they can meet the conditions, and it is not for us to make a judgment on that, if they passed the conditions in previous years.[59]

The lack of clarity on this issue is a result of the fact that the definition of 'eligible childcare' (for those under the age of eight) is currently contained in legislation which was written to confirm who <u>must</u> register as child minders and does not consider those who may wish to but are not required to do so. The relative generosity of the childcare tax credit, compared to the financial support for childcare under Family Credit, is likely to offer an incentive to parents to ensure that their childcare costs come within the definition of 'eligible childcare' for the purposes of the credit.

The registration of childcare for children over the age of eight is not provided for in the *Children Act*. As the childcare disregard under Family Credit is available for children up to the age of 11, it was necessary to offer a wider definition of childcare to accommodate children in this age group. This definition is contained in Regulation 13A(2)(c) of the *Family Credit (General) Regulations 1987* and includes care provided in schools, such as

59 Social Security Select Committee HC 29 1998-9, pp 67-8

out of school clubs, or other establishments that are exempt from registration. However, this does not cover, for example, children over the age of eight looked after by a carer in his or her own home, unless that person also happens to look after children under the age of eight. The childcare tax credit will be payable for childcare costs for children up to the age of 14 (aged 16 if the child is disabled) which is likely to exacerbate this anomaly. The credit is being introduced against the background of a review of the regulation of childcare and an expansion in the supply of childcare through the National Childcare Strategy.[60] The review of the regulation of childcare will examine the adequacy of the current arrangements in protecting children and ensuring minimum standards are maintained. It will not assess how appropriate the regulations are in defining which types of childcare costs should be eligible for help under Family Credit or the new tax credits. It therefore remains to be seen whether further legislative clarification will be required to establish who can claim the childcare credits.

The wide discrepancy between the Government's estimate of the cost of the childcare tax credit as £200 million and the IFS' estimate of £4 billion represents different interpretations of the effect on people's childcare arrangements that the tax credits will have. The exact effect will depend on how easy it is for informal carers, such as relatives, to register as childminders and how great the incentive of the childcare tax credit will prove to be for those making their childcare arrangements.

60 For further details see DfEE, DSS, Ministers for Women, *Meeting the Childcare Challenge: a framework and consultation document*, Cm 3959, May 1998 and DfEE and DOH, *Consultation Paper on the Regulation of Early Education and Day Care*, 1998

IV Reform of the Tax and Benefit Systems

The establishment of the Martin Taylor Taskforce, and its subsequent recommendations, led to an increase in interest in the relationship between the tax and benefit systems. Possible reform in this area ranges from full-scale integration, though this now seems unlikely, to a gradual development of the roles of the DSS and the Treasury.

The possibility of integrating the benefits system with the tax system has been discussed ever since the 1940s when the Beveridge Report set out the basis for the present structure of social security.[61] The central argument for a closer alignment of the two systems, or even full integration, is summarised by Andrew Dilnot and Christopher Giles of the Institute for Fiscal Studies, as follows:

> Why have a tax system that takes money away from the poor and a social security system that gives it back?[62]

Proposals for integration fall into two main categories: a negative income tax, under which the tax system is extended to cover those whose incomes are below the tax threshold so that their liability to tax becomes negative; and, a social dividend or basic income guarantee, under which all individuals are paid a basic income free of tax.

Over the past twenty years, considerable interest in integration has been shown on three occasions: first, in the wake of a Green Paper on tax credits published during the tenancy of the Heath Government in 1972;[63] second, during the Thatcher Government's review of social security in the mid 1980s; and most recently with the current Labour Government's Task Force on tax and benefits. On the first occasion, the Select Committee which reported on this proposal recommended adoption of a scheme, but was split on party lines.[64] Subsequently the new Labour Government dropped the idea of a tax credit but decided to merge the system of child tax allowances and the social security benefit family allowance to create child benefit. On the second occasion, despite numerous proposals for integration being put forward, the Government's Green Paper, *The Reform of Social Security* contained no such proposals but instead suggested a system of Family Credit to be paid through the pay packet.[65] Most recently, the possibility of wholesale integration was again debated widely following the Government's decision in May 1997 to set up the Taylor tax and benefit task force. In the event Mr Taylor did not recommend 'full-blown integration', when his report was published at the time of the spring 1998 Budget, but rather a series of measures including the credits which will be introduced by the *Tax Credits Bill*.

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61 *Social insurance and allied services*, Cmnd 6406 1942
62 "Little benefit in other country's solutions", *Observer*, 5 October 1997
63 *Proposals for a Tax Credit System*, Cmnd 5116 1972
64 *Select Committee on the Tax Credit*, HC 341 26 June 1973
65 This was published in 3 volumes: Cmnd 9517, 9518 & 9519, 3 June 1985

On each occasion significant barriers to integration were considered. In his memoirs of the period at the end of the 1980s when the issue of integration arose in relation to social security reform, the then Chancellor Nigel Lawson outlines the "overwhelmingly practical case for keeping the two systems apart."[66] Mr Lawson goes on to argue:

> The key point is that the tax and social security systems are *not* simply mirror images of each other, with social security payments a form of negative taxation. Whereas liability for tax is measured over a period of 12 months, … income-related benefits have to be assessed on a weekly basis to ensure that poor families can always meet their basic needs. Again, tax liability is based on individual income; whereas means-tested benefits are based on the finances of the household, which is essential if benefit is to flow where the need is greatest. Moreover, income-related benefits look at circumstances such as the capital resources of the claimant , which the income system does not and should not do. It may be that the social security authorities pry too far; but the features of a system for taxing income to pay for public spending can hardly be the same as those of a system of payments to relieve poverty.[67]

Martin Taylor also concluded that these differences in the two systems could not be resolved and his rejection of full-scale integration appears to have resulted in the idea being dropped from the political agenda. However, the decision to accept the Taylor recommendations for a system of tax credits and transfer responsibility from the DSS to the Treasury, does raise issues about the changing roles of the these two parts of Government. Other measures can be seen as part of this change. For example, the administration of National Insurance Contributions (NICs) is to be moved from the DSS to the Inland Revenue by the *Social Security Contributions (Transfer of Functions etc) Bill 1998-9* and some commentators have suggested that this may be the first step towards merging tax and NICs.[68] Professor John Hills notes the new role for the Treasury as follows:

> The dominance of the Treasury in making welfare and social policy is new and striking. Not only have most of the significant developments been made as part of its Budget and spending arrangements, but the tax system is also being used as an explicit instrument of social policy.[69]

Under the proposals in the *Tax Credits Bill*, the Treasury will be taking responsibility for a system which will redistribute money to low income families while the DSS retains responsibility for the Child Support Agency (CSA). The CSA seeks to collect money from absent parents to contribute towards the costs of their children as a substitute for

[66] Nigel Lawson, *The View From No 11*, 1992, pp 596-597

[67] *Ibid*

[68] see John Hills, *Thatcherism, New Labour and the Welfare State*, Centre for Analysis of Social Exclusion, 1998, p 29

[69] *Ibid*, p 32

social security benefits. In its response to the original proposals for the CSA, the Social Security Select Committee recommended that the CSA should be a 'next steps' agency of the Inland Revenue rather than the DSS.[70]

It has been noted that one advantage of a system of tax credits administered by the Inland Revenue, rather than in-work benefits administered by the DSS, is that the public may accept increased spending in the form of "tax reductions" more readily than additional welfare spending.[71] This draws on the US experience where there is a clear distinction in terms of public perception between tax credits and the increasingly stigmatised welfare system. The UK system also appears to be moving towards a situation whereby the Treasury takes responsibility for the working poor while the DSS retains responsibility for those out of the labour market.

While full-scale integration appears to have been ruled out, the Government see the introduction of the WFTC and DPTC as a first stage.[72] Further steps will result in more changes in the respective roles of the Treasury and the DSS and may lead to further debate about the direction of social security policy.

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70 Social Security Select Committee, *Changes in maintenance arrangements: the White Paper "Children come first" and the child support bill*, 18 June 1991, HC 277-II 1990-91, xxii, para 10

71 Samuel Brittan, "How to make work pay", *Financial Times*, 22 January 1998

72 HM Treasury, *The Modernisation of Britain's Tax and Benefit system, Number Three: The Working Families Tax Credit and work incentives*, March 1998, p 4

V The Bill's Provisions

The Explanatory Notes which accompany the Bill provide detailed descriptions of each clause. The following is intended to provide a brief overview of the clauses for quick reference and should be read in conjunction with the Explanatory Notes.

A large amount of the Bill consists of the transfer of functions to the Inland Revenue and the Treasury from the DSS. Additional comment is made only where the clauses would create significantly different arrangements to those which exist under the current in-work benefit system.

A. Transfer of functions

Clause 1 replaces Family Credit and Disability Working Allowance with two new tax credits: Working Families Tax Credit and Disabled Person's Tax Credit.

Clause 2 provides for the transfer of the regulation making powers contained in social security legislation to the Board of Inland Revenue and the Treasury.

Clause 3 transfers to the Treasury the property, rights and liabilities relating to the functions being transferred to the Treasury from the DSS. This will allow the contracts currently held by the DSS to be transferred to the Treasury. As Benefits Agency staff in Northern Ireland are employed by the Northern Ireland Civil Service and tax matters are dealt with by staff of the Home Civil Service, this clause allows for these staff to be transferred also.

Clause 4 provides for WFTC and DPTC to be under the care and management of the Board of Inland Revenue. This would give the Inland Revenue the powers to employ staff to pay, manage and account for payments.

B. Payment of credits by employers

Clause 5 provides for the payment of tax credits by employers from April 2000. It would also give regulatory powers to require employers to:

- Make payments to employees when notified by the Inland Revenue
- Account for payments made and provide documentary evidence
- Provide documentary evidence to employees about the amount of any tax credit paid

Regulations under **clause 5(3)** may also provide for

- Arrangements to fund employers for the tax credits they have paid out including arrangements to offset payments against tax and National Insurance liability
- The recovery of excess payments made to employers to fund credits

- The calculation and payment of interest on amounts due or from the Board
- The appeals process in relation to these arrangements

The Inland Revenue has recently published information on the new tax credits and, in particular, how the system of payment through the pay packet is expected to operate.[73] The proposals will be the subject of regulations to be made under powers provided in the Bill and the announcement follows a period of consultation with employers' representatives. The information published by the Inland Revenue answers some of the questions raised by the Social Security Select Committee and which they criticised officials for failing to answer in their oral evidence.[74]

The Inland Revenue will calculate entitlement and notify employers of the amount to be paid to an individual employee and for how long payments are to be made. A copy of the assessment will be sent to the claimant. The employer will usually be expected to take responsibility for paying tax credits:

- 14 days after a notification is sent by the Inland Revenue for weekly paid employees; and
- 42 days after a notification is sent by the Inland Revenue in all other cases.[75]

The figure sent to employers will be a daily rate and employers will convert this to an amount equivalent to the normal pay period with the help of conversion tables provided by the Inland Revenue.[76] This way employees will receive their credits at the same time as their normal pay and it will be shown on the pay slip as a separate addition to net pay. It will not be calculated as an adjustment to PAYE as employers' representatives had wished.[77] This is because the Inland Revenue believe that adding a positive tax credit to the present system would result in distortions of an individual's tax position.

Where a claimant has more than one job, the employer who is paying the highest amount at the time the claim is made will be responsible for paying the credits.[78] When an employee leaves, the employer must provide a certificate of payments showing tax credits paid by the employer up to the date the employee leaves. The employee will then need to send this certificate to the Inland Revenue to ensure payments continue for the remainder of the assessment period. Responsibility will pass to the new employer if there is one and the Inland Revenue will make direct payments during the transition period. Self-employed claimants will be paid direct by the Inland Revenue.[79]

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73 Inland Revenue Press Release, *Booklet published on working families and disabled person's tax credits*, 17 December 1998. The booklet is available on the internet www.inlandrevenue.gov.uk

74 Social Security Select Committee, HC 29 1998-9, para 12

75 Inland Revenue Leaflet, W*orking families and disabled person's tax credits*, p 9

76 *Ibid*, p 8

77 see evidence from Bill Knox, Federation of Small Businesses, p 20

78 Inland Revenue Leaflet, W*orking families and disabled person's tax credits*, p 13

79 *Ibid*, p 6

Employers will be expected to recover the tax credits they pay out by deducting the amount paid from their National Insurance and tax liability. If the amount of the tax credits to be paid is expected to exceed the employer's tax and NI liability, employers will be able to apply to the Inland Revenue for the additional funding required. This will be the only circumstance under which advance payment will be provided by the Inland Revenue and employers are expected to "review - and if necessary modify - their budgeting procedures if they think that paying tax credits will cause them cash flow problems".[80]

C. Fraud prevention and penalties

Clause 7 would bring the arrangements for employer payment of tax credits within existing tax legislation and therefore enable the Inland Revenue to call for documentation in relation to such payments under Sections 20 and 20B of the *Tax Management Act 1970*.

Clause 8(1) and **8(2)** reproduce the effect of Section 95 of the *Tax Management Act 1970*. This covers the penalties applicable where a person fraudulently or negligently provides an incorrect return or accounts for income tax or capital gains tax. The arrangements for fraudulent and negligent claims of the new tax credits will be identical. Therefore, claimants will be liable to a penalty of no more than the difference between the amount of tax credit which they have been paid and the amount which they should have received if the claim been made correctly. This penalty will be added to the overpayment which the claimant will have to repay. Appeals against such penalties will be to the unified appeal tribunals set up by the *Social Security Act 1998*.

Currently, civil penalties for fraudulent claims of Family Credit and Disability Working Allowance can only be imposed if there are grounds for a criminal prosecution and the claimant accepts a penalty of 30% of the overpayment in return for immunity from prosecution.[81] These measures were introduced by the *Social Security Administration (Fraud) Act 1997*. The effect of the financial penalties contained in clause 8 of the *Tax Credits Bill* would be to extend the scope for civil financial penalties on claimants and reduce the burden of proof required for such penalties to be imposed. This would bring tax credits into line with other tax matters. According to the *British Tax Guide* "the Revenue frequently exact penalties after investigations though they seldom insist on the maximum amounts".[82]

Clause 8(3) provides for penalties for failure to provide information or to deliver documents. This applies to information from claimants and employers and a maximum

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80 *Ibid*, p 10
81 Section 115, *Social Security Administration Act 1992*, as amended
82 CCH Editions Ltd, *British Tax Guide*, Volume 1, para 141-360

penalty of £300 can be imposed **(clause 8(4)(a))**. A maximum additional penalty of £60 per day can be imposed if the information requested is not provided after the first penalty **(clause 8(4)(b))**. No penalty can be imposed after the offence is remedied. There are currently no provisions within Social Security legislation to impose penalties on claimants for failing to provide information to support a claim. If a claimant fails to produce information required to support a claim for benefit the claim will not usually be allowed and benefit will not be paid.

Fraudulent or negligent furnishing of information in respect of a claim may be liable to a penalty of no more than £3,000 under **clause 8(5)**. This applies to claimants and employers. Again, this would bring the arrangements for tax credits in to line with other tax matters. Similarly, **clause 8(6)** provides for a penalty of up to £3,000 where an employer refuses or repeatedly fails to make tax credit payments, to the point that the Inland Revenue need to make direct payments to the claimant. **Clause 8(7)** provides for penalties for employers where they have fraudulently or negligently made or received incorrect payments of tax credits. Penalties under this clause shall not be imposed until the end of the tax year and only one penalty can be applied in relation to an individual employee's claim.

Schedule 4 deals with procedures for penalties for non-compliance with obligations under the legislation. This includes the provision that interest will be payable on unpaid penalties imposed under this section **(para 8)**.

Under the measures contained in this Bill, claimants will be appeal to against such penalties to the unified Social Security Appeal Tribunals and employers to the tax commissioners.

Clause 9(1) provides that no penalty can be imposed in relation to the failure to provide information, evidence or documents once the failure has been rectified. **Clause 9(3)** would allow employers and claimants extra time to remedy the failure to provide documentation and, in the case of employers, make payments of tax credits.

Section 64 of the *Social Security Act 1998* introduced new sections into the *Social Security Administration Act 1992.* The new sections 121C and 121D provide powers to the Secretary of State to transfer the responsibility for unpaid company national insurance debts to directors of a company if they are considered to have acted in a negligent or fraudulent way and thus contributed to the non-payment of the debt. **Clause 10** provides for company directors to have the same responsibility for unpaid tax credits. Regulation making powers under this section of the *Social Security Administration Act 1992* will transfer to the Board of the Inland Revenue.

D. Miscellaneous provisions

Clause 6 would protect employees from unfair dismissal if the fact that they are entitled to tax credits is used against them by employers. The details of the arrangements for protection against unfair dismissal are contained in **Schedule 3** to the Bill. This would add new subsections to the *Employment Rights Act 1996* giving protection against unfair dismissal from day one of employment. This would bring tax credits into line with the protection of employees from unfair dismissal where they are exercising a statutory right, for example, under the national minimum wage legislation.

Clause 11 provides for tax credits to be added to the Inland Revenue's general restrictions on the disclosure of information. These restrictions are contained in Section 182 of the *Finance Act 1989* and make it a criminal offence for a person to disclose information held by him in the exercise of tax functions about any matter relevant to tax in the case of an identifiable person. This does not apply if (or if he believes) he has lawful authority or the information has lawfully been made available to the public, or if the person to whom the matter relates has consented.

Clause 12 allows for forms which refer to Family Credit and Disability Working Allowance to be used after the introduction of the tax credits. This will enable work outstanding on claims for Family Credit and Disability Working Allowance to be dealt with after the transfer of functions.

In order to be eligible for Disability Working Allowance, claimants must have been receiving a qualifying benefit within the previous 56 days. **Clause 13** would extend this to 182 days under DPTC thus making it easier for people to qualify for the new tax credit by giving them longer to find work after their condition has improved. The Disability Benefit Consortium, an alliance of disability groups, has welcomed this concession.[83] The issue for DPTC is likely to be that of take up rates and how large an effect the relaxation of the eligibility criteria will have. The Social Security Select Committee made the following comments:

> 65. It is to be hoped that the improvements which DPTC will offer over the present DWA will lead to a considerable improvement in the current low levels of take-up. Striking evidence quoted by the Disablement Income Group in their written evidence indicated, for example, that 20 per cent of people in supported employment were eligible for DWA but did not receive it. **We recommend that the Government should implement an active take-up strategy for DPTC, publishing annual targets for take-up and reporting annually to Parliament on progress in meeting those targets and the methods used to achieve them.**[84]

The provisions in the Bill will extend to Northern Ireland **(Clause 14)**. Similarly the provision of tax credits is a reserved matter for Westminster and will not come under the authority of the future Scottish Parliament and Welsh Assembly.

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83 *Disability Benefit Consortium Policy Group response to the HM treasury proposals for Disabled Person's Tax Credit*, 22 December 1998

84 Social Security Select Committee, HC 29 1998-9

Clauses15-18 deal with the definition of terms used in the Bill, transitional provisions to facilitate the preparation work before the introduction of the credits in October 1999 and payment by employers in April 2000, and the commencement and extent of the Bill.

The costs of transferring staff and implementing new IT systems are estimated as follows:

- £16.9 million in 1998/9
- £31m in 1999/2000
- £28m in 2000/01
- £24m in 2001/02[85]

The Inland Revenue expects to offset some of these costs in the longer term by identifying efficiencies in the operation of the new system.[86]

Schedule 1 to the Bill lists the legislation in which the names Family Credit and Disability Working Allowance need to be replaced by Working Families Tax Credit and Disabled Person's Tax Credit.

Schedule 2 lists the references to the functions which are transferring to the Treasury and Officers of the Board of the Inland Revenue. It also lists the modification of various sections of social security legislation. This includes the removal of the obligation on claimants of Family Credit and Disability Working Allowance to co-operate in seeking maintenance from an absent parent through the CSA. The penalty for non-compliance is currently a reduction in benefit of £20.14 per week.

Schedule 5 allows the Inland Revenue to pool the information they hold in relation to tax credits, tax, national insurance contributions, statutory sick pay, statutory maternity pay and functions in relation to pension schemes. It also provides for the mandatory exchange of information between the Inland Revenue, the DSS and local authorities in relation to the administration of council tax benefit and housing benefit.

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85 Explanatory Notes, p 18

86 *Ibid*

VI Reaction to the Bill

The structure of the new tax credits and the effect they will have on claimants' marginal rates of tax were announced at the time of the March 1998 Budget. The main political parties and interest groups reacted to the proposals at the time.[87] In the Budget debate, William Hague said:

> Today the Chancellor has produced a plan: a reform that increases expenditure, increases the number of people tangled up in the benefit system, and increases complexity. The central reason for that mess is the scrapping of Family Credit and its replacement with the Working Families Tax Credit … [WFTC] will cost the taxpayer a great deal more, will be a disincentive to work for thousands of people, and will mean that hundreds of thousands of women will see more than £50 a week taken from their purse and placed into their partner's wallet.[88]

In his speech on the Budget proposals, David Rendel, Liberal Democrat Spokesperson on Social Security, welcomed the introduction of the tax credits as a way of reducing stigma for claimants. However, he went on to criticise certain elements of the proposals such as the transfer of payments from men to women and the risk of fraud.[89] The Low Pay Unit welcomed the proposals but had reservations about the administration and flexibility of the scheme.[90] The Daycare Trust described the childcare tax credit as "the first much needed step towards making childcare more affordable in the UK".[91]

There has been little reaction to the publication of the Bill. This may be due to the fact that the primary legislation proposed is largely enabling legislation and the details will be in the draft regulations which have not been published to date. Also, most pressure groups with an interest in this area gave oral or written interest to the Social Security Select Committee. In the debate on the Queen's Speech the main opposition parties made the following comments on the announcement that a Bill would be introduced in this parliamentary session. Iain Duncan-Smith, Shadow Secretary of State for Social Security, said:

> Nothing in the WFTC will help the single-earner household. We have seen from the figures--I shall cite them in a moment--that the WFTC will create greater problems. The Chairman of the Social Security Select Committee, the hon. Member for Roxburgh and Berwickshire, referred to the likelihood of increased fraud, partly because employers will know which employees are receiving the credit, as will their colleagues. That will lead to stigma and increased costs. Most businesses do not want that to happen … the working families tax credit will

87 Further details of these reactions to the original announcement are contained in Research Paper 98/46
88 HC Deb 17 March 1998 cc 1116-7
89 HC Deb 19 March 1998 c1450-1453
90 Low Pay Unit Press Release, 17 March 1998
91 Daycare Trust Press Release, 17 March 1998

> attack single-earner couples. I said that the difference between single-earner couples and lone parents will be made more stark by the working families tax credit. If a single-earner couple and a lone parent each earn £15,000 a year, the couple will receive next to nothing from the WFTC, and the single parent will receive about £70 a week more. That creates a position of divide and rule, it causes chaos for those who want to provide for themselves and to save, and it creates disincentives for those who are able to do so.[92]

Steve Webb, Social Security Spokesperson for the Liberal Democrats, said:

> The working families tax credit puts me in a quandary. It is £1.5 billion for the low paid. Perhaps low paid is stretching it a bit, given that it will reach higher rate taxpayers, but in principle it is for the lower paid. On the whole, I tend to favour extra money for the poor and the low paid. However, that is about the only good thing that I can say about the scheme, because it is incredible how little evidence there is for the Government's views on how that £1.5 billion should be spent.
>
> It is said that the working families tax credit will make work pay. That sounds laudable. It is said to be good for work incentives. Whom is it supposed to encourage into work? It applies to only two groups--lone parents and working couples or couples with children. The biggest barriers for lone parents are not primarily low pay or the incentive structure, but the availability of child care and jobs. In the debate some months ago on cutting lone parent benefit, the hon. Member for Cynon Valley (Ann Clwyd) said that there were barely any vacancies at her local job centre, but there were dozens of lone parents looking for work. The failure to tackle the supply of jobs will not help incentives.
>
> There is a more fundamental issue. The Chancellor has cut the taper in the working families tax credit. Clearly, that will mean that fewer people will lose 70p in the pound at the margin, but more people will lose 50p in the pound at the margin. Is that unambiguously good for incentives? Where is the evidence? The Chancellor has not put any forward and I do not suppose that there is any. It is an act of faith.
>
> What about the argument that paying the benefit through the pay packet rather than through the social security system will reduce stigma? Where is the evidence for that? The money will still have to be claimed. Where is the evidence that the take-up of the working families tax credit will be greater than the high take-up of family credit? There is none.[93]

The Disability Benefit Consortium, an umbrella group of organisations for disabled people, "warmly welcomes" the changes from DWA to DPTC that will make the tax credit more generous than the benefit it replaces.[94] The Consortium also welcomes the

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92 HC Deb 26 November 1998 cc416-8

93 HC Deb 1 December 1998 c748-9

94 *The Disability Benefit Consortium Policy Group response to the HM Treasury proposals for Disabled Person's Tax Credit*, 22 December 1998

extension of the childcare tax credit in respect of children aged 14, or 16 in the case of disabled children. It does express concern, however, that the poverty trap problems inherent in the current system will be imported into the new structure unless changes are made to the structure of Housing Benefit. It also highlights the particular problems of childcare for those with disabled children:

> We are still concerned that eligible childcare does not extend to childcare provided in the child's home perhaps by formal arrangement. This may be an issue for disabled children especially if their home is adapted for them or if they have difficulty responding to someone they do not know.

VII Further Reading

Social Security Select Committee, *Tax and Benefits: an interim report,* 19 November 1997, HC 283 1997-8

Social Security Select Committee, *Tax and Benefits: pre-Budget report*, 4 March 1998, HC 423 1997-8

Social Security Select Committee, *Tax and Benefits: implementation of tax credits*, 2 December 1998, HC 29 1998-9

HM Treasury, *The modernisation of Britain's tax and benefit system: employment opportunity in a changing labour market,* November 1997

HM Treasury, *The modernisation of Britain's tax and benefit system number two - work incentives: a report by Martin Taylor*, 1998

HM Treasury, *The modernisation of Britain's tax and benefit system number three - the Working Families Tax Credit and work incentives*, 1998

Inland Revenue, *Working Families Tax Credit and Disabled Person's Tax Credit: proposals for a new system of tax credits for people in work from October 1999*, December 1998

J Goode, C Callender, R Lister, *Purse or wallet? Gender inequalities and income distribution within families on benefit*, Policy Studies Institute, 1998

Rowlingson and Berthoud, *Disability, Benefits and Employment*, DSS Research Report No 54, 1996

House of Commons Library Research Paper 98/46, *Working Families Tax Credit and Family Credit*, 9 April 1998

Research Paper 98/46 includes a section on international comparisons and, in particular, tax credit schemes in the USA and Canada. The main sources for information on the merits of these schemes are:

- Jeffrey Liebman, *Lessons about tax-benefit integration from the US Earned Income Tax Credit experience*, Joseph Rowntree Foundation 1997

- Michael Mendelson, *The WIS that was: replacing the Canadian Working Income Supplement*, Joseph Rowntree Foundation 1998