Welfare Reform Bill (Northern Ireland) – Committee Stage

Evidence from the Low Incomes Tax Reform Group

1. Who we are

1.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

1.2 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

2. General Comments

2.1. We are pleased to have the opportunity to submit evidence to the Committee about the provisions contained in the Welfare Reform Bill.

2.2. The Bill is very much a framework Bill that sets out the broad structure of Universal Credit (UC) with enabling powers but provides very little other detail. This makes it difficult to give detailed comments and it is therefore important that Committee members have available to them a full set of draft regulations to inform their deliberations.

2.3. We are generally supportive of many of the aims of UC such as administration under one Government department rather than two, a single withdrawal taper for earned income rather than many and one set of rules governing what were previously several different

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benefits. However, we are concerned that many of these positive aims will be lost if UC becomes complex in its rules and is not adequately resourced (when many of the proposals seem to rely on face to face intervention).

2.4. The proponents of UC refer to the fact that it will ensure that people are better off in work than on out of work benefits. However without taking into account things like passported benefits and travel to work costs, as well as acknowledging that some people will face higher marginal deduction rates under UC, we are not convinced that the reality will match the intent.

2.5. Our evidence is primarily concerned with the proposals in the Bill that impact on those who are self-employed. Based on our experience of the current tax credits system, we are also concerned about how the civil penalty provisions will impact on all claimants of UC.

3. Self-employment (Schedule 1, Para 4(4))

3.1. There are more than 4 million self-employed people in the UK, over 100,000 of whom are in Northern Ireland. The self-employed are a diverse body of people, ranging from budding entrepreneurs to those with little or no business acumen, and all sorts in between. Self-employment can also be an important option for people for whom traditional employment may not be suitable (eg for reasons of health or disability). Finally, it is a real alternative for those living in Northern Ireland who are finding employment opportunities scarce due to the current difficult economic climate. As a result, those figures are likely to continue to rise.

3.2. Self-employment can be precarious and carries a great deal of risk. It can also be a long time before it begins to generate a profit. Given the importance of self-employment in the economy, and for those where employment is not a realistic option, it is crucial that work incentives in the tax and benefits system encourage those who are self-employed at least as much as the employed worker.

3.3. There is also an argument that support from the State should be more generous for the self-employed, given the advantages enjoyed by the employed in return for their NI contributions – reduced rates where an employer contributes to their pension, holiday pay, protection during illness, and paid leave for maternity, paternity and adoption – none of which are available to the self-employed.

3.4. To do this effectively, it is imperative that welfare systems, like tax, should aim to reflect the economic reality of a business. It is right that as a business becomes more profitable, welfare support for the entrepreneur should diminish; equally, declining profits, trading losses and substantial investment in or expenditure on essential equipment can be a drag on the performance of a business and welfare provision for the entrepreneur should reflect that.

3.5. At present this is broadly achieved through the structure of working tax credit (WTC). As the basis of assessment of WTC is the tax year, and the measure of income is broadly the profit or loss for income tax self-assessment purposes, the tax credits award simulates how the business is doing financially. Relief for losses through tax credits operates in much the same way as for income tax, with adjustments to reflect the fact that tax credits are awarded jointly to couples, and to remove the facility for carrying losses back to earlier assessment periods that are closed for tax credits purposes. Crucially, as for income tax, loss relief is only granted where a business is 'carried on upon a commercial basis with a view to the realisation of profit'[1] – thus manipulation and avoidance can be countered, and support directed towards those whose business activity is genuine and not simply a (possibly extended) hobby.

3.6. As the tax system recognises, and as is currently reflected in the WTC, periods of little or no profit, or of substantial investment in the wherewithal to carry on a business, are not confined to the early years. It is important to note that a business can experience difficulties at any time, not just when it is starting out. For example, a one-person business can easily dip into loss when the proprietor decides to take on a new employee, perhaps for the first time. A state that helps and encourages people into work should equally support new employers to provide that work. The current system recognises the economic reality of self-employment.

3.7. The 2010 White Paper[2] stated that the Government proposed a 'minimum income floor (MIF)' so that under UC the self-employed should be deemed to have earnings at least equal to the national minimum wage for the hours they work.

3.8. Schedule 1, para 4 (4) of the Bill allows this MIF to be implemented. The justification for this MIF was to deal with claimants (of which we are told there are some in the tax credits system) who under-declare their income, or are carrying on a hobby rather than trade or are not working the hours that they declare. That is a justification for targeting those who manipulate their accounts to maximise their UC claim or who are not honest about the hours they work, not for denying support to the majority of genuine cases who really need it.

3.9. The notional income rules in tax credits, the enabling provision for which is replicated in para 4(3)(a) of Schedule 1, already give protection against such abuse through under-declaring of income. Similarly, the tax credits legislation requires hours worked to be 'for payment or in expectation of payment' which ensures that only those who are genuinely self-employed receive support for the actual hours they are working.

3.10. Creating an additional power to impose an MIF adds nothing to the powers that already exist; it is otiose. We firmly believe that implementing the MIF for all self-employed claimants will mean that self-employment will no longer be a viable option for many. This includes those who cannot find any other form of employment or people with disabilities who may not be able to take on an employed job but would be able to work as self-employed.

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[1] Tax Credits (Definition and Calculation of Income) Regulations 2002, SI 2002/2006, reg 3(1) Step 4.

[2] http://www.dwp.gov.uk/docs/universal-credit-full-document.pdf

3.11. We therefore recommend removal of Schedule 1, para 4(4). If the MIF is to be implemented it is crucial that those who are starting out in self-employment and those who find themselves hitting difficult times (for example through the loss of a client) are protected and not subject to the MIF.

3.12. Along with removal of the MIF, it is essential that any regulations enacted under the Bill also support those in self-employment by ensuring that the definitions of self-employment and income from self-employment are aligned to those in the tax system, that recognition is given for genuine business expenses and that genuine trading losses are fully taken into account.

4. Civil penalties – Clause 112

4.1. Clause 112 of the Bill introduces new clauses 109C and 109D to the Social Security Administration Act 1992. The clause seeks to implement a penalty for claimant error, with no parallel clause relating to official error even though in the current system claimant and official error are roughly equal.

4.2. The imposition of a civil penalty on claimants without any similar recognition of official error would create an unfair balance of responsibility on claimants, many of whom struggle to understand and meet their responsibilities due to language, literacy or sickness and disabilities. Claimants should not be subject to penalties for 'innocent' errors in addition to the recovery of the overpayment that arises from the error.

4.3. The Impact Assessment claims that the aim of introducing a civil penalty is to deter errors and place greater emphasis on personal responsibility for errors that could have reasonably been prevented. However, overpayments that arise from errors are likely to be higher than £50 and sufficient in themselves to encourage those genuinely negligent to take more care in the future. UC claimants will include some of the most vulnerable members of society who may make frequent numerical or clerical errors, or fail to understand and put right errors made by the Department, through ignorance and inability to understand or deal with complex matters rather than through deliberate non-compliance.

4.4. According to their 2011 annual report[1], HMRC imposed only 1,221 penalties issued to tax credits claimants under similar legislation in 2010/11. These figures also include penalties for fraud – and 70% were in fact waived. These statistics suggest that HMRC have not in fact found these powers of widespread value in improving claimant responsibility.

[1] http://www.hmrc.gov.uk/specialist/annual-report-com-tax-credits.pdf

4.5. We do not think the use of a £50 penalty is warranted in innocent/genuine error cases. The liability to repay substantial overpayments will itself be sufficiently penal and therefore the additional penalty is unnecessary and ineffective. Penalties should be reserved only for cases of deliberate error.

LITRG

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