

Tax credits: The current picture

Introduction

Tax credits form a vital component of the Government's strategy for tackling child poverty and making work pay. Almost six million households rely on tax credits to supplement their income and fund their childcare costs¹. For those on the lowest incomes a tax credit award, including childcare, can be a substantial part of their weekly income. A lone parent with two children working 20 hours a week at £6 an hour and with £75 weekly childcare costs would, for example, be entitled to around £200 in working and child tax credits. Families on higher incomes receive £10.

Since tax credits were introduced in 2003 Citizens Advice Bureaux have helped hundreds of thousands of people with tax credit enquiries. Our 2005 report *Money with your name on it?* highlighted problems with poor administration, complex systems yet poor explanatory information, long delays in resolving problems and high levels of overpayment and recovery. These were causing significant hardship to families dependent on tax credit income. In response the then Prime Minister, Rt Hon Tony Blair MP, apologised for the hardship caused to some families. The Government announced a series of administrative changes. These were followed by more substantial changes to entitlement rules and overpayment recovery in the 2005 pre-budget report.

Two years on some improvements have been introduced. But tax credits continue to be a major area of work for the Citizens Advice service. In 2006/07 Citizens Advice Bureaux in England and Wales helped people with over 186,000

tax credit problems – a rise of 21 per cent from the previous year.

CAB evidence suggests that the complexity of the tax credits system creates many problems for claimants who find it difficult to understand their entitlement. Overpayments and harsh and complex recovery regimes still cause too much confusion and hardship.

In order to understand more about the problems, we asked visitors to our public website in April and May 2007 to tell us about their experiences of claiming tax credits. One and a half thousand people responded. Respondents were roughly representative of the tax credit population as a whole, but a disproportionate number in the survey considered tax credits to be a very important part of their income. The results are summarised below:

The value of tax credit income

An overwhelming majority of survey respondents (86 per cent) felt that tax

¹ Child and working tax credit statistics: finalised annual awards 2005/06, HM Revenue & Customs (HMRC). Note: six million includes thousands of out of work families who still receive social security support for their children and not child tax credits.

credits were an important or very important part of their income. Many respondents mentioned tax credit income as enabling them to meet mortgage and childcare costs.

“As we are in low income jobs this extra amount helps towards childcare costs – without it I wouldn’t be able to work.”

“I could not manage without this as my wages just cover my mortgage payment each month. Therefore I live on and pay the rest of my bills with tax credits.”

“50% of my income is tax credits.”

Respondents were less positive about the reliability of tax credits as a source of income. Many expressed concerns that the unpredictable nature of tax credit payments made it very difficult for them to budget.

“When you are on a limited income the most important thing is to know how much you have coming in and when so that you can budget – I have been unable to do this since this system started, leading to stress, worry and bank charges.”

“When working to strict budgets it is made increasingly difficult when tax credits are reduced to claw back overpayment. When working out my finances I constantly have to juggle funds when my income from tax credits keeps altering.”

“I wish I had never bothered [claiming], the worry and anxiety disturbs my sleep and pervades my thoughts.”

“I budget very well, but now I am in debt to them £5,000 and even if they

take it slowly, I get very stressed from the fact that I owe money, and that I get reduced or no tax credits anymore.”

“I had taken my current job based on the figures I was given for my entitlement to tax credits. This was budgeted for quite carefully. When the award was made the overpayment made the budget meaningless.”

“My tax credits were a pivotal part of my household income and loans and credit cards were taken out knowing that we could pay them back from the tax credit money, a year later I’m told I’ve been overpaid and had £140 per month reduced, thus causing me to default on all loans and credit cards. Now I have threatening letters from debt collectors almost daily.”

Understanding tax credits

All tax credit claimants will be familiar with the tax credit award notice. Award notices are issued to claimants when a claim is made and when a change of circumstance has been recorded. *Money with your name on it?* highlighted the need for urgent improvements in notices to help claimants to understand their entitlement. From April 2006 award notices have included more information to help people understand what their award is based on. They are now accompanied by simple checklist which highlights what pieces of information claimants must check and what changes they must report. However, award notices still do not explain any overpayment that may appear.

Our survey asked claimants about the most recent award notice they had received. We found that:

- over half of respondents (58%) felt that award notices were difficult to understand.
- only 28% thought that they were easy to understand.

Respondents who had been overpaid were much more likely to find their award notices difficult to understand than those who hadn't been overpaid (62 per cent/40 per cent).

It was clear from comments that many respondents found it very difficult to understand how tax credits were calculated.

“My life was much easier when I was claiming under the old system of receiving a set amount for my child each week on income support. I knew where I was. The new system is too complicated for me.”

“It is a system which is impossible for the claimant to understand. What is on the award notices is not always what is on their system and when you make phone calls you cannot understand what you are being told. I don't get the impression that the operators understand too much themselves.”

Tax credit entitlement is based on household and work circumstances, such as number of children, childcare costs and working hours, as well as annual income. Knowing what circumstances affect tax credit entitlement is key to ensuring that overpayments and penalties for late reporting are avoided. Tax credit payments can only be backdated for three months, so reporting on time is important to ensure no entitlement is lost.

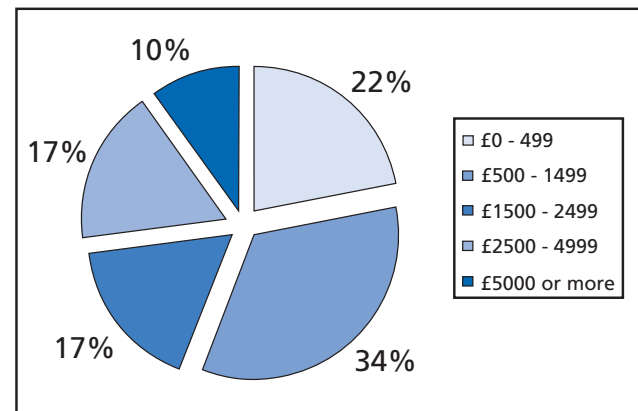
Over two thirds of respondents felt that they were either “fairly confident” or “very confident” that they knew what changes in circumstances to report. Respondents who had been overpaid were less likely to be confident about the changes they needed to report than claimants who had not been overpaid (67 per cent/74 per cent).

Overpayments

HM Revenue & Customs (HMRC) figures show that around a third of all awards were overpaid each year for the first three years of the system.² A significant majority (80 per cent) of our survey respondents had been told that they had been overpaid tax credits.

A third of respondents who had been overpaid reported overpayments of between £500 and £1,499 (see figure 1). Over a quarter of those overpaid had been told that they owed more than £2,500. Ten per cent had been overpaid more than £5,000.

Figure 1: Size of overpayments



Base: 1,131 respondents, CAB survey April/May 2007

Most of those respondents who had been overpaid (81 per cent) reported that they did not find it easy to understand why they had been overpaid and that

² Child and working tax credit statistics: finalised annual awards 2005/06, Supplement on payments 05/06, HMRC.

explanations were difficult to get. Many respondents reported getting different answers every time they called.

“It took over five hours in total on the phone to the helpline, over two weeks, and finally a letter asking for a breakdown of payments received before I could understand why I was overpaid.”

“To this day I do not understand why I am still paying money back, but unfortunately I don’t seem to have a say in the matter, it’s very frustrating. I wish that we did not need the money and then I would not have to put up with this yearly hassle and anguish.”

“I received three different explanations as to why I owed money and still haven’t received one that makes sense. I have now been told that I have no further right to appeal and must pay £588. I think I am entitled to a detailed explanation that I can understand before I agree that I owe this.”

Sixty five per cent reported that they had challenged the overpayment and the majority of these (83 per cent) reported that they found this difficult.

“Not knowing what criteria the Tax Credit Office use when working out entitlement it is very hard to understand how they reach the figures they do. Therefore it is extremely hard to challenge whether I am receiving the correct amount.”

“The whole system needs simplifying as it is very difficult to understand, I think that is why most people don’t even try to challenge overpayment.”

“Detailed information about how the award/overpayment has been calculated, as with other benefits, would enable claimants to challenge decisions which appear to be incorrect.”

Recovery of overpayments

HMRC has two different ways of recovering tax credit overpayments. By requesting the money back directly (direct recovery) or by reducing future tax credit payments.

Claimants do not have a choice about the method or the rate of recovery. If they have an ongoing award, payments will be reduced by 10 per cent, 25 per cent or 100 per cent, depending on the size of their tax credit award. If the overpayment is from an earlier award, (e.g. when a single person was part of a couple or vice versa) claimants will be asked to pay back the money directly within 30 days, with an option to extend recovery over twelve months or longer by negotiation. Claimants with an overpayment from both a past and a current award can face recovery of both overpayments simultaneously. This combined recovery can result in losing much more than 10 or 25 per cent of their tax credits.

Our survey found that:

- 58% of respondents had their ongoing payments cut to recover their overpayment
- 31% received a payment demand
- 14% had experienced both forms of recovery.

Respondents reported that having their payments cut without warning caused them tremendous difficulties budgeting.

“Big chunks of our family income vanished overnight with no warning or information.”

“We rely on the tax credits we receive and to suddenly stop getting the amount we expected and had budgeted for was a struggle.”

“Being on a low income we budget around a weekly income, so when it is suddenly reduced this can be very, very hard.”

“The shock and stress of the payments going down very suddenly has meant I had to borrow from relatives to meet childcare costs.”

Hardship

Following announcements in the 2005 pre-budget report, the end of 2006 saw the introduction of a limit to the cuts that could be made to payments. Families with the highest value awards should no longer see their payments cut by more than 10 per cent.

However 71 per cent of overpaid respondents reported that the recovery had caused or was causing their family financial difficulties.

“We have actually had to go without basic items such as clothing and baby milk and at one point the phone was nearly cut off.”

“My child tax credit had been reduced to £39 and my income support was £39 due to repaying budgeting loans and council tax arrears. I was put on medication for anxiety and stress which I am still taking.”

“I have had to go without paying my rent so I could buy food for my daughter and me. I have taken out loans to pay my rent arrears.

“After money was stopped I had to find work immediately. This put a serious strain on our family as I took a job working nights so I could be with my children during the day. When our payments restarted they were so reduced that we were playing catch-up for the money we had lost. My son has been diagnosed with autism but I’m unable to give up work. I cannot spend the quality one-to-one time he needs because I work 9pm to 3 or 4am and am so tired.”

“We have had to borrow money from friends and relatives and are getting into debt. I have a bank loan which insurance is covering ‘til the end of May then we really are in trouble.”

Overall experiences of claiming tax credits

Our final question asked respondents whether their experiences of claiming tax credits made them more or less likely to want to claim them again in the future (see figure 2).

- 13% of respondents reported that they would be more likely to claim again.
- 33% said they were neither more or less likely.
- 25% were less likely.
- 24% reported that they would definitely not want to claim again.

Many of the comments reflected that people felt they had no choice but to claim as they needed the money to survive. Despite the stress and uncertainty experienced they would continue to claim.

“I have no other option but to claim as the money is very important to us but have had sleepless nights over it.”

“You can never depend on this money as they seem to keep moving the goalposts. I feel I kept them informed of all changes, but they still say they overpaid me. I don't trust them at all; I only continue to claim as I am paying back an overpayment made by them.”

It is worrying that almost half (49 per cent) of the survey respondents reported that their experiences of claiming tax credits meant that they were less likely or definitely did not want to claim tax credits in the future.

Being overpaid was really significant in determining someone's overall experience of claiming tax credits. Fifty six per cent of overpaid respondents reported that they were less likely or would definitely not claim again compared with 19 per cent of respondents who had not been overpaid.

“This £5,000 debt was totally unexpected and not accounted for in our budget. I am now too frightened to reclaim tax credits on the basis that I will end up with another debt.”

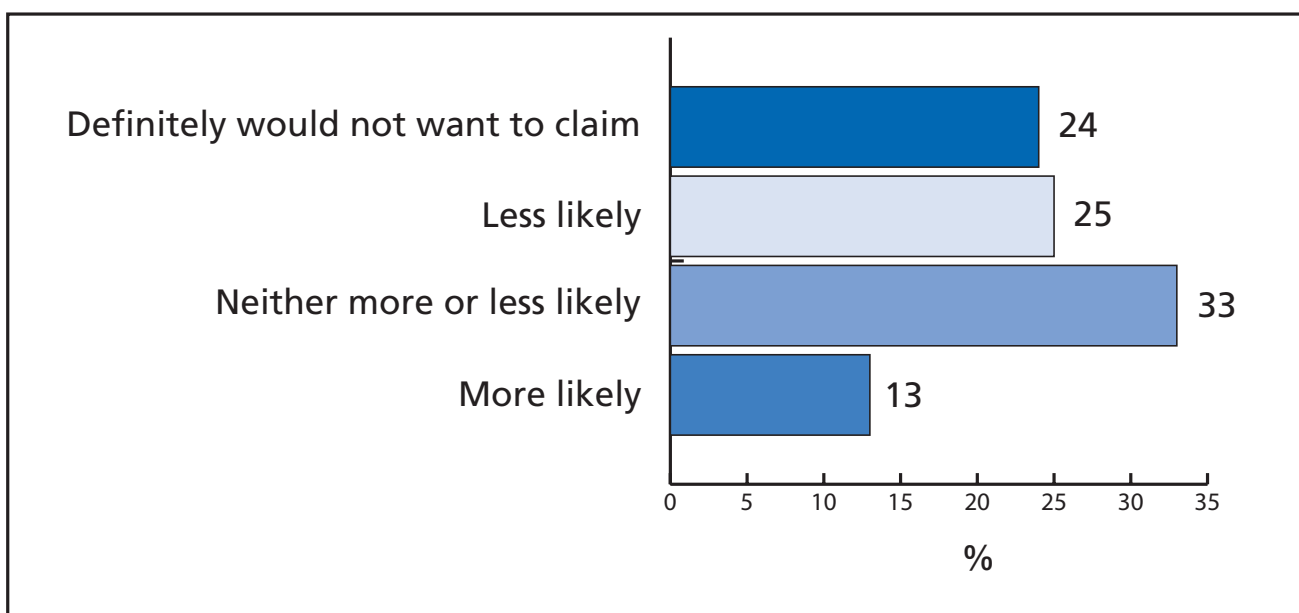
“I received working tax credit because I am employed and registered partially sighted. I ended up having to repay over £700 and would never apply again. They take months to reply to letters and the amount of time and effort required to keep track of the paperwork is enormous.”

“Due to my circumstances I do not have much choice but to claim, but if I could go without claiming for child tax credits I would definitely not claim again and would not have if I would have known I was going to be served with such a large overpayment.”

A considerable number of respondents highlighted the devastating impact tax credit problems had had on their family lives. People referred to having to sell or re-mortgage their homes; to their families breaking up and to severe stress.

“[I'm] in [the] process of fighting it. If I have to pay it back I won't be able to visit my two children who live 200 miles away for the two years they think it will take to pay it all back.”

Figure 2: Impact of experience of tax credits on future claiming



Base: 1,345 respondents, CAB survey April/May 2007

“It has led to increased debt and the money problems led to the break up of our family.”

“I am filling this in on behalf of my son...his wife left him because of the pressure of the debt. The result was that the family had to take out a loan which they could ill afford and my son is having to try to re-mortgage to make the payments.”

Positive comments were few but included:

“Tax credits are amazing. They enable people like me to return to work after children and pay for quality childcare. Without tax credits most of my salary would be taken up with childcare costs, and I would have to seriously question if it was worth working at all.”

Conclusions and recommendations

Around £17 billion is paid to approximately six million families every year under the current tax credits system. It is more generous than the systems before it, such as family credit and working families' tax credit, and take-up has been significantly higher. Yet tax credits have not been popular with all recipients. The vast majority of people in our survey said tax credits were an important part of their income. However, almost half of these said that they were less likely to claim in future as a result of their experiences.

We believe that the HMRC must urgently:

- Improve the quality of information and advice available to claimants on award notices, over the helpline and where necessary face to face.
- Provide routine explanations of causes of overpayment.
- Postpone recovery of overpayments until after communication with claimants.
- Introduce a statutory right of appeal on overpayment recovery on grounds of official error.
- Introduce further limits to overpayment recovery to prevent excessive loss of income. Claimants should not have to face higher recovery rates because their overpayments are being recovered in different ways.
- Work closely with the Department for Work and Pensions (DWP). They must ensure that people getting both DWP benefits and tax credits do not experience high combined recovery rates because their income comes from two different Government departments.
- Review the operation of the annual system and consider the introduction of fixed awards to increase stability of income, thereby better enabling families to budget.

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