The Child Tax Credit and the Working Tax Credit: an introduction

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The Child Tax Credit and the Working Tax Credit were introduced in April 2003. This note briefly describes the background to the new tax credits and outlines the main features of the system. A further series of standard notes will give details of particular aspects of the new tax credits.

Contents

A. Introduction

In April 2003 both the Working Families' Tax Credit (WFTC) and the Disabled Person's Tax Credit (DPTC) were abolished and two new tax credits were introduced:

- The **Child Tax Credit**, payable to people in or out of paid work who have children; and

- The **Working Tax Credit**, payable to people in low-paid work, including those without children.

The stated purpose of the new tax credits is to 'tackle child poverty and help to make work pay'.[1] The new tax credits differ from the previous system in a number of respects:

- Assessment and awards are made annually, with reassessment on significant changes in income or other family circumstances

- Awards are calculated on the basis of gross taxable income

- Child Tax Credit is paid to the main carer in a family

- Working Tax Credit extends in-work support, for the first time, to people without children.

The Child Tax Credit is also replacing the child allowances within Income Support and income-based Jobseeker's Allowance, and the increases for child dependants paid with non-means tested benefits such as Incapacity Benefit. The intention is that the Child Tax Credit, along with Child Benefit, will constitute a 'single, seamless system of support for families with children, payable irrespective of the work status of the adults in the household.'[2] The Government hopes that this will ease the transition from welfare to work for families with children, and create a more inclusive system of support for children that does not stigmatise poorer families.[3]

At 5 July 2004 6.1 million families containing 10.5 million children were in receipt of tax credits.[4] Total expenditure on tax credits is projected at £13.8 billion for 2004-05.[5]

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1 HM Treasury, *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, Number 10, April 2002, para 1.2: http://www.hm-treasury.gov.uk/media/8D5/BD/new_tax_credits.pdf

2 *ibid.* para 2.3

3 *ibid.*

4 Inland Revenue, *Child and Working Tax Credits: Summary Statistics July 2004*: http://www.inlandrevenue.gov.uk/stats/personal-tax-credits/cwtc-quarterly-stats.htm

5 HM Treasury, *Budget 2004*, HC 301 2004-05, 17 March 2004, Table C11: http://www.hm-treasury.gov.uk/budget/budget_04/bud_bud04_index.cfm

B. Background

1. A brief history of in-work benefits[6]

The first social security benefit for people in low-paid work, Family Income Supplement (FIS), was introduced as a stopgap measure in 1971, in anticipation of a tax credit scheme which was never actually introduced. In the event, FIS lasted until 1988 when it was replaced by Family Credit.

Family Credit had first been proposed in the 1985 Green Paper, *Reform of Social Security*.[7] The original intention was that Family Credit would operate as a tax credit, either offsetting tax or being paid through the pay packet. However, this was vigorously opposed, partly because it would involve a transfer of resources from men to women (or "wallet to purse", as this was termed), but also because of the burden on employers.[8] In the face of opposition in the House of Lords the Government announced that the new benefit would be paid directly to recipients.[9]

Family Credit was more generous than FIS, and this, together with greater alignment with other means tested benefits, was designed to ease the 'unemployment trap' (the situation where people may be no or little better off in low-paid work than out of work and on benefits). While FIS was withdrawn at a rate of 50 per cent of any increase in gross income Family Credit had a withdrawal rate of 70 per cent and was based on net income. The overall effect was to reduce the disincentives for low earners.[10] Family Credit was payable for six months at the same rate regardless of changes in circumstances, whereas FIS awards were for 12 months.

There were a number of further changes made to Family Credit after its introduction. These included:

- The reduction in the working hours threshold from 24 to 16 hours a week in 1992

- The introduction of a disregard form certain childcare costs in October 2004. The maximum weekly amount that could be offset against earnings was increased from £40 a week to £60 in April 1996, and to £100 a week (for families incurring childcare costs for two or more children) in June 1998

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6 For further detail see Research Paper 98/46, *Working Families Tax Credit and Family Credit*, 9 April 1998; and 99/3, *Tax Credits Bill*, 18 January 1999

7 Cmnd 9517, June 1985

8 For debate see SC Deb (B) 18 March 1986 cc 933-985

9 HC Deb 23 June 1986 cc 40-43

10 The 'poverty trap' can however never be eliminated entirely in a means-tested system, since such benefits, by definition, require the withdrawal of support as income rises.

- The introduction of a bonus for people working more than 30 hours a week from July 1995.

A further development came in April 1992 with the introduction of Disability Working Allowance (DWA), an in-work means-tested benefit for people with a long-term illness of disability. DWA operated in a similar way to Family Credit.

A recurring concern with both FIS and Family Credit was the level of take-up. Take-up of FIS was estimated at around 50 per cent in its early years, and by 1986-87 estimated caseload take-up was still only 51 per cent, although on an expenditure basis take-up was slightly higher (60 per cent).[11][12] In its final year of operation Family Credit was received by around 757,000 families.[13] Take-up was 66 to 70 per cent on a caseload basis, and 73 to 79 per cent by expenditure.[14] In its last full year of operation (1998-99), total expenditure on Family Credit was £2,429 million.[15]

2. Working Families' Tax Credit

In May 1997, the Chancellor, Gordon Brown, set up a task force under Martin Taylor, the chief executive of Barclays. The terms of reference as set out in the Labour Manifesto were to "examine the interaction of the tax and benefits system 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."[16]

In his July Budget, the Chancellor made it clear that the task force had been asked at an early stage to look at the advantages of introducing a tax credit drawing upon the American experience of the earned income tax credit (EITC).[17]

Martin Taylor's report concluded that the EITC had much in its favour, although a UK tax credit would have to be different in a number of respects:

> I concluded that the US EITC had much to recommend it. Although the differences between the UK and US tax and benefit systems need to be recognised, there is no overriding reason why the UK should not have a tax credit payable through the pay packet to families in work. The advantages were clear:

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[11] Caseload take-up compares the number of benefit recipients with the number who would be receiving benefit if everyone took up their entitlement during the period. Expenditure take-up compares the total amount of benefit received with the total amount that would be received if everyone took up their entitlement.

[12] DSS, *Social Security Statistics 1991*, Table H5.02

[13] DSS, *Social Security Departmental Report*, Cm 4614, April 2000, Table 10

[14] DSS, *Income Related Benefits: Estimates of Take-up in 1998/99*

[15] Cm 4614, Table 6

[16] Labour Party, *New Labour because Britain deserves better*, 1997 p 13

[17] HC Deb 2 July 1997 c.210

- As a tax credit rather than a welfare benefit, it would reduce the stigma currently associated with claiming in-work support;
- It would prove more acceptable than social security benefits to most claimants and taxpayers as a whole;
- Paid through the wage packet, it would reinforce the distinction between the rewards of work and remaining on welfare;
- It could help lower marginal tax and benefit withdrawal rates.[18]

The Working Families' Tax Credit (WFTC) and Disabled Person's Tax Credit (DPTC) replaced Family Credit and Disability Working Allowance respectively in October 1999. The following table compares the main features of Family Credit and WFTC. The amounts and thresholds are those which applied when WFTC was first introduced.

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
• One adult credit per household, plus age related credit for each child	• One adult credit per household, plus age related credit for each child

[18] HM Treasury, *The Modernisation of Britain's Tax and Benefit System Number Two - Work Incentives: A Report by Martin Taylor*, 1998 p 22

• 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

As the table indicates, the main differences were the method of payment, the higher threshold for withdrawal and the lower withdrawal rate. However, the overall structure of WFTC was very similar to Family Credit.[19] Indeed, Wikeley, Ogus and Barendt's *The Law of Social Security* comments:

> The value of the tax credit was made substantially more generous than family credit in a number of respects, but the underlying rules of entitlement were not changed at all. The introduction of tax credits was essentially a re-branding. All the changes that were made could equally have been brought forward under the existing family credit scheme.[20]

By early 2003 1.48 million families were in receipt of WFTC, and 40,000 were in receipt of DPTC.[21] Take-up of WFTC in 2001-02 was estimated at 71 to 74 per cent of families on a caseload basis, and 80 to 85 per cent on an expenditure basis.[22] Total expenditure on WFTC and DPTC was £6,458 million in 2002-03.[23]

3. The new tax credits

The Government set out proposals for a new 'integrated child credit' and 'employment tax credit' in the 2000 Budget. The integrated child credit would bring together support for children from a variety of existing sources:

> **5.16** Although the reforms so far have made progress in tackling child poverty and delivering new resources fairly, the Government is determined to go further in

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19 The Disabled Person's Tax Credit was likewise very similar to DWA.

20 5th edition, 2002, p 386

21 Inland Revenue, *Working Families' Tax Credit Statistics: Summary Statistics United Kingdom February 2003*; *Disabled Person's Tax Credit Statistics: Summary Statistics United Kingdom January 2003*: http://www.inlandrevenue.gov.uk/stats/personal-tax-credits/menu.htm

22 Inland Revenue, *Working Families' Tax Credit: Estimates of Take-up rates in 2001-02*, 2003: http://www.inlandrevenue.gov.uk/stats/wftc/takeup_rates.htm

23 *Report of the Commissioners of Her Majesty's Inland Revenue for the year ending 31st March 2004*, Cm 6050, December 2003, p 101. This total includes both the negative tax element (the part of the credit that is less or equal to the tax liability of the family) and payments exceeding this liability. The negative tax element was £790 million and the expenditure element was £5,668 million.

improving the transparency and administration of income-related payments through the tax and benefit system. **The Government will therefore introduce an integrated child credit from 2003**.

5.17 The integrated child credit will bring together the different strands of support for children in the Working Families' Tax Credit, the Disabled Person's Tax Credit, Income Support and the Children's Tax Credit, building on the foundation of universal Child Benefit. It will be paid to the main carer in families in and out of work, and as a tax credit it will be administered by the Inland Revenue. The integrated child credit will be complemented by an employment child credit paid through the wage packet to working households, as described in Chapter 4.

5.18 The integrated child credit will create:

- a more transparent system of support for children to help parents to understand what they can expect to receive, and facilitate public debate about the appropriate level of support;
- a portable and secure income bridge spanning welfare and work to improve work incentives;
- a common framework for assessment and payment to give every family a stake in the system of child payments while allowing extra resources to be directed at those most in need;
- a system where all support for children is paid to the main carer; and
- efficiency gains for Government and reduced hassle for parents.[24]

The Budget Report stated that the employment tax credit, which would broadly replicate the adult support within WFTC, "…could provide a clearly understood generalized platform for in-work support alongside the National Minimum Wage and the New Deal, demonstrating the benefits of work over welfare and providing additional financial support to people in low paid work".[25] The Government was still considering how far to extend in-work support to people without children.[26]

Further details of the Government's plans were given in a separate Budget 2000 paper, *Tackling Poverty and Making Work Pay – Tax Credits for the 21st Century*.[27]

On 19 July 2001 the Government issued a consultation paper and partial regulatory impact assessment (RIA) for the new tax credits.[28] The deadline for responses was 12 October 2001. The Government's response was issued as an Inland Revenue press notice following the First

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24 HM Treasury, *Budget 2000*, HC 346 1999-2000, 21 March 2000
25 *ibid.* para 4.73
26 *ibid.* para 4.72
27 http://www.hm-treasury.gov.uk/budget/budget_2000/bud_bud00_index.cfm
28 Inland Revenue, *New Tax Credits: Supporting families, making work pay and tackling poverty: A Consultative Document*: http://www.inlandrevenue.gov.uk/consult_new/new_tax_credit.htm

Reading of the *Tax Credits Bill* on 28 November 2001.[29] The Bill received Royal Assent on 8 July 2002. The legislation governing the new tax credits is contained in the *Tax Credits Act 2002* and in a series of statutory instruments made under it.

A paper published by the Treasury at the time of the 2002 Budget, *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, described the detailed structure of the new tax credits and set out the Government's thinking on how the new system would work. It also outlined the proposed transitional arrangements and the rates and thresholds for the new tax credits.[30]

Detailed guidance for Inland Revenue staff and others is contained in the *Tax Credits Technical Manual* (TCTM), which is available at the Inland Revenue website.[31] Paragraph TCTM01002 gives the following overview of the structure and purpose of the new tax credits:

> **The purpose of CTC and WTC**
> From April 2003, the Child Tax Credit (CTC) and Working Tax Credit (WTC) provide a new system of support to help families, tackle child poverty and make work pay. They separate support for adults from support for children in a family, while providing a common framework for assessing entitlement.
>
> CTC and WTC have replaced:
> - The Children's Tax Credit;
> - Working Families' Tax Credit;
> - Disabled Person's Tax Credit;
> - The New Deal 50+ Employment Credit.
>
> In October 2003, the Minimum Income Guarantee, MIG, was replaced by the Pension Credit. The Pension Credit provides the money for the adults previously provided by the MIG. CTC replaces the money for any children. And, in 2004, CTC will replace the money for children in Income Support and income-based Jobseeker's Allowance.
>
> **CTC**
> Building on the foundation of universal Child Benefit, the CTC brings together income-related support for children and for 16-18 year olds in education into a single tax credit, payable to the main carer, most often the mother. Families can claim whether or not the adults are in work.
>
> **WTC**
> The WTC provides in-work support for low income people, with or without children. It extends eligibility to in-work support to people aged 25 and over without children

29 HM Treasury press notice, *Details announced of new tax credits to make work pay, support children and tackle poverty*, 29 November 2001: http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2001/press_132_01.cfm

30 http://www.hm-treasury.gov.uk/media/8D5/BD/new_tax_credits.pdf

31 http://www.inlandrevenue.gov.uk/manuals/tctmanual/index.htm

or a disability. It contains a childcare element in recognition of extra costs faced by working parents with childcare needs. The childcare element is paid directly to the main carer of the children and entitlement to the childcare element is extended to include childcare by an approved home carer providing care in the child's own home.

CTC and WTC

The system of support provided by CTC and WTC is designed to deliver:

- A secure stream of income for families with children which does not depend on the employment status of the parents, creating a stable income bridge when families move into work;
- Help to tackle poor work incentives and persistent poverty among working people;
- A system in which all support for children is paid direct to the main carer - usually the mother - in line with Child Benefit;
- A common framework for assessment, so that all families are part of the same system;
- An annual system, under which awards run in line with the tax year;
- A modern income test, which brings the definition of income for tax credits more closely into line with tax; and
- A responsive system, in which a family's tax credit award can be adjusted to reflect changes in a family's income and circumstances. The system responds to all falls in income in the current tax year, compared with last, but only responds to rises in income of more than £2,500, so that recipients do not see their tax credit for the current tax year reduce as soon as their income rises.[32]

C. The new tax credit system

1. How awards are calculated[33]

A family’s tax credit award is based on:

- Their **current circumstances**: for Child Tax Credit (CTC), the number of children; for Working Tax Credit (WTC), whether (and for how many hours) they are working, and the amount of any eligible childcare costs; and

- Their **gross income** (joint income for a couple) before income tax and National Insurance, but after deducting pension contributions.

Tax credit awards are based initially on a family’s current circumstances and its income for the previous tax year. When the current year’s income (or an estimate) is reported, the award is recalculated, but the first £2,500 of any increase above the previous year’s income is ignored. If the family’s circumstances do not change during the year, and no change is

[32] http://www.inlandrevenue.gov.uk/manuals/tctmanual/TCTM01002.htm

[33] This section is based on the description given in the 2004-05 edition of the HM Treasury *Tax Benefit Reference Manual*

prompted by the reporting of the current year's income, the award runs for 12 months and is then renewed at the end of the tax year. Some changes of circumstances (including a change in the number of adults in the household, and significant changes in childcare costs) must be reported in-year by the claimant, and the award is adjusted accordingly. Other changes in circumstances, and changes in income, do not need to be reported in-year, but claimants may do so if they wish. If they do not report changes in circumstances or changes in income as they occur, there is an "end of year reconciliation" which may or may not result in a recalculation of their award for the year. At this point, the following year's award is also initially determined.

The first stage in calculating a family's tax credit award involves calculating the maximum award to which the family would be entitled. This involves adding together the different elements for which the family is eligible.

CTC includes a "family element" which is available to any family with a qualifying child or young person and it contains separate "child elements" for each child. There are also elements providing additional support for families with a disabled or severely disabled child, and a higher family element is payable in the year following a child's birth.

WTC includes a basic element for all those eligible for WTC, plus a couples/lone parent element, disabled worker elements, an element for people aged 50 or over who are returning to work, and an element for people or couples working at least 30 hours a week. WTC also includes a childcare element.

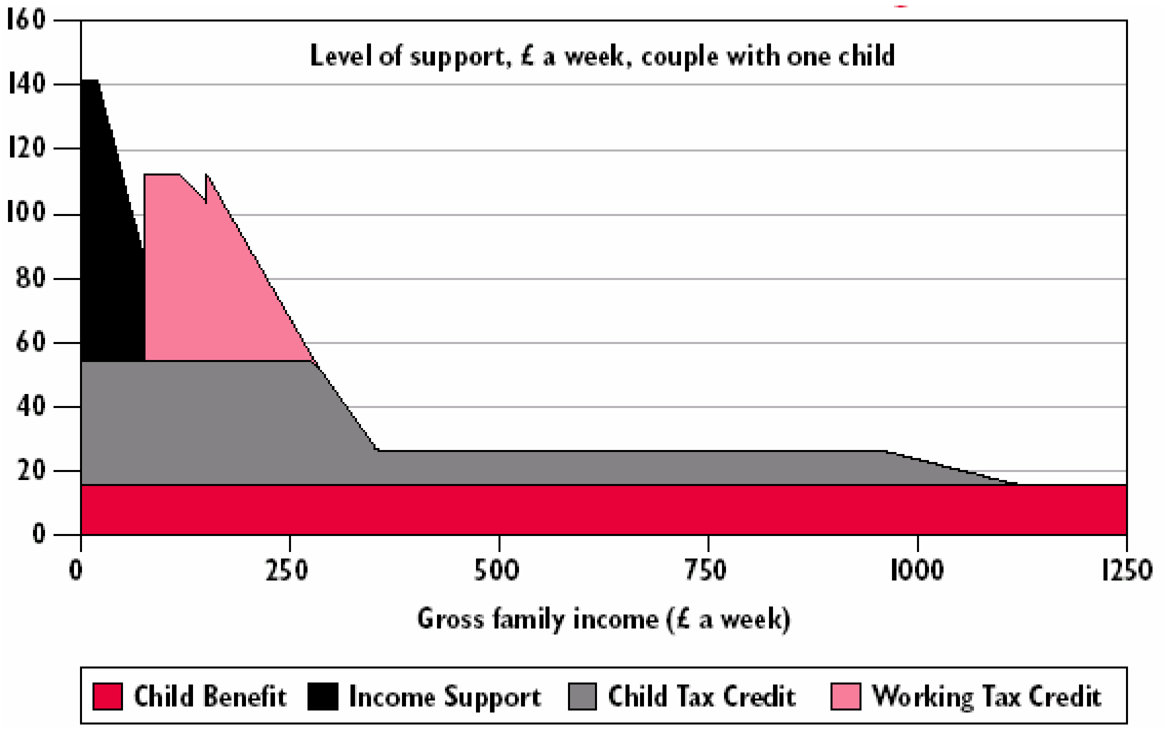
Individuals and couples with an income up to the threshold of £5,060 a year receive the maximum tax credit award. Those with an income above the threshold of £5,060 receive less than the maximum amount, with the award being reduced at the rate of 37p for each pound of additional gross income. For families eligible for CTC with incomes up to £50,000 the minimum award payable is the family element (including where relevant the "baby addition"). This minimum award is tapered away gradually as income exceeds £50,000.

The combined taper for WTC and CTC operates in the following order:

- The basic element of the WTC is the first to be tapered away
- When this is exhausted, the other elements of WTC are withdrawn, with the childcare element the last to be tapered away
- Once WTC is exhausted, CTC starts to be tapered away
- The family element of the CTC is retained until income reaches £50,000 a year
- Beyond £50,000, the family element is tapered away at a rate of £1 for every £15 of income.

The rules are slightly different for families entitled to CTC but not WTC. Families in this situation who receive Income Support or income-based Jobseeker's Allowance automatically receive the maximum CTC award. Other families eligible for CTC are only entitled to maximum CTC until their income reaches £13,480, at which point it begins to be tapered away. The latter group will include, for example, families headed by student nurses, since they are not deemed to be in "qualifying remunerative work" and are not therefore entitled to WTC.

The following chart helps to illustrate the structure of the new tax credits by indicating a hypothetical family's entitlement at different levels of gross weekly income. The chart – from the April 2002 HM Treasury Paper *The Child and Working Tax Credits* - is based on tax credit and benefit rates for 2003-04 and should not therefore be used to estimate a family's entitlement in the current tax year. The basic structure of the tax credits system, and the first and second income thresholds, are however unchanged from 2003-04.



The band along the bottom of the chart represents Child Benefit, which is paid to families both in and out of work, and is not affected by income. At the lowest gross income levels it is assumed that no one in the family is in full-time work and that the family is also in receipt of Income Support and full Child Tax Credit. As gross income rises, entitlement to Income Support drops (Income Support is withdrawn pound for pound for earnings above a small disregard). When the number of hours worked exceeds 16 hours a week, the family ceases to be entitled to Income Support and becomes entitled instead to Working Tax Credit. The family is entitled to the maximum tax credit[34] until gross income reaches £5,060 a year (£97 a week), at which point the award starts to taper away at a rate of 37p for every pound of additional gross income. Once WTC is exhausted CTC begins to taper away, until only the family element remains. This is retained until income exceeds £50,000 (around £960 a week), when it too is tapered away at a rate of 1 in 15.

[34] The "kink" in the WTC is due to the family becoming entitled to the WTC 30 hour element

Further examples of tax credit award calculations for different families are given in the Appendix.

2. The Child Tax Credit

a. Entitlement

Child Tax Credit is payable to all families responsible for at least one child under 16 (or under 19 if in full-time education up to A level or equivalent standard) until 1 September following their 16th birthday.

A person is treated as responsible for a child if the child "normally lives" with them.[35] This is not defined in regulations. If there are competing claims for CTC for the same child, it is paid to the person with "main responsibility" for him/her. Again, this is not defined in the regulations, but Inland Revenue guidance gives the following examples of factors that may be taken into account:

- Who the child normally lives with and where they keep the majority of their belongings such as clothes, toys;
- Who is responsible for the day to day spending for the child such as buying clothes, food and providing pocket money;
- Who the main contact is for school/nursery/childcare;
- Who is responsible for the health care and hygiene of the child such as making appointments with the doctor/dentist, doing the child's laundry;
- What is the registered address for contact for the school/nursery/child care, healthcare; and
- Who has legal custody of the child[36]

This is not an exhaustive list, however; other factors may be taken into account. There is no provision to split the Child Tax Credit between different people.

b. CTC elements

The maximum Child Tax Credit award is made up of different elements:

- The **family element**, which is paid at twice the normal rate for families with a child under the age of one (this is also called the **baby addition**);
- **Child elements** for each child or qualifying young person in a family; or
- **Disabled child** and **severely disabled child** elements.

[35] Regulation 3(1) *Child Tax Credit Regulations* SI 2002/2007

[36] Inland Revenue, *Tax Credits Technical Manual*, para TCTM02201. Available at: http://www.inlandrevenue.gov.uk/manuals/tctmanual/TCTM02201.htm

The disabled child element is payable if Disability Living Allowance is payable in respect of the child, or the child is registered/certified blind, or has been taken off the blind register within the 28 weeks before the date of the claim.[37]

The severely disabled child element is payable if the highest rate DLA care component is payable in respect of the child (or would be in receipt but for suspension or hospitalization).[38]

The child element, the disabled child element and the severely disabled child element are mutually exclusive. One element only – the highest for which the child or young person qualifies – will be payable for each child or young person.

c. Maximum rates

The maximum value of each of the CTC elements in 2004-05 is given below.

Family element	£545
Family element (child under one)	£1,090
Child element	£1,625
Disabled child element	£3,840
Severely disabled child element	£4,730

3. The Working Tax Credit

a. Entitlement

People can qualify for the Working Tax Credit via one on four “routes”.

People aged 16 or over who with **dependent children** can qualify for WTC if:

- They, or their partner, work at least 16 hours a week; and
- They, or their partner, are responsible for a child or young person who normally lives with them.

People aged 16 or over who are **disabled** can qualify for WTC if:

- They work at least 16 hours a week; and
- They have a physical or mental disability which puts them at a disadvantage in getting a job; and
- They satisfy either the ‘qualifying benefit’ test or the ‘fast-track’ rules.[39]

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[37] Regulation 8(2) *Child Tax Credit Regulations* SI 2002/2007

[38] *Ibid.* regulation 8(3)

[39] The ‘qualifying benefit’ test and the ‘fast-track’ rules are explained in Inland Revenue booklet, WTC2, *Child Tax Credit and Working Tax Credit – A guide*, April 2003, pp 11-14: http://www.inlandrevenue.gov.uk/leaflets/credit.htm

People who are **aged 50 or over** can qualify for WTC if:

- They work at least 16 hours a week; and
- They are returning to work after at least six months spent on a qualifying out-of-work benefit.[40]

People who are **aged 25 or over** can qualify for WTC if:

- They work at least 30 hours a week.

In the case of couples, a joint claim must be submitted; partners cannot submit separate claims. A person and his/her partner counts as a couple if they are married, or unmarried but ‘living together as husband and wife’.

b. WTC elements

Working Tax Credit contains several elements. The **basic element** of WTC is paid to any single claimant or couple who meet the conditions. There are extra amounts payable for:

- Lone parents – the **lone parent element**
- Couples – **the couple element**[41]
- People who work at least 30 hours per week (couples with at least one child can claim the 30 hour element if they work at least 30 hours a week between them) – the **30 hour element**. Only one 30 hour element is payable per couple.
- Working people with a disability or people with a disability which puts them at a disadvantage in getting a job, or have been receiving certain qualifying benefits – **disability element**. Can be paid in addition to other elements. Paid for each member of a couple who qualifies.
- People with a severe disability, where the claimant and/or partner receive either Disability Living Allowance (highest care component) or Attendance Allowance (higher rate) and qualify for WTC, an extra amount of the **severe disability element** will be payable. Can be paid in addition to other elements. Paid for each member of a couple who qualifies.
- People aged 50 or over who have just returned to work after a period on benefit – the **50 plus element**. There are two separate rates – one for people who work 16-29 hours a week, and one for people who work for 30 hours or more. Can be paid in addition to other elements. Paid for each member of a couple who qualifies.
- Working families who spend money on approved child care – the **childcare element**

c. Maximum rates

The maximum value per year of each element in 2004-05 is listed below.

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40 This is explained further on p 8 of Inland Revenue leaflet WTC2

41 This is not payable to people who qualify for the 50+ element who work less than 30 hours a week, unless they have responsibility for a child or qualify for the disability element.

Basic element	£1,570
Lone parent element	£1,545
Couple element	£1,545
30 hour element	£640
Disability element	£2,100
Severe disability element	£890
50 plus element (working 16-29 hours)	£1,075
50 plus element (working 30 hours or more)	£1,610

In addition, a childcare element worth up to 70 per cent of eligible childcare costs may be payable. The weekly limit on eligible childcare costs is £135 for one child, and £200 for two or more children. Further information on the childcare element is given below.

d. Childcare element

The childcare element may be paid to lone parents who work at least 16 hours a week, or to couples if both partners work at least 16 hours, or where one partner works at least 16 hours and the other is incapacitated.

The care must be provided by 'approved' providers. These currently include:

- Registered childminders, nurseries and playschemes
- Out-of-hours clubs on school premises run by a school or a local authority
- Child care schemes run by school governing bodies under the `extended schools' scheme
- Child care schemes run by approved providers, for example, an out-of-school-hours scheme or a provider approved under a Ministry of Defence Accreditation scheme
- In England only, child care provided in your own home by a person approved to care for your child or children
- In England only, child care provided in your own home by a domiciliary worker or nurse from a registered agency who cares for the child or children
- In Scotland only, child care provided in your own home by (or introduced through) child care agencies, including sitter services and nanny agencies, which are required to be registered.

Families cannot claim for the costs of child care provided in the parents' own homes by relatives.

On 17 May 2004 the Department for Education and Skills announced proposals to broaden the categories of 'approved' childcare for WTC purposes.[42] The consultation document,

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[42] DfES press notice, *Childcare more affordable- Hodge*, 17 May 2004: http://www.dfes.gov.uk/pns/DisplayPN.cgi?pn_id=2004_0109

Childcare: Extending protection and broadening support, is available at the DfES website.[43] The consultation ended on 16 August 2004.

D. Miscellaneous

1. 'Income' for tax credits purposes

Tax credit awards are based on gross annual income. As a general rule, income is taken into account if it is taxable, though there are exceptions. The *Tax Credits Technical Manual*, which is available at the Inland Revenue website, contains the detailed rules.[44]

There is no capital limit. Any income from capital is however counted. Up to £300 of income from capital may nevertheless be disregarded, depending on other types of income the person receives.

In the first year of the new tax credits (2003-04), initial awards were base on incomes in 2001-02, but from 2004-05 onwards, awards will normally be based on income in the previous tax year. If however income in the current tax year is less that the previous year, the current year's income is used. Also, if income in the current year exceeds that in the previous year by more than £2,500, the current year's income minus £2,500 is used.

2. Changes in circumstances

Awards of Child Tax Credit and Working Tax Credit are based on income for the previous tax year and run for twelve months. Certain changes in circumstances must be reported in-year and can lead to an adjustment of the award. Other changes during the year, including changes in income, may be reported to the Inland Revenue as they occur, but there is no requirement for claimants to do so. If a claimant decides not to report a change it is taken into account in the 'end-of-year reconciliation' or 'annual review', and the award for the year is recalculated accordingly.

The Inland Revenue must be notified within three months if:

- The number of adults in the household changes; or
- The claimant leaves the UK permanently, or goes abroad for more than eight weeks (twelve weeks if he/she goes or remains abroad because of illness or because a member of his/her family is ill or had died); or
- Weekly childcare costs either stop or reduce by £10 a week or more for four consecutive weeks.[45]

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[43] http://www.dfes.gov.uk/consultations/conDetails.cfm?consultationId=1247
[44] Paras TCTM04001-TCTM04950A: http://www.inlandrevenue.gov.uk/manuals/tctmanual/tctm04000.htm
[45] Regulation 21 *The Tax Credits (Claims and Notifications) Regulations* SI 2002/2004

Failure to report one of the above changes within the time limit can result in a financial penalty.

While claimants do not need to report other changes in circumstances during the year, it may be in their interests to do so if they would result in an increased award, since most changes can only be backdated for up to three months. If a change would reduce the award, it may also be in the claimant's interest to report it during the year, to avoid an overpayment following the end-of-year reconciliation.

Further details of the rules regarding changes in circumstances are given in standard note SN/SP/3205.[46]

3. Overpayments

Overpayments may emerge either during the year (for example, following notification of a change in the claimant's circumstances), or as a result of the end-of year reconciliation.

The Inland Revenue may recover in-year overpayments by reducing the award for the remainder of the tax year or by stopping payment completely. In 2003-04 the Revenue made discretionary top-up payments to families facing hardship as a result of a reduction or suspension of their award. Similar arrangements are in place for 2004-05.[47] Any additional payments made are counted as income and can therefore affect a family's tax credit award for the following tax year.

The Revenue may decide to recover some or all of any overpayment which emerges following the annual review at the end of the tax year. The usual means of recovery is by a reduction in the award for the following year. There are limits on the maximum reductions for families in receipt of more than the family element of the Child Tax Credit.

The Revenue may decide not to recover overpayments where this would cause 'hardship', or where the overpayment was due to official error. The Revenue's Code of Practice on repayments, *What happens if we have paid you too much tax credit?*[48], states that it will not ask for the return of an overpayment if it was caused by a mistake by the Inland Revenue and the claimant could reasonably have thought their award was right.

Further details of the rules are given in standard note SN/SN/3205, *Tax credits: annual assessments, changes in circumstances and overpayments*.

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46 SN/SP/3205, *Tax credits: annual assessments, changes in circumstances and overpayments*, October 2004

47 See Inland Revenue booklet COP 26, *What happens if we have paid you too much tax credit?*, August 2004: http://www.inlandrevenue.gov.uk/leaflets/credit.htm

48 *Ibid.*

Claimants cannot appeal against a decision to recover an overpayment. It is however possible to appeal against a revised award which results in an overpayment.[49]

4. Passported benefits

Some tax credit recipients may be able to get 'passported benefits' such as help with health costs, funeral costs and court fees. The rules on entitlement can vary according to where the person is in the United Kingdom. Inland Revenue booklet WTC6, *Child Tax Credit and Working Tax Credit: Other types of help you may be able to get*[50], gives details.[51]

A separate standard note is available which looks at the rules on entitlement to free school meals for families receiving tax credits.[52]

5. Families in receipt of Income Support or income-based JSA

The Child Tax Credit is replacing the child elements paid with means-tested benefits such as Income Support and income-based Jobseeker's Allowance. Families in receipt of Income Support or income-based JSA did not however have to claim CTC in the first year of the new tax credits[53], and are to be 'migrated' to the CTC. In the meantime, the child elements within these benefits have been adjusted so that families receive the same amount in respect of their children as they would have done had they claimed CTC.

A written answer in May 2004 gave details of Government's original plans to 'migrate' families on means-tested benefits to the Child Tax Credit:

> **Mr. Willetts:** To ask the Secretary of State for Work and Pensions (1) if he will make a statement on the proposed timetable for transferring the child elements of jobseeker's allowance and income support to child tax credit payments; [166482]
>
> (2) if he will place in the Library a copy of the agreement reached between the Department and the Inland Revenue ensuring that families do not lose the child element of jobseeker's allowance and income support until child tax payments are guaranteed. [166542]
>
> **Mr. Pond:** The transfer of income support and jobseeker's allowance cases on to child tax credit began on 6 April 2004 as planned. Families on income support and jobseeker's allowance who were already receiving child tax credit have started to receive support for their children solely through child tax credit. New claimants of

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49 See also the Child Poverty Action Group factsheet, *What to do if the Inland Revenue says you have been paid too much tax credit*: http://www.cpag.org.uk/cro/Briefings/tc_paid_too_much.htm

50 August 2004

51 http://www.inlandrevenue.gov.uk/leaflets/credit.htm

52 SN/SP/3113, *Tax credits and free school meals*, 25 June 2004: http://hcl1.hclibrary.parliament.uk/notes/sps/snsp-03113.pdf

53 Families could however claim CTC if they wished. In such cases, under special transitional rules CTC was counted as income when calculating entitlement to IS or income-based JSA.

> income support and jobseeker's allowance are no longer awarded child allowances in those benefits, but receive child tax credit instead.
>
> The automatic phased transfer on to child tax credit of the remaining families with children within income support and jobseeker's allowance is planned to begin from October 2004. Meanwhile, families will continue to receive the same level of support through their benefits as they would from child tax credit.
>
> We have always recognised that it is important to ensure a successful and smooth migration for claimants of income support and income-based jobseeker's allowance on to child tax credit. We have therefore taken steps to ensure that those families will not lose the child element of jobseeker's allowance and income support until we have confirmation that child tax credit has been awarded. The technical design of the income support and jobseeker's allowance computer systems ensure this. The child and family elements will automatically continue to be paid until a confirmation that child tax credit has been awarded is received from Inland Revenue.
>
> In April 2002, The Treasury published "The Child and Working Tax Credits" (HMT 2002), which made it clear that continuity of payment is of particular importance to us. [54]

The Paymaster General announced on 21 October 2004 however that the transfer of IS/JSA recipients would be postponed until some time in 2005:

> **The Paymaster General (Dawn Primarolo):** I said in a written answer on 11 March 2004, *Official Report*, column 1645W, that the timing of the phased transfer on to child tax credit (CTC) of the remaining families with children in receipt of income support/job seekers allowance, planned to begin from October, would be subject to a final review in the summer and that in the meantime, families would continue to receive the same level of support through their benefits as they would from CTC.
>
> It is extremely important to safeguard continuity of support for children among this particularly vulnerable group. Following further consideration of the proposed timetable, I have decided that the transfer should be deferred and begin instead in the course of next year. This will allow a full cycle of tax credits activity to be completed before these families are transferred in.
>
> Meanwhile, as I announced in March, I can again confirm that families will continue to receive the same level of financial support through their benefits as they would from CTC. [55]

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[54] HC Deb 27 May 2004 cc 1795-1976w

[55] HC Deb 21 October 2004 c 39WS

6. Payment of tax credits

Child Tax Credit, and elements of the Working Tax Credit intended to cover childcare costs, are normally paid to the main carer. Working Tax Credit (apart from help with childcare costs) is paid to the person who is in full-time work (couples where both partners are in full-time work may decide who is to receive payment). Employees in receipt of WTC currently receive payment via their pay packet. However, in the 2004 Budget the Chancellor announced that the Government had decided 'in principle' that WTC should be paid directly to claimants:

> Payment via employers has helped reinforce the principle that tax credits are a reward for work, reducing the stigma associated with claiming. Tax credits are now firmly established as the fair approach to providing financial support to working families. Further, at the end of January 2004, six million families were benefiting from the new tax credits exceeding the Government's ambitious expectations. The Government accepts the case, in principle, that the benefits to business justify moving to direct payment of the Working Tax Credit, reducing the cost of payroll administration and addressing a key area of business concern. The reform will be particularly valuable to the 1.2 million small businesses that stand to benefit. The Government will consult with employers on the detail of implementation.[56]

Payments made directly to claimants are normally made by credit transfer into a bank or similar account. Those without an account are expected to open one. People can only be paid by other means if there are 'exceptional circumstances' which mean that they unable to obtain an account.[57]

7. Appeals

Tax credit appeals are currently being heard by the same appeal tribunals that consider social security appeals. The Government's intention is that the tax appeals system will eventually take over responsibility for tax credit appeals once the necessary machinery is in place. There is currently no indication of when this might take place.

Further information on the current arrangements is given in Inland Revenue booklet WTC/AP, *The Child and Working Tax Credit: How to appeal against a tax credit decision or award.*[58]

E. Further information

General background to the new tax credits, including information on their expected impact and a discussion of the rationale for them, is available in the April 2002 Treasury paper, *The*

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56 HC 301 2003-04, 17 March 2004, para 3.53

57 Regulation 14 *The Tax Credits (Payments by the Board) Regulations* SI 2002/2173

58 February 2003: http://www.inlandrevenue.gov.uk/leaflets/credit.htm

Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System. It is available here:
http://www.hm-treasury.gov.uk/media/EE15F/new_tax_credits.pdf

The detailed rules for the Working Tax Credit and the Child Tax Credit are set out in the *Tax Credits Technical Manual*, which is available at the Inland Revenue website here:
http://www.inlandrevenue.gov.uk/manuals/tctmanual/index.htm

The Inland Revenue's online tax credits entitlement calculator is available at:
https://www.taxcredits.inlandrevenue.gov.uk/HomeIR.aspx

Various Inland Revenue booklets and guides to the tax credits are available here:
http://www.inlandrevenue.gov.uk/leaflets/credit.htm

Appendix: Examples of tax credit calculations

- **Example 1: Couple with two children under 16, working 36 hours per week, with gross earnings of £10,000 per year**

Maximum WTC	=	Basic element + Couple element + 30 hour element
	=	£1,570 + £1,545 + £640
	=	£3,755
Maximum CTC	=	Family element + 2 x (Child element)
	=	£545 + 2 x £1,625
	=	£3,795
Maximum tax credit award	=	£3,755 + £3,795
	=	£7,550

The family's income is greater than the threshold (£5,060). Excess income above the threshold is £4,940 (£10,000 - £5,060).

37 per cent of excess income is £1,827.80. Subtracting this from the maximum tax credit award gives a **tax credit award of £5,722.20** (£3,795 CTC and £1,927.20 WTC).

- **Example 2: Lone parent with one child under 16, working 25 hours a week, with gross earnings of £8,000 per year and allowable childcare charges of £40 a week**

Maximum WTC	=	Basic element + Lone parent element + Childcare element
	=	£1,570 + £1,545 + £1,456 (i.e. 70% of £40 x 52)
	=	£4,571
Maximum CTC	=	Family element + 1 x (Child element)
	=	£545 + £1,625
	=	£2,170
Maximum tax credit award	=	£4,571 + £2,170
	=	£6,741

The family's income is greater than the threshold (£5,060). Excess income above the threshold is £2,940 (£8,000 - £5,060).

37 per cent of excess income is £1,087.80. Subtracting this from the maximum tax credit award gives a **tax credit award of £5,653.20** (£2,170 CTC and £3,483.20 WTC).

- **Example 3: Disabled single person, working 30 hours a week, with gross earnings of £8,000**

Maximum WTC	=	Basic element + 30 hour element + Disability element
	=	£1,570 + £640 + £2,100
	=	£4,310
Maximum tax credit award	=	£4,310

The person’s income is greater than the threshold (£5,060). Excess income above the threshold is £2,940 (£8,000 - £5,060).

37 per cent of excess income is£1,087.80. Subtracting this from the maximum tax credit awards gives a tax credit award of £3,222.20 (all WTC).