

Tax credits

Time for a clean slate

In this briefing we make the case for writing off outstanding tax credit overpayments from 2003/04 & 2004/05.

In this time of recession, banks have been asked to show forbearance in debt collection; in this proposal we show how the government can minimise the impact of debt on low-income families.

We estimate that up to **1.5 million families** will benefit from this action which will help achieve child poverty targets, reduce debt, and restore confidence in the system, and improve work incentives.

£4.4 billion in recoverable overpayments arose from 2003/04 and 2004/05 of which **£1.7 billion** is still to be collected. The 2007/08 HM Revenue and Customs accounts allocated £1.8 billion as debt that they expected to have to write off in the future. An early write off of debts that are not expected to be recovered anyway would serve both to relieve hardship on families and save administrative costs of continuing to collect.

- These debts originate from a period when Government acknowledge administration was poor.
- Many overpayments would simply not arise under current rules, as entitlement rules have been changed.
- Recovery of these debts continues to push people into financial hardship.
- In cases where families' circumstances look unlikely to improve, HMRC spend time and money negotiating and renegotiating affordable repayment plans, and repeatedly deferring recovery.
- Many debts do not represent a loss to the exchequer – they arose when claimants received the right amount, but did not return their end of year forms, thus technically making that money recoverable.

Writing off outstanding tax credit overpayments from 2003/04 & 2004/05

We believe that writing off the overpayments outstanding from the first two years of tax credits, would help achieve child poverty targets, reduce debt, and restore confidence in the system, thus improving work incentives.

What's the problem?

Many families are living on very low incomes and in poverty as a result of repaying old tax credit debts. Some have been steadily repaying for several years and the reduction in their disposable income leaves them below the poverty line. For example, a lone parent with two children and on income support would have her payments reduced by £40 a month to recover an overpayment. Other clients seen by bureaux are still trying to establish how the overpayment arose, how much they actually owe and whether all - or any of it is - repayable. Many of these cases have become very complicated, demanding significant resources from both HMRC and CAB advisers in establishing what happened when. There are many families who failed to report a change in their household, or to *finalise* an award at the end of the year, and as a result have overpayments of thousands of pounds that they will never be able to repay.

What's the justification for writing the debts off?

- These debts originate from a period when Government acknowledge administration was poor.
- The system is complex, yet in the early years less support was available to help people understand and navigate their way through it.
- Many overpayments would simply not arise under current rules, as entitlement rules have been changed.
- Many debts do not represent a loss to the exchequer – they arose when claimants received the right amount, but did not return their end of year forms thus technically rendering amounts paid as recoverable.
- Many claimants have yet to receive a full explanation of the cause of the overpayment. When challenged advisers find the amounts said to be due even vary.
- Recovery of these debts continues to push people into financial hardship.
- In cases where families' circumstances look unlikely to improve, HMRC time and money is spent negotiating and renegotiating affordable repayment plans, and repeatedly deferring recovery.

These debts originate from a period when Government acknowledge administration was poor. The problems in the first two years of the system have been well publicised and acknowledged by Ministers. Though administration has now improved, the legacy of the debts from these years remains.

The system is complex – yet in the early days less support was available for claimants

There is now a much better recognition of the support that is needed to help claimants understand and navigate the complex system in order to meet their reporting requirements. Following a redesign, the transparency of award notices, for example, improved in April 2006. Initiatives under the transformation programme have been designed to support claimants at different stages of their claim: claimants who have failed to finalise their awards in the past are now reminded by letter and phone; 'health checks' involve HMRC contacting claimants with high awards who have not been in

contact for six months, to check their details are still up to date. None of these forms of support were available in these early years.

Many overpayments would simply not arise under current rules, as entitlement rules have been changed

Many overpayments would simply not exist now, as entitlement rules have changed. In the first three years of the system the income disregard was only £2500 but in order to reduce the number of overpayments arising from income rises, the 2005 pre-budget report increased the disregard to £25,000. This change was largely responsible for the fall in the number of overpaid awards from 1.9 million in 2003/04 to 1.3 million in 2006/07¹.

Failure to finalise awards – ‘notional overpayments’

Many debts do not represent a loss to the exchequer – many claimants received monies due but did not return their end of year forms, thus technically rendering some, or all of the money paid, recoverable. At the start of every new tax year, claimants are sent papers that summarise the circumstances used to calculate their award; they are required to check them and report any changes along with their actual income for the previous year. This process both ‘finalises’ their previous year’s award and - if appropriate - renews it for the current year. Failure to return the forms (or ‘finalise’ over the telephone) results in monies paid becoming recoverable.

In 2004/05 131,000 families were overpaid as a result of failing to renew their awards papers, a figure that increased the following year to 143,000. Average overpayments were £1649 and £1443 respectively². Claimants on the lowest incomes - and therefore entitled to higher awards - will find themselves with very high overpayments. The penalty for non-renewal therefore falls disproportionately on low income families. Recovering this money directly contradicts the Government’s intention to tackle child poverty since - unlike other overpayments - they represent money actually assessed as necessary support for the families concerned. A recent case illustrates the problem:

A woman sought help from a Hampshire CAB after she received an unexpected letter from HMRC about an overpayment of £2081.05. The letter claimed 'we have already told you' but she said she knew nothing of the debt. On calling the helpline she was advised that it was for 2003/4. She tried to recall what happened. She had moved to her previous address in May 2004, her husband had left in 2005 and her son who was disabled had turned 20 and she had stopped receiving child tax credit. Because she had moved house, she had not received the renewals papers and because she was no longer receiving payments for her son, she had not been aware of her need to ‘renew’ (and finalise).

Finalisation and renewals can be a particularly complex process. Families whose household has changed in the year – for example, if they have separated or formed a new relationship - will receive multiple sets of forms, each of which will need a response. HMRC now recognised that many families struggle to comply with tax credits requirements, and has designed a number of initiatives under its tax credit transformation programme, aimed at tailoring support to customer needs. One such initiative - ‘reach out renewals’ - targets ‘vulnerable’ claimants and offers them additional support to renew their claims. Those who miss the renewals window, yet remain entitled to tax credits, will be helped back into payment as soon as possible³.

¹ HM Revenue & Customs 2008, Child & Working tax credit statistics, finalised awards – supplement on payments 2006/07

² Hansard, 10 Nov 2008 : Column 939W

³ Tax credits: improving delivery and choice – a discussion paper, HMRC, HMT, May 2008

There is a strong case for changing the rules on the recovery of overpayments that arise following the failure to finalise or renew an award. Michael Jabez Foster MP has highlighted the disproportionate penalty these overpayments present to families. Instead of making the award recoverable, he suggests imposing a fixed penalty for late renewals⁴. In advance of any policy changes, we suggest that overpayments resulting from failure to finalise 2003/04 and 2004/05 awards should be written off, on the basis that these claimants were not provided with the support that vulnerable families can now expect during the renewals window.

Many claimants have yet to receive a full explanation of the cause of the overpayment. When challenged advisers find the amounts said to be due even vary.

CAB advisers find that many of the debts from 2003/04 and 2004/05 do not stand up when challenged. They find that the cases have become very complicated. When working with HRMC to investigate an overpayment they often find that the figures change and the true figure can be difficult to establish even though it is still being pursued. Sometimes, the claimant is told there is a mistake and there is no debt at all, but without bureau intervention the client could well continue to pay! The following cases illustrate this:

At various times the client had been given five different figures for the overpayment including one at nearly £4000. This client was very well organised, had kept the TCO fully informed of changes in circumstances and kept all the relevant correspondence. Despite this it took a year and a half of our involvement, numerous letters and contacts from us and eventually an appeal, before it was established that the overpayment was actually just over £1000. That overpayment has now been written off as the TCO accepted there was no way that she could have realised she was being overpaid.

A lone parent whose children were no longer dependent received a letter advising of a £4000 overpayment. The bureau adviser phoned the helpline. They checked the history of the case and initially found there were overpayments from 2005 to 2008 totalling several thousand pounds, but on further investigation found a discrepancy had been made early on in calculations which would have completely altered the whole case. He said the case would have to be reviewed and corrected. He advised the bureau to contact debt collections in Cumbernauld to ask them to put a hold on proceedings (something he should have been able to do on her behalf). The adviser could not get through on the number given, despite numerous attempts. He called back the main number and was just told to 'keep trying'.

Recovery of these debts continues to push people into financial hardship

Families with an ongoing maximum award will have any overpayment recovered by a 10 per cent reduction in their ongoing payments. In 2003/04 802,000 families entitled to maximum child tax credit were overpaid by a total of £1.06bn - an average of £1324 per family⁵. Recovery at this rate for a family can take several years, leaving those on the lowest incomes below poverty levels during this period. On this basis, a lone parent with two children and in receipt of income support would repay £40 a month.

Claimants with overpayments on old awards have to agree repayments via HMRC's Debt Management and Banking Unit. They are initially sent notifications requesting repayment within 30 days and are advised that they can agree repayment by 12 month instalments. Whilst recovery can be suspended or repayment over a longer period agreed, we are concerned that arranging an affordable repayment plan depends too much on the ability of a claimant to negotiate their position.

⁴ EDM 2148 - Tax credits overpayments, 06.10.2008., Foster, Michael Jabez

⁵ HM Revenue and Customs 2005, Child and Working Tax Credits Statistics, Finalised awards - supplement on payments in 2003-04

CAB evidence suggests many claimants simply pay up immediately or agree to repayment plans they cannot afford to keep. The case below illustrates:

A woman in her seventies had been making regular repayments of £10 for three and a half years before she was referred to her bureau by the warden of her sheltered accommodation. She had been looking after her grandson following her daughter's death in 2001 but failed to promptly report when he left school in 2004.

A young Bangladeshi couple sought advice both for help getting their current claim put right and for help with overpayments of over £3500. She had recently been sent a letter threatening legal action and had been so scared had phoned HMRC and agreed to repay within 12 months. She had set up direct debits of £297 a month – more than her total income from income support and carers allowance. The overpayment appeared to have arisen as a result of her husband spending five months abroad. On his departure she made a claim for income support and on his return advised Jobcentre Plus and submitted a joint claim. She had expected Jobcentre Plus to pass this information on to HMRC but as they did not her tax credit claims did not reflect the changes to her household until eighteen months later. In the course of the interview the adviser found out that they had had an earlier overpayment in 2003/04 but the husband had taken out a loan to repay it without querying it.

The cost, time and effort of resources put into negotiating affordable repayment plans, or repeatedly deferring recovery in cases where families' circumstances look unlikely to improve, costs time and money for HMRC.

A widow in her sixties and reliant on pension credit sought help from her CAB after receiving a demand for £5000 – along with another identical letter addressed to her deceased husband. The helpline advised the bureau that the £5000 was only half of the remaining debt, some of which dated back to a dispute about her husband's working hours in 2004. She had not heard anything about the debt for eighteen months and could not get any explanation about why the notice only covered half what she was reported to owe. With an income of £124 a week the maximum she could afford to repay would be £5 a week - probably for the rest of her life.

A couple were referred to the CAB by their GP for help on benefits, after they had received a court summons. The husband was seriously ill with lung and spine cancer. The wife was disabled and in receipt of higher rate DLA for both mobility and care. They had a severely disabled son. In 2007 they were notified of an overpayment of £13,000 for the years 2003-4 and 2004-5. In panic they ended their current claim, hoping that future entitlement would cancel out the debt. The CAB adviser believed that the debt appeared to have originated from 2003 when a tax credit error resulted in the deletion of the husband's income when the wife advised them that her income had increased due to receipt of carer's allowance for her son. Cancelling their claim meant that the overpayment had been passed for direct recovery by the Debt Management and Banking Unit. They also missed out two years tax credits payments.

How should the debts be written off?

We would like HMRC to consider ways in which certain debts could be written off without claimants having to request it. The simplest way to do this would be to write off all outstanding debt from 2003/04 and 2004/05, excluding that which arose from fraud. In particular we argue that the focus should be on the following three groups:

1. Where overpayment claims have become particularly complicated demanding a significant amount of resources for both claimants or advisers and HMRC, to investigate and resolve. Examples here would be where the cause of overpayment, or the amount and the liability, has become difficult to untangle.
2. Where the 'debt' owed presents no loss to the exchequer as the claimants had an underlying entitlement to the money.
3. Claimants repaying debts from very low incomes and consequently facing the prospect of surviving for many months or years on incomes well below poverty levels.

How much will it cost and how many families will benefit?

1.9 million families were overpaid in 2003/04 and 2 million in 2004/05. £4.4 billion in recoverable overpayments arose from 2003/04 and 2004/05 of which £0.7 billion had been written off by April 2008 and £2.1 billion had been recovered. This leaves **£1.7 billion** still to be collected⁶. It is not clear how many families still owe money from 2003/04 and 2004/05 because some will have been overpaid in both years, and because there are no figures available to link the amounts written off or repaid with the numbers of families.

It is not possible to distinguish exactly how much of the £1.7 billion would be covered by the criteria highlighted above, or how much relates to fraud. The 2007/08 HM Revenue and Customs accounts allocated £1.8 billion as debt that they expected to have to write off in the future. Given that the outstanding debts from 2003/04 and 2004/05 are the oldest, it is likely that a significant proportion of this £1.8 billion provision relates to this period. An early write off of debts that are not expected to be recovered anyway would serve both to relieve hardship on families and save administrative costs of continuing to collect.

Conclusions

We believe that fear of getting overpayments has an impact on an individual's confidence to claim. Whilst claimants are now getting more support to manage and understand the system, it will be difficult to restore confidence in the system for those still repaying overpayments from the early years. In an online survey of tax credit claimants in 2007 we found that 80% of respondents had been overpaid, and most of these people said they did not find it easy to understand why. 71% reported that the recovery of overpayments had or were causing their families financial difficulties. But - most worryingly - almost half 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 future⁷.

HMRC are working hard to improve the take-up of working tax credit in particular, but it must do more to assure claimants that things have changed – that the current tax credit system is not as it was in 2003/04 and 2004/05. Writing off the old debts would be a positive message to claimants, reinforcing the improvements being made by the transformation programme.

We believe that writing off these old debts would help reduce child poverty and restore confidence in the tax credit system. The current economic situation means that financial pressure is now even harder on families. We believe that now is the perfect time to wipe the slate clean and help people make a fresh start.

⁶ Figures rounded so do not quite sum

⁷ Citizens Advice 2007, CAB survey findings: Tax credits: the current picture

