

TAXREP 1/06

THE ADMINISTRATION OF TAX CREDITS

Submission dated 15 December 2005 from the Tax Faculty of the Institute of Chartered Accountants in England & Wales to the call for evidence by the Treasury Sub-Committee of the House of Commons on 9 November 2005

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THE ADMINISTRATION OF TAX CREDITS

INTRODUCTION

1. This document sets out the comments of the Institute of Chartered Accountants in England and Wales (ICAEW) in response to the call for evidence by the Treasury Sub-Committee of the House of Commons on the administration of tax credits.
2. The Annex to this paper explains who we are and our particular interest in tax credit issues.

SUMMARY

3. Our submission covers the following key points:
 - We broadly welcome the measures announced by the Government on 5 December but with some reservations.
 - The increase in the income disregard will give most claimants much greater certainty about the level of their awards and reduce overpayments for 2006/07.
 - We are concerned that claimants may wrongly expect this to apply when their 2005/06 awards are finalised.
 - We would like to see the increased disregard and the change to the limits for in-year overpayment recovery to be introduced sooner.
 - HMRC not actively encourage claimants to report income changes which could cause in-year overpayments until the new rules are in place.
 - We do not support the reduction of the time to notify mandatory changes of circumstance from one month to three months.
 - We are not convinced that bringing forward the renewal deadline to 31 August 2006 will be wholly effective.
 - To encourage earlier renewal, more should be done to inform claimants about provisional payments and how these may lead to overpayments, and by sending out the renewal packs sooner.
 - The suspension of overpayment recovery in cases of dispute is welcome, but it needs to be clear what constitutes a 'dispute' and what happens about suspension where the claimant makes an appeal.
 - We welcome improvements to the award notice but note that detailed calculation should also be available on request.
 - The 'technical overpayments' concession should also be extended to non-compliance cases (see paragraph 21).
 - There should be an independent right of appeal against an HMRC decision to recover an overpayment.
 - Tribunals should have a judicial review function so that they can consider aspects of administrative justice relating to the tax credits system.
 - HMRC should accept notification of changes in advance.
 - HMRC should make better use of information provided by claimants to parts of HMRC other than the Tax Credits section.

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- Claimants should have a wider choice of ways to contact HMRC, such as email.
- The calculation of childcares costs should be made simpler.
- Greater clarity is needed about when and how to report a change in working hours where the claimant's hours vary from week to week.
- HMRC should provide training and support on the forthcoming changes to intermediaries who advise tax credits claimants.

THE PROPOSALS ANNOUNCED ON 5 DECEMBER 2005

4. In general we welcome the changes announced by the Paymaster General at the time of the Pre-Budget Report.

Income disregard and in-year recovery of overpayments

5. The increase in the income disregard to £25,000 for 2006/07 onwards effectively means that for the vast majority of claimants, their tax credits will be fixed with reference to prior year income, which will undoubtedly give greater certainty about the amounts they receive. For this reason we welcome this proposal.
6. This change tackles one of the main causes of tax credit overpayments – an increase in income compared to the base year. Although claimants are encouraged to tell HMRC every time their income changes, it is not mandatory to do so, and some claimants (notably the self employed) find it hard to estimate their current year income. Also, an important point which has not been clearly communicated to claimants is that even if income rises are notified promptly, it is still possible to have an overpayment if income increases substantially part-way through the year, because of the way that tax credits are based on income averaged over the whole year rather than income in the week or month when the tax credits are paid. With the increase in the disregard to £25,000 this is no longer likely to be a problem in practice except in a minority of cases.
7. We have a concern that claimants will not understand, at the next round of renewals, that the new level of disregard will not apply to the finalisation of 2005/06 awards. The comparison between 2005/06 and 2004/05 income will be based on the current £2,500 disregard. There will still be significant numbers of 2005/06 overpayments arising from the 2006/07 renewals process. HMRC will have a difficult public relations task to avoid confusion and loss of confidence in the system at that time.
8. Some claimants have actually chosen not to report increases in income when they occur, because they anticipate an overpayment, and the way in which in-year overpayments are recovered is currently less favourable than the mechanism for overpayments established after the year-end. The announcement that from November 2006 the limits used to recover overpayments identified in-year will be the same as those for cross-year recoveries is greatly to be welcomed.

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9. In view of the positive benefits of both these changes (the increase in the disregard and the change to in-year recovery limits) it is disappointing that they will not be introduced until the next tax year. While we appreciate the lead time needed to amend IT systems, we wonder if there is some way to bring them in earlier.
10. In particular, we are aware that in early 2006 HMRC intend to run a pilot exercise to contact claimants and urge them to report increases in 2005/06 income so that adjustments can be made in-year. In view of the currently unfavourable regime for recovering in-year overpayments compared to cross-year ones, claimants would often be better advised not to report income increases until after the year-end and we strongly recommend that HMRC should not undertake this exercise until the new recovery limits and disregard limit are in place.

Time limits for reporting changes and for renewals

11. Other major reasons for overpayments are due to delays, particularly in finalising and renewing awards, and in reporting changes of circumstances. Most of the other PBR proposals are designed to address this. While we support the initiative to tackle delays, we have concerns about some of these proposals.
12. From April 2007, the time allowed for mandatory reporting of changes in circumstance will be reduced from three months to one. We are not convinced that this proposal has been properly thought through and we do not support it. We can see that this should help to avoid overpayments, but we are concerned that this requirement may prove onerous and unrealistic for many claimants. For example, it is often difficult to pinpoint exactly when a relationship has ended, or when a new permanent relationship has started. One month is a very short time for a claimant to be able to decide on such a sensitive issue. Childcare costs are another example: a decrease in these must be notified once it has lasted for at least four weeks, which means the claimant will not know whether to notify for four weeks and will then have to do so immediately.
13. It is also crucial that the penalty regime should be applied with a light touch if the time to notify is to be reduced to one month and the list of notifiable circumstances expanded.
14. We are not convinced that shortening the renewal period by one month will produce significant changes in encouraging early renewal. 31 August falls in the holiday period for families with children. Also, the current 30 September deadline is aligned with the (non-statutory) deadline for filing self-assessment returns, which is familiar to many people even if they are not in self assessment. For those who are both in self assessment and claiming tax credits, aligning these two deadlines has the advantage of simplicity.
15. Delays in renewals create overpayments because claimants continue to receive provisional payments until their 2006/07 award is confirmed, and these provisional payments are often too high. We welcome the measure to uprate the income figure used for provisional payments by average earnings but it is

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disappointing that this will not be until 2008. Other ways to tackle this problem would be to get provide better information about provisional payments and how they may lead to overpayment – in which context, we continue to be concerned that Code of Practice 26 does not cover this issue at all – and to get the renewal papers sent out more quickly after 6 April.

16. The PBR changes are to apply from a variety of different dates. While we understand that this is due to IT and other systems constraints, we are concerned that it may prove confusing for claimants and those who advise them.

THE SIX MEASURES ANNOUNCED ON 26 MAY 2005

17. So far, few changes arising from the six measures announced by the Paymaster General on 26 May have emerged into the public domain. This is disappointing in that six months have now elapsed, though we appreciate that changes cannot be made instantaneously. However, we are aware of the work which HMRC has been doing on these and they have been consulting with representative bodies including ourselves. The Sub-Committee will no doubt be aware of this.
18. One change which has been implemented is the suspension of recovery where an overpayment is disputed. We welcome this but raise one area of concern. It is not made sufficiently clear what constitutes a ‘dispute’ which will then trigger suspension. As we understand it, if a claimant makes an appeal but does not dispute the overpayment recovery, the overpayment will not automatically be suspended. A dispute must be specifically notified in writing, either using form TC846 or by letter. Claimants need clear advice on this area; both the TC846 and the appeal form need to be improved in this respect. We are aware that HMRC are working on this.
19. We also note that once HMRC have reviewed a disputed overpayment and decided that it is recoverable, they will no longer suspend recovery. If the claimant objects his or her only recourse is to take a complaint to the Adjudicator or Ombudsman, or seek judicial review. In view of the time it may take to pursue redress by these routes, the recovery of the overpayment in the meantime may cause financial difficulties for the claimant and deter them from taking the matter further.
20. We welcome the introduction of a new improved award notice from April next year. However, for practical reasons this notice will not be able to show full details of how an award has been calculated, and we very hope that such information will be available, for those who want it, in an understandable format.

OTHER COMMENTS ON THE RECOVERY OF OVERPAYMENTS

‘Technical overpayments’ concession

21. HMRC prefer to recover an overpayment against an ongoing award where there is one. However, this is not possible where an award has ceased, in which case the

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overpayment is collected by direct recovery. Problems occur where changes in the claimant unit are not reported on time; for example, where a single claimant becomes part of couple, which brings to an end the single claim and requires a new joint one. It is not always clear when a new permanent relationship starts, and meanwhile the single award payments run on and may create a significant overpayment, due to the single award being higher than the joint one and because the joint award can only be backdated three months. HMRC have a procedure which they apply in such situations (referred to as ‘technical overpayments’). They will compare the actual overpayment with the situation which would have arisen had the couple dealt with their change of circumstances promptly and made the new claim on time, and only recover the excess. In our view this is a welcome and sensible procedure but we have one objection – it is only applied when the error comes to light via an examination or enquiry. For claimants who discover a problem themselves and report the change without being involved in any compliance activity, the full amount of the overpayment is recovered. This seems to us inequitable and we would like to see the concession extended.

22. All the new measures announced so far require procedural changes rather than regulatory ones. There are two areas where we recommend changes to legislation.
23. The first is the right of appeal against an HMRC decision to recover an overpayment, which many representative bodies have been pressing for. Under the current system, it is HMRC who review their own decision on whether they responsible for an error or delay, and whether the claimant could reasonably have known that their credits were wrong. It is essential that there should be the option for third party scrutiny of such decisions. We are aware that the claimant can take their case to the Adjudicator or Ombudsman, but in our view a legal right of appeal would give better protection. We are aware that the Paymaster General has not ruled this out, and we would like to see discussion of it given a higher priority.
24. The second is a power for the tribunals to exercise a judicial review function. In many cases, tax credit problems arise from HMRC maladministration rather than from decisions or other issues which carry a right of appeal. Tribunals are well suited to establishing facts and deciding such cases, but at present such a function is outside their jurisdiction. The claimant’s only recourse is to go to the Adjudicator or Ombudsman, or seek judicial review in the High Court, which for practical reasons is out of the question for most claimants (even if they have heard of it). A judicial review function for the tribunals would address this problem, and in view of the ongoing reorganisation of the tribunal structure and powers, this would seem an opportune time to introduce it.

OTHER COMMENTS ON TAX CREDITS ADMINISTRATION

25. The measures announced on reporting changes are all designed to encourage quicker reporting after the change has happened. We recommend that HMRC should also consider accepting information reported in advance of changes – for example, the date when a child will be leaving school.

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26. The Tax Credits programme should also make better use of information which claimants have provided to other parts of HMRC – for example, details of children reported for child benefit purposes; changes of address or tax information provided when a person leaves the UK.
27. HMRC place great emphasis on the Tax Credits Helpline as the primary route for claimants to contact them. However, many of the changes being made to the system will require claimants to have more contact with HMRC than they do at the moment, as there will be more things to report, and system changes which will require explanation. We recommend that HMRC should offer claimants more alternative methods to contact them. For example, many claimants would prefer face to face contact (in which context, we are concerned to learn that there may be plans to restrict the face to face service currently available in HMRC enquiry centres). Many claimants favour email as means of communication and we recommend that HMRC should offer this as a means of notifying changes or making enquiries (in which context, we note that the Child Benefit Agency has just introduced such a service).
28. The calculation of childcare costs, especially in order to report changes, is a difficult area for claimants, where mistakes are often made. Where costs vary, they are told to calculate an average, or to estimate costs for the next 12 months – neither of these is easy. More should be done to improve understanding in this area and to look at how to simplify matters. At one stage HMRC did consult with representative bodies on this issue, and we recommend that this consultation should be revived.
29. Another difficult area is where hours of work change. Many people work different hours from week to week, and where this fluctuates around the 16 or 30 hour level, it is difficult for them to know when to report a change. This will be particularly important once it becomes mandatory to notify changes in working hours which decrease an award. As far as we are aware there is no clear guidance on how to deal with varying working hours.
30. In view of all the changes arising from the PBR announcements and from other work in progress, there will be a lot of new documentation and procedures introduced into the tax credits system over the 12–18 months. It is crucially important that HMRC take care to introduce these to claimants in a way which they will understand and accept during this transitional period.
31. It will also be important to ensure that intermediaries advising tax credit claimants (which include members of the ICAEW) have access to good information and understand them. We recommend that, as at the start of the new tax credits system, HMRC should offer workshops on the new developments for intermediaries and financial support to voluntary sector bodies who can themselves provide training.

WIDER ISSUES

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32. Although this enquiry is about administration not policy, we would like to make a brief mention of wider issues.
33. The Government has said it will continue to listen to the case for a system of fixed awards, but has no plans to change the current system. The increase in the income disregard will go some way to addressing the problem of fluctuating awards. We are not convinced that a system of completely fixed awards, as opposed to one which is responsive to changes in circumstances, would be the best thing for claimants. There is a trade-off between how responsive a system is, and how much interference by the revenue authorities in people's lives is required to operate it. With the proposed changes, we will have a system where claimant will have to have a great deal of contact with HMRC. It would be interesting to see some research on what claimants themselves would actually prefer in terms of this trade-off.
34. Tax credits specialists and representative bodies have mooted ideas for more radical changes, such as uncoupling the child support and work incentive aspects of tax credits; making the income level for maximum entitlement lower than at present and doing away with the £545 family element of CTC; adding the family element to child benefit; and making child benefit taxable or means-tested. While we do not intend to expand on the pros and cons of these here, we feel the Government has perhaps missed an opportunity for a broader look at the tax credits system and a debate around some of these ideas.

JMM

15 December 2005

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ANNEX

WHO WE ARE

35. The Institute of Chartered Accountants in England & Wales is a professional body representing some 128,000 members. The Institute operates under a Royal Charter with an obligation to act in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
36. The Tax Faculty is a centre for excellence and an authoritative voice for the Institute on taxation matters. It is responsible for tax representations on behalf of the Institute as a whole and it also provides services to more than 11,000 Faculty members who pay an additional subscription.
37. The Tax Faculty is concerned with tax credits both from the point of view of our members who are advising clients, and as part of our wider public interest responsibilities. We have been represented on all the HMRC tax credits consultations since these began, and members of the Tax Faculty also lecture and write on tax credits.