TAXREP 18/02

CHILD TAX CREDIT AND WORKING TAX CREDIT

Memorandum submitted in June 2002 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales commenting on draft secondary legislation issued in May 2002 by the Revenue

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CHILD TAX CREDIT AND WORKING TAX CREDIT

A GENERAL COMMENTS

1. We welcome the opportunity to comment on the draft secondary legislation posted onto the Revenue's website under cover of a memorandum dated 9 May 2002. We appreciate being able to review early drafts of detailed legislation such as this because it increases the likelihood that misunderstandings and ambiguities can be eliminated before the rules have to be applied in practice. Our comments are confined to the Working Tax Credit (Payment by Employers) Regulations and the Tax Credits (Definition and Calculation of Income) Regulations.

on with the Revenue which followAs a policy point, we remain of the view that the Child Tax Credit (CTC) and Working Tax Credit (WTC) should have to be operated only by employers who have 5 or more employees. We are very concerned about the burdens being placed upon very small employees and believe that they should be exempt from operating CTC and WTC. This exemption for very small employers would be consistent with the Government's position on workplace access to stakeholder pensions.

2. We have discussed the employers' regulations with the Revenue. There are various aspects that need to be clarified and we highlight those in the detailed comments below.

3. We are concerned that the regulations for the definition and calculation of income do not achieve what we understand is intended, namely claimants' means will be determined on the basis of taxable income, so that the information can be drawn from readily-available sources such as forms P60 and P11D, payslips, interest reports from banks, etc. We favour this approach as it will save time.

4. However, these draft regulations fail to achieve this simple objective without the person who is trying to calculate the claimant's means having to perform extensive additional calculations. Indeed, anyone wishing to use the regulations to determine a claimant's means for the purposes of CTC and WTC will find that he will not be able to do so unless the Government issues guidance – which being extra statutory, will not be enforceable if there is an appeal. This is because the draft regulations seem to be an amalgam of income tax and national insurance contribution (NIC) rules, each of which has its own distinctive code. Examples include the use of the terms 'employed earner' and 'self-employed earner' which are NIC terms but are not defined here.

5. We do understand that revised regulations are being drafted to reflect the desired objective and we look forward to being able to comment on these in good time before they have to be laid.

6. The proposals referred to in paragraphs 16 to 21 of the Revenue's covering memorandum for ignoring income from student loans and tuition fees and the existence of capital are sensible simplifying measures.

B DRAFT WORKING TAX CREDIT (PAYMENT BY EMPLOYERS) REGULATIONS

7. There have been some welcome changes since the last draft which we were shown. There remain some points on which we would welcome confirmations and clarification.

Regulations 4 and 5

Start and amendment notices – tolerance levels

8. We welcome the institution of tolerance levels in regulations 4 and 5. As a result, employers will not be required to activate payment of tax credits in response to a 'start notice', or to change the amount of existing payments in response to an 'amendment notice', unless the amount of WTC payable or variation in the amount payable, exceeds a certain level.

9. Although the administrative burden on employers would be eased by their not having to process start and stop notices at six-monthly intervals, the saving thus generated could have been wiped out by the requirement to process changes in the tax credit award in-year. As it is, the tolerance levels will mean that the Revenue will see to payment of very small awards, or very small variations in awards. The amount of the tolerance levels will be a matter for negotiation (they are not yet specified).

10. Where an employee's income rises during the year, there will in any event be no change in his/her entitlement to credit unless the increase is more than £2,500. This should be sufficient to cover ordinary annual pay increases, though maybe not bonus payments or large extra amounts of overtime. But where income falls, so that the employee becomes entitled to more tax credit, there is no such 'disregard slice'. While this is welcome for the employee, it would have created a burden for the employer if there had been no tolerance level, as the employer would have been obliged to pay any increase in the amount of the award in response to an amendment notice, however small.

Regulation 8

WTC funding – SMP, SPP and SAP

11. Under regulation 8, the employer must pay WTC first out of PAYE deductions, then out of student loan deductions, then out of NIC deductions, and only when those funds are exhausted may the employer apply for funding. We would welcome confirmation that the regulations make allowance for the obligation to pay statutory maternity, paternity and adoption pay out of the NIC pool. There will be a similar overlap with the tax credits available to non-profit making companies for research and development expenditure.

WTC funding

12. Regulation 8 provides that an employer may apply for funding in two cases, namely under reg 8(1)(a), where 'rule 4 stated in regulation 7(2) applies' (i.e. the PAYE, student loan and NIC funds are exhausted) and under reg 8(1)(b), where the employer considers that the rule will apply on a subsequent date. In each case, 'the employer

may apply to the Board for funding' and reg (3) provides that 'if the relevant employer's application is accepted' the Board will put them in funds.

13. This discretion on the part of the Revenue to reject an application for funding is appropriate where the application is made under reg 8(1)(b), but hardly where it is made under 8(1)(a). The funds are either exhausted or they are not, and when they are, it should be an automatic right for the employer to receive funding.

14. In our view, the only occasion when the Revenue would be justified in refusing funding is when they have reasonable grounds to believe that the 'pool' of PAYE etc funds has *not* been exhausted. Although the present draft is in similar form to the WFTC employers' regulations, we believe that now would be the time to reassure employers by making this change.

15. Furthermore, there should be a time limit within which the Revenue are obliged to put the employer in funds, which should ensure that at no time will the employer be out of pocket. There is none at present.

16. Reg 8(2) states 'For the purposes of paragraph (1) "writing" includes writing produced by electronic communications that are approved by the Board.' Whilst this is undoubtedly intended to be helpful, we would welcome confirmation that it will not become a target of clauses 132 and 133 Finance Bill 2002. If so, it would be unconscionable to refuse funding to an out-of-pocket employer who had the temerity to submit his application to the Revenue on paper when ordered to do so on-line, at least for the present given the large number of employers who do not use computers.

Regulation 10

Recovery of overpaid WTC funding

17. Regulation 10 could have the effect of bringing the entire panoply of Revenue collection procedures down upon an employer, who for whatever – maybe wholly innocent – reason failed to use all his WTC funding to pay tax credits. This could quite easily happen, with the potential frequency of in-year changes in the amounts of awards giving rise to amendment notices. In such circumstances, keeping a tally of how much WTC had been paid as opposed to how much was due from one pay period to another could become an administrative nightmare, leading to innocent error on the part of the employer.

18. We understand that this machinery will only be invoked where the employer is deliberately misusing WTC funding or obstinately refusing to repay an amount of over-funding, and that, in a normal case, matters will be evened out at the end of each year. We would welcome written confirmation of this, preferably in the Code of Practice, a draft of which we understand is due to be circulated for consultation.

19. We would also welcome confirmation that WTC over-funding in respect of one employee will be able to be set off by employers against under-funding in respect of another, or carried forward to a subsequent pay period.

C DRAFT TAX CREDITS (DEFINITION AND CALCULATION OF INCOME) REGULATIONS

General comments

20. We appreciate having the opportunity to comment on the form of these regulations at such an early stage in their development. Nevertheless, we would have profound misgivings if the final version of these regulations were anything like the present text.

21. One can see the sense in producing a set of self-standing regulations to which tax credit claimants and their advisers can refer for a comprehensive definition of the income that is to be taken into account when assessing a claim. However, the present draft, in attempting to reconstruct a 'tax credits' definition of income from random scraps of tax, NIC and social security legislation, defining some terms but not others, has produced a very uneasy mixture of the three and it is hard to see how it would work.

22. The most serious discrepancies arise in the definitions of employment income and income from self-employment.

We also have concerns about the definitions of social security income and investment income, although have not had sufficient time to comment on these.

23. If the regulations on employment income go ahead in anything like their present form, we can envisage that employers will be expected to return benefits subject to income tax on form P11D and, on a separate form, let us call it form P11D(TC), all the variations for tax credits (viz taxable benefits not taken into account and non-taxable benefits which are taken into account). With so many variations for tax credits, we question how employers would continue to benefit from dispensations, the point of which is, of course to obviate the completion of forms. Of course, the Revenue may decide to apply the rules in practice in such as way as to ease the administrative burdens, but this is not a realistic long-term solution. The choice will be between an administrative nightmare for employers and Revenue alike, or ignoring the law altogether and working out a practical extra-statutory compromise. The former would be undesirable, the latter would not be in accordance with the law.

We suggest that the sensible approach would be to redraft the regulations, incorporating the Schedule E provisions by reference, then listing those benefits in kind that are to be taken into account. We suggest that such a list should ensure that benefits covered by a PAYE settlement agreement are not included within means for CTC and WTC purposes.

24. Turning to income from self-employment, if the draft regulations go ahead as they stand, the position for self-employed claimants will be no better than it is at present, in that they will have to compute their trading profit twice – once for income tax and once for tax credits purposes. We understood that the Revenue had appreciated the excessive compliance burden that this entailed, and that this lay behind their stated intention to align definitions more closely with those for income tax.

25. A better way to proceed would be to incorporate more of the income tax definitions by reference, rather than setting them out in extenso, or – worse – trying to

reconstruct them in another form and introducing a whole new set of misalignments in the process. There seems no reason why the regulations should not, when defining income from self-employment, simply refer to the net profit as computed for self-assessment purposes, if that is what is intended. If any differences were intended, those could be enumerated in tabular form, using income tax terms and definitions. We would emphasise the need to keep any such differences to a minimum to avoid the necessity for double calculations, particularly at the lower end of the income scale.

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