The Life and Death of Child Tax Credit and Working Tax Credit

Michael Godwin and Colin Lawson

No. 1/12

BATH ECONOMICS RESEARCH PAPERS

Department of Economics

The Life and Death of Child Tax Credit and Working Tax Credit

Michael Godwin and Colin Lawson

Abstract
The Tax Credits system introduced in the UK by the previous Labour government is from 2013 to be replaced by a Universal Benefit system. The new system should have some major potential advantages, provided it avoids the problems experienced with the Tax Credit system. The paper reviews and updates previous research on Tax Credits and sets out recommendations for the design and administration of future welfare benefit systems, drawing on critical analyses of the Tax Credit system.

Keywords: tax credits: welfare benefit administration; welfare benefit design.

JEL Classification Codes: H53; H55; I38.

Introduction

Child Tax Credit and Working Tax Credit (CTCs and WTCs, collectively TCs) were a substantial social support programme introduced in 2003, which delivered unprecedented financial support to working families during the past decade, contributing to "The previous government had a target of halving the number of children in relative low (BHC) income poverty in the UK between 1998–99 and 2010–11, from 3.4 million to 1.7 million. We now know that this measure of child poverty fell by 1.1 million children over the period. This is by far the largest reduction since our consistent series began in 1961, but the target was still missed by the substantial margin of 600,000 children" (Cribb *et al.,*2012:5).

TCs are about to be subsumed in the new Universal Credit (UC). Now that the demise of this major New Labour social policy has been announced, it is timely to assess its successes and failures. This article builds on the analysis of the period 2003-08 by Godwin and Lawson (2009a, 2009b). It investigates, using both official and unofficial published sources, how the programme has developed during its final years, and assesses the issues that the new Universal Credit will face in the light of the tax credit experience. It concludes with a set of recommendations for the design of the administration of future welfare programmes, drawing lessons from the Tax Credit experience.

Rationale and Design

The New Labour administration was elected in 1997 with a commitment to support poor, working families. Taylor, the adviser who recommended the new support system, suggested a structure influenced by the US Earned Income Tax Credit (EITC); the Australian system and the Canadian systems of working taxpayer support (Taylor, 1998). Taylor emphasised that tax credits should be distinct from benefits; to this end, he argued that is was desirable that they should be paid via the employer

(PVE) as part of remuneration rather than directly by government. This applied to the Working Families Tax Credit (WFTC), the initial attempt at tax credits (1999-2003), and subsequently to the Working Tax Credit, though not to the Child Tax Credit. The Working Families Tax Credit offered payment via the employer, but following a ‘purse or wallet’ argument (Goode *et al.,*1998), there was always an option for couples to have WFTC paid direct to a non-working spouse.

However problems with take-up and fraud arose soon after the introduction of WFTC. As much as 10 per cent to14 per cent of expenditure was thought to be fraudulent, and the benefit was withdrawn after less than four years of operation (October 1999 - April 2003). A training organisation interviewed by the present authors (Godwin and Lawson, 2009b :193) expressed the view that “WFTC was complicated: you could fiddle the system by working for only six weeks, but getting six months’ benefit. Employees would ask payroll to put overtime or bonuses on next months’ pay in order to continue to qualify. It is much more difficult to fiddle under WTC”.

Brewer (2006a:31), giving evidence to the House of Commons Treasury Committee on the administration of tax credits said “The scope for… gaming the system in the current system of tax credits is of course much less than under the Working Families Tax Credit, because in the Working Families Tax Credit there were periods of time where the Revenue was not looking at your income and periods where it was”.

The launch of Working Tax Credit and Child Tax Credit

The system introduced in April 2003 split the WFTC into two separate credits, the Working Tax Credit which was compulsorily paid via the employer (with no option for direct payment) and the Child Tax Credit which could be paid direct to the carer. It soon became clear that the Revenue and the computer system to deal with claims were quite unprepared for the number and type of queries which the new system generated among claimants. The system had been set up by EDS, a contractor who had frequently provided computer services to the UK government.

Davies (2007:60) described the events: “Exactly what happened between the announcement of the new tax credit schemes and their disastrous launch in April 2003 is the stuff of Whitehall legend. The challenge of building an IT system that could cope with these new demands fell to the vast American company EDS, and it notoriously failed to rise to it… Delays varied from a few days to several months: over 400,000 applicants received their first payment later than they had been told to expect, while by 2nd July 220,000 people had still not been paid. The Revenue was forced to make 200,000 emergency payments, and call centres were swamped, with over 2m calls made on some days. The Inland Revenue had received a rude awakening to its new sphere of responsibility, as women arrived in tax offices with their children asking how they were expected to feed them that week”.

At the start of the programme, telephone helplines were overwhelmed with enquiries. They were undermanned by inadequately trained staff, with the result that many claimants received incorrect advice or failed to get through to the helplines at all.

For employers to operate the system without unnecessary over and underpayments they required start and stop notices in real time order. The Inland Revenue`s computer did not always achieve this basic objective. Sometimes stop notices were issued for employees for whom there was no start notice. Moreover employers received many more amendment notices than the Revenue had predicted. In our survey, one payroll manager commented: ‘Six changes in a month is excessive… but last month one worker got four tax credit changes simultaneously’ (Godwin and Lawson, 2009b:192).

Eventually the contract with EDS, along with other government contracts, was terminated and transferred to another company, Cap Gemini.

Numerous official and welfare rights group reports have criticised the administration of tax credits, including the Child Poverty Action Group (Howard, 2004), Citizens Advice Bureau (Lane and Wheatley, 2005), the National Council for One Parent Families (Griggs *et al.,* 2005), the Parliamentary Ombudsman (2005), and the Public Accounts Committee of the House of Commons (2006). The introduction of CTC and WTC was criticised as a ‘debacle’ in the influential Mirrlees Review (Shaw *et al.,* 2010:1103).

Employer Compliance Issues

Godwin and Lawson (2009b) carried out a series of forty case study interviews with employers, training organisations and payroll bureaux about the changeover from WFTC to WTC. The sample included five payroll bureaux, four training organisations, and thirty-one employers with work forces varying from 13 to 27,000. Between them the interviewees represented a very large number and a very wide range of employees and clients.

TCs had a very inequitable compliance impact, depending on the pay rates and employment structure of the workforce. Over half the interviewees suggested that the costs were “minimal”, and comments reporting problems and high costs of operating WTC came from only a minority of respondents. Five respondents gave a figure of ten per cent or more of payroll costs, especially among firms with high labour turnover, which was a key variable driving compliance costs. Respondent firms in low pay industries, such as retailing, cleaning and catering reported extensive problems with the operation of WTC; and some large employers had encountered multiple problems. Responsible employers offered advice services to employees and took up their cases with the Revenue when they encountered errors. The majority of interviewees reported ‘many’ queries; some employers reported being ‘inundated’ and employees continued to seek advice even after PVE had ceased.

WTC assessment began when an employee filed a claim with HMRC, including income and family information. For an accepted claim the employer was required to implement a start notice, which operated until either the employee left, entitlement stopped or was amended. Employers` National Insurance and PAYE payments were reduced to compensate their WTC pay outs.

Employers should have had no role in WTC assessment, beyond confirming applicants` work hours. But the survey made clear that in practice many felt it a duty to help their employees receive their entitlements, or noticed HMRC errors, when responding to their employees` questions. Such questions were a significant compliance cost, the more so because employers did not know the basis for the Revenue`s decisions.

Employers` costs originated from a variety of factors. For example a successful claim might alert other employees to ask the employer if they also were eligible. Employers claimed to have had problems with the timing of start (paying WTC) and stop notices, to have received multiple notices, and because of intra-firm communication problems, to have been timely in stopping payments, for example because of employees leaving.

It became apparent that with payment via the employer (PVE), costs were imposed in an uneven and inequitable manner on employers. Industries where low pay was widespread and labour turnover was high frequently had many WTC cases, whereas industries with high pay and low labour turnover encountered few WTC cases.

There was also a suggestion that smaller employers were reluctant to employ more staff if they would have to operating WTC for them – exactly the opposite effect to that which the policy was designed to achieve. Many of our respondents pointed out such practices were illegal or unethical. But a small manufacturer with 14 employees said, 'I would consider carefully before employing anyone who would need to claim'.

Attempt at Reform: the Tax Credits Transformation Programme

The Tax Credits Transformation Programme attempted to improve the administration of tax credits and to reduce overpayments and underpayments. "The aims of the Transformation Programme are to: create a tax credit service which is clearly understood and trusted by claimants and align that delivery with child benefit where it makes sense to do so; and ensure the right claimants receive the right money at the right time through a range of services and communications tailored to meet their individual needs and circumstances" (National Audit Office, 2009:42). It was recognised that the Revenue's original 'one-size-fits-all' approach to claimants had "paid little regard to claimants' domestic or financial circumstances or their level of literacy and numeracy" – a costly error which the Department of Work and Pensions would have been less likely to make. The issue was highlighted in a newspaper interview by the then Comptroller and Auditor General, Sir John Bourne: "The thing about tax credits, and I find this just incredible, is the failure of imagination and sociological competence. A scheme has been designed in which we over-pay a lot of poor people, who often have trouble managing money. So when we later demand repayment that causes a great deal of anguish". (Sunday Telegraph, 2006)

It was found disproportionate risks came from a relatively small group of claimants - six per cent of claimants were responsible for 29 per cent of all losses. HMRC therefore started to group claimants according to the behaviour that led to the overpayment as well as their circumstances, and created a Debt Recovery Co-ordination Group; tested a campaign-based approach to the recovery of debt; and trialled using the PAYE system to recover overpayments through Income Tax coding adjustments on a voluntary basis.

The system of direct payment of WTC via the employer was abandoned in favour of direct payment in 2006 as experience demonstrated that employers were unwilling to take on the task of benefit administrators.

From 2003 to 2006, the first £2,500 of any difference between previous year and current year's income was disregarded. The frequency of changes in income resulted in a new code of practice being instituted in 2006-7 under which this 'disregard' was increased tenfold to £25,000, so that if income rose by up to £25,000 in one year, the tax credit award for that year was unaffected, reducing the chance that overpayments would be generated. The estimated cost to the Exchequer was some £500m per year; subsequently the disregard was reduced to £10,000 in April 2011, and is expected to be further reduced to £5000 in April 2013.

"The price paid for more responsiveness [than WFTC] has been the problem of overpayments and the attendant lack of certainty" (Brewer, 2006b:144). Giving evidence to the Parliamentary Treasury Committee, Brewer commented that "If the reforms announced in the Pre-Budget Report do not work, then I cannot see anything else the Government could do to make tax credits more palatable to members of the public currently receiving it, other than scrapping it. It would take another couple of years to assess whether the reforms were working … perhaps looking at years (Brewer (2006a:Ev31)".

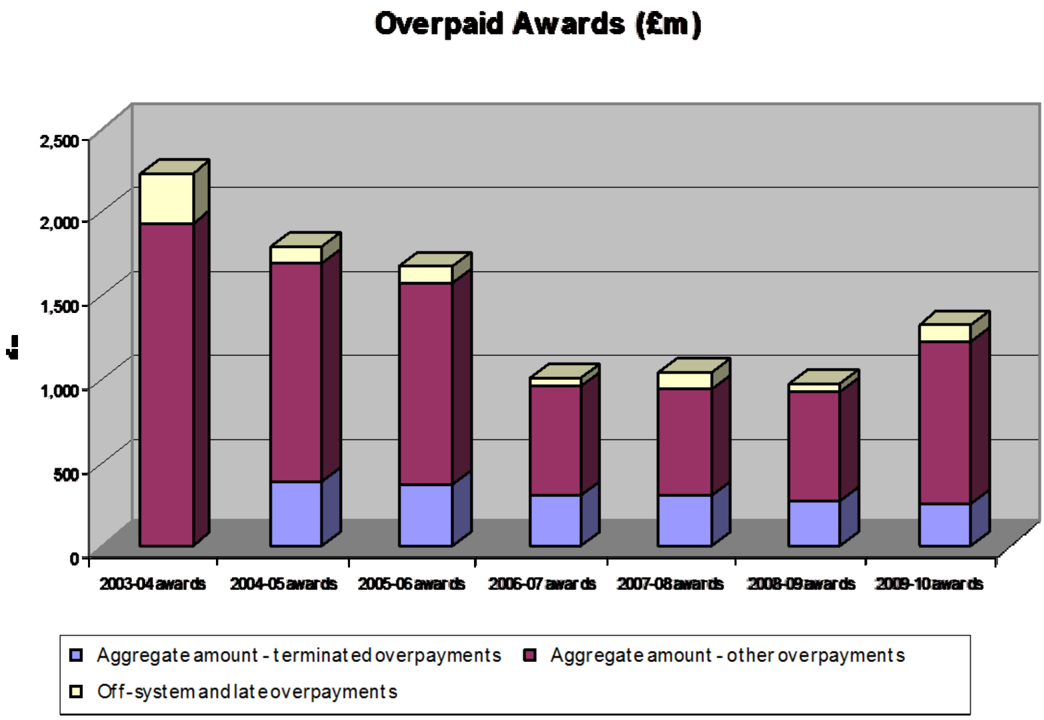
Overpayment, Underpayment and Complaints

The difficulties of assessing and collecting overpayments and underpayments on an annual basis has caused problems throughout the life of TCs. Substantial numbers of complaints were generated every year, and were reported on and the Adjudicator - the independent officer responsible for dealing with complaints against HM Revenue and Customs (HMRC) - highlighted a number of continuing problems with the tax credits system, including: delays in claimants receiving their correct entitlement; difficulties in contacting the tax credit helpline; failure by the Revenue to update claimants' records; payments made to the wrong bank account; and problems relating to the recovery of overpayments, including differing interpretations of the department's code of practice on overpayments (COP26). (Adjudicator's Report 2004-5),

Most complaints have related to refusal to write off overpayments (Adjudicator's Report 2011:18). After the reforms of the Tax Credit Transformation Programme (see below) complaints fell slightly, from 1543 in 2006/7 to 1451 in 2008/9 and 1239 in 2009/10 (Adjudicator's Report 2009 :8). A serious backlog of 1509 tax credit cases built up (Adjudicator's Report 2010:12). However, by 2010-1, the number of new complaints had fallen substantially to 766, enabling the backlog to be cleared, But even after these reforms, 66 per cent of complaints were upheld partly or substantially in the most recent year available (Adjudicator's Report 2011:18).

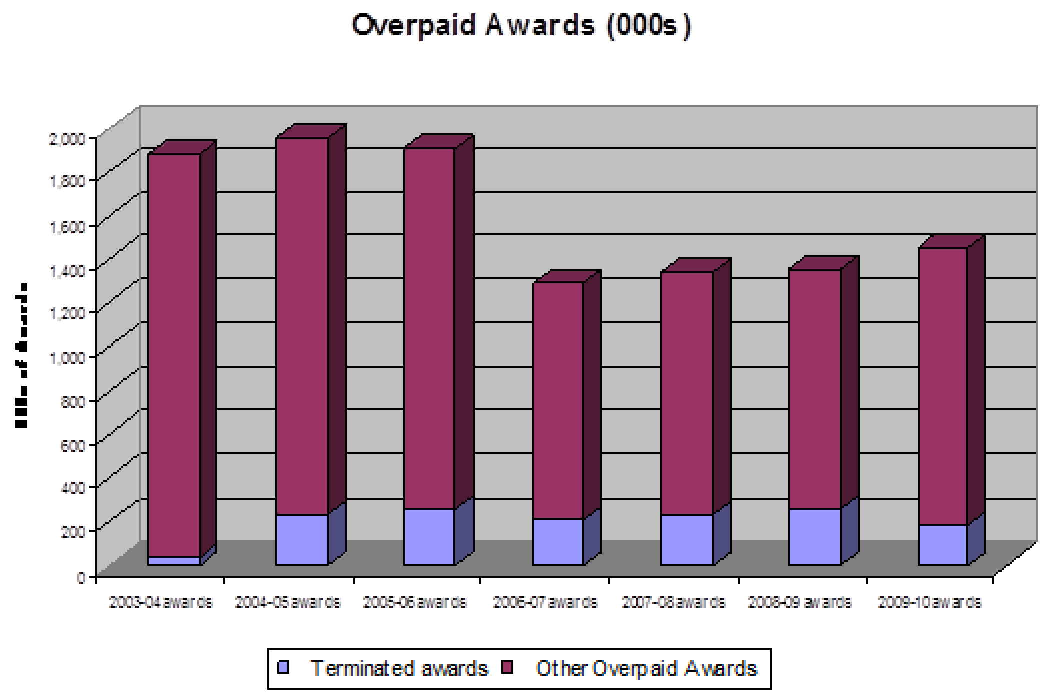
It can be seen from the Charts 1 and 2 that some control was exerted on overpayments after 2005-6, when they stood at £2.2bn (1.88 million cases). In 2006-7 they were £1bn (1.45 million cases); but they then began to rise again, reaching £1.3bn by 2009-10.

Chart 1: Overpaid awards (£m)
Terminated awards (blue) are those where claimants failed to report income by the due date, or to sign an award notice, or ceased to qualify; continuing awards are in mauve. Off-system and late overpayments are in white.



Source:
HMRC (2011b) Child and Working Tax Credits Statistics, Finalised annual awards 2009-10: Supplement on payments in 2009-10
www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-final-awards-supp-may11.pdf
accessed 21/8/2012

Chart 2: Overpaid Awards (thousands)
Terminated awards are shown in blue; continuing awards are in mauve. Off-system and late overpayments are omitted from this chart.



Source: HMRC (2011b) Child and Working Tax Credits Statistics, Finalised annual awards 2009-10: Supplement on payments in 2009-10 www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-final-awards-supp-may11.pdf accessed 21/8/2012

Error and Fraud
Error both by the Revenue, and error and fraud by claimants were substantial and have subsequently shown little sign of coming under control. HMRC's latest estimate is that in 2010-11 error and fraud resulted in overpayments of between £2.08 billion and £2.46 billion, (between 7.5 and 8.8 per cent of total TCs expenditure). Error in favour of claimants has been substantial since 2003, but deliberate fraud has risen dramatically in the last four years, from 0.3 per cent to more than 2.0 per cent of finalised credits. Error was down to 5.7 per cent in 2010-11 from 7.9 per cent in 2005-6.

In December 2005, the "e-portal" used for on-line TC applications was closed after organised criminals used the stolen identities and personal details of public sector staff to make fraudulent online TC claims. Three years earlier HMRC had been warned to improve their security, but had 'failed to reassess the security of the internet channel at any point in the three years after the e-envoy's guidance was issued' (House of Commons Committee of Public Accounts, 2007:12).

HMRC reassured Parliament that the tax credit e-portal would only be reopened when it was proofed against security breaches, but identity authentication proved difficult to achieve (Kennedy, 2008).

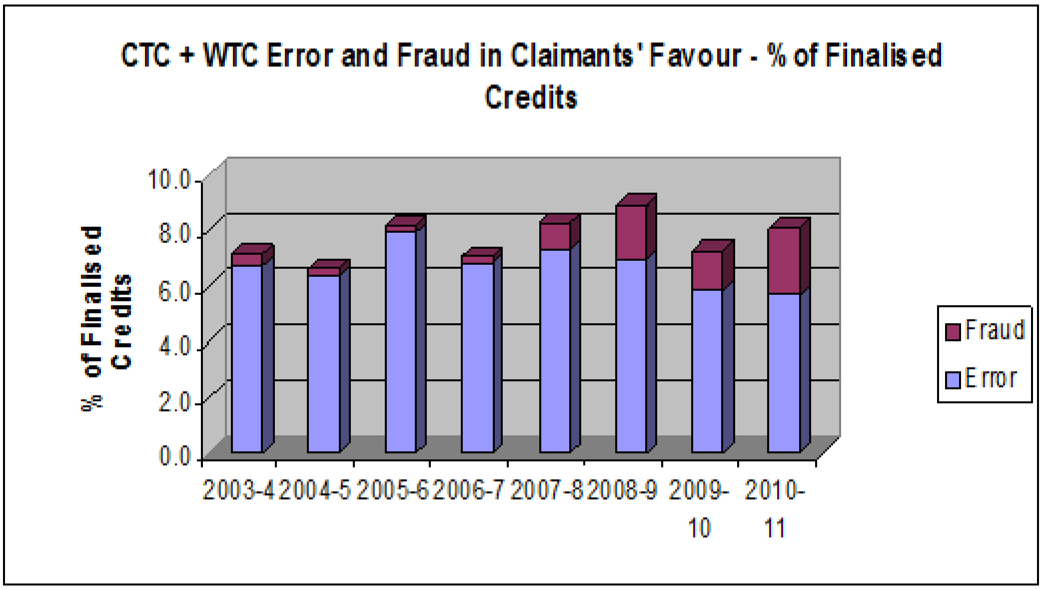
A second potential fraud problem involved single parents, 2.1 million of whom received CTC in 2005-6. But the 2006 Labour Force Survey estimated there were only 1.9 million single parents, using a slightly different definition (Brewer and Shaw, 2006; Field and Cackett, 2007).

A third problem is caused by the incentive for both employees and employers to understate earnings. If they do then employees can claim more benefits and pay less tax and National Insurance, and employers can pay lower taxes and National Insurance.

A fourth problem involves illegal benefit claims by non-residents. Because HMRC cannot single out specific national groups, there is no nationality question on the TC form, which hinders residency checks. The Public Accounts Committee also established that at least before 2007 HMRC had no capability to check whether a claimant`s non-resident child actually existed (Committee of Public Accounts, 2007).

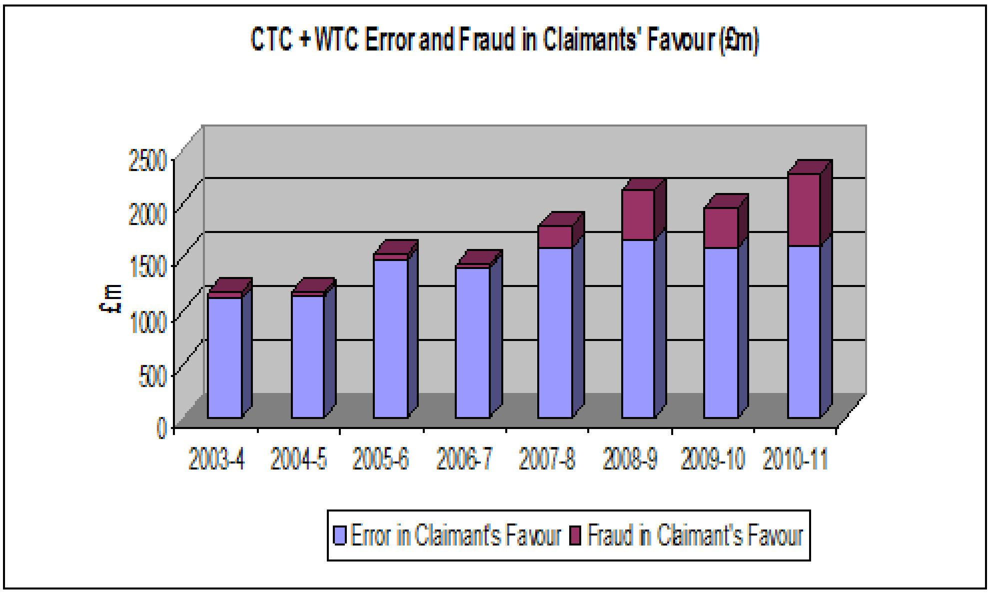
In July 2008, partly in response to such shortcomings HMRC announced a target to limit tax credit losses due to error and fraud to a maximum of five per cent of the value of finalised entitlement (NAO, 2011b:44). But this target was badly missed: in 2010-2011 error alone was 5.7 per cent of finalised entitlement, and fraud was at a new high of 2.4 per cent (HMRC, 2012).

Chart 3 Error and Fraud by Claimants in Percentage terms: Error in blue, fraud in mauve



Source:
HMRC (2012) Child and Working Tax Credits Error and Fraud Statistics 2003-4 to 2010-11, www.hmrc.gov.uk/stats/personal-tax-credits/error-fraud.htm accessed 21/8/2012

Chart 4 Error and Fraud by Claimants in £m: Error in blue, fraud in mauve

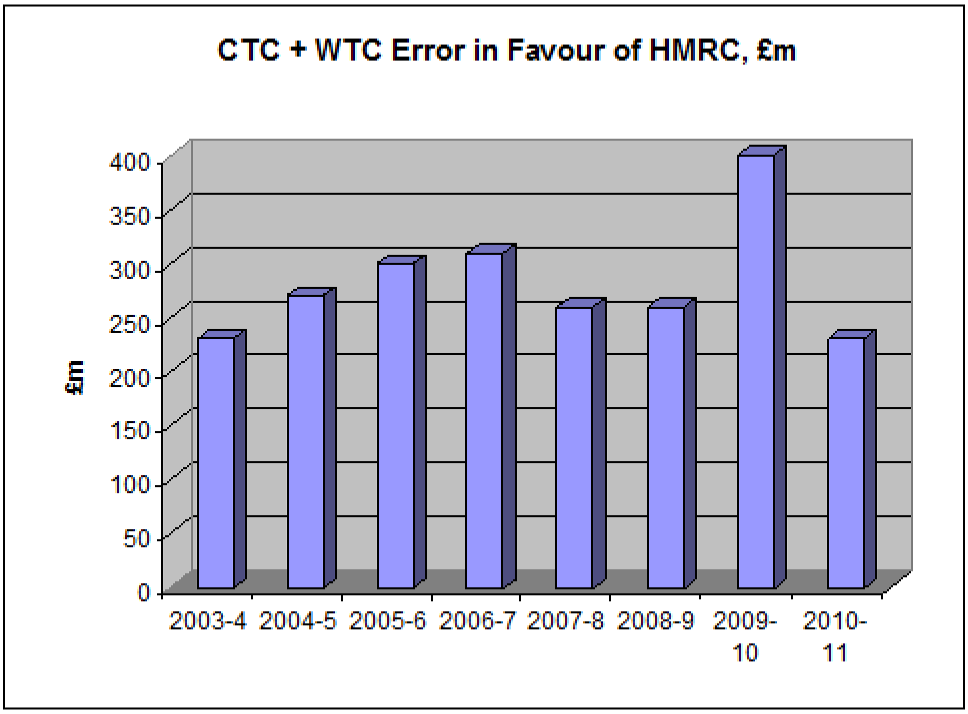


Source:HMRC (2012) Child and Working Tax Credits Error and Fraud Statistics 2003-4 to 2010-11, www.hmrc.gov.uk/stats/personal-tax-credits/error-fraud.htm accessed 21/8/2012

Error in favour of claimants has been running at around £1.1 – 1.6bn since 2003, but deliberate fraud rose dramatically in the last four years for which data are available, from £70m in 2003-4; £210m in 2007-8; £460m in 2008-10, and reached a new high of £670m in 2010-11.

It is also worrying that administrative errors in favour of the Revenue are still substantial. The 2006-7 and 2007-8 reforms temporarily curbed the amount collected erroneously, but there was a further spike to a new peak of £400m in 2009-10. However the most recent figures show a reduction to the same order of magnitude as 2003-4.

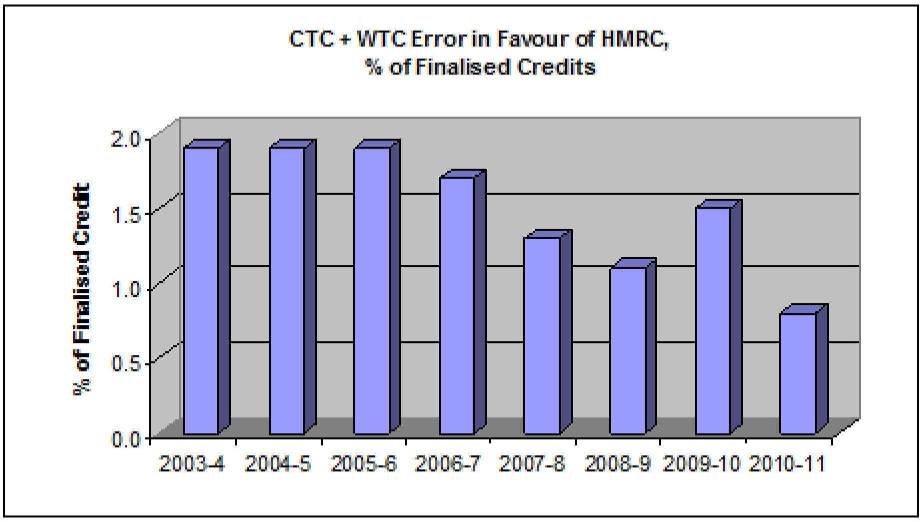
Chart 5 Error in favour of HMRC in £m



HMRC (2012) Child and Working Tax Credits Error and Fraud Statistics 2003-4 to 2010-11, www.hmrc.gov.uk/stats/personal-tax-credits/error-fraud.htm accessed 21/8/2012

TC`s administrative errors in favour of the Revenue were running at 1.9 per cent of finalised credits between 2003 and 2006, when an attempt was made to control them. The effort to control administrative error had an impact, as the most recent figure for 2010-11 is the lowest so far, at 0.8 per cent.

Chart 6 Error in Favour of HMRC in Per Cent



HMRC (2012) Child and Working Tax Credits Error and Fraud Statistics 2003-4 to 2010-11, www.hmrc.gov.uk/stats/personal-tax-credits/error-fraud.htm accessed 21/8/2012

Take-up Issues

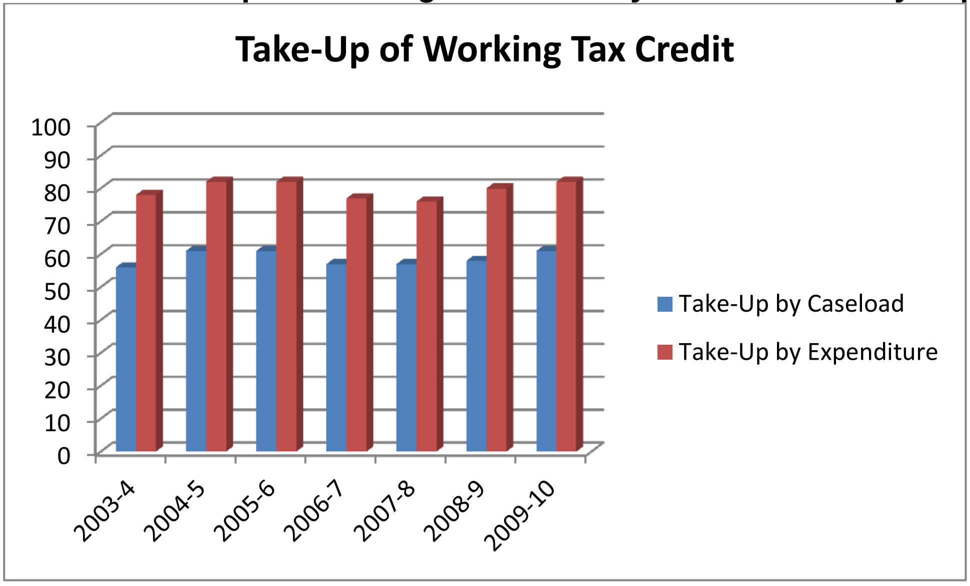
It should be noted that take-up can be calculated by caseload or by expenditure. It is a feature of tax credits that the expenditure rates tend to be higher than the caseload rates, presumably because smaller amounts are less likely to be claimed.

Take-up Issues and WFTC

In its final year of 2002-3 the 1999 WFTC system encountered take-up problems in the range 72 to 76 per cent, though expenditure take-up was higher at 82 to 88 per cent (estimates are based on statistical procedures that are subject to a plus or minus 2 to 4 per cent error bar, described in *Child Benefit, Child Tax Credit and Working Tax Credit Take-up Rates 2009-10* (HMRC, 2011a).

It had been hoped that take-up would be increased under TCs, and take-up of CTC did improve to 81 per cent by caseload and 90 per cent by expenditure. However WTC take- up remained low – it evidently got off to an uncertain footing by the compulsory routing of the payment through the employer and has never been taken up by more than 61 per cent of claimants. Its average take-up of 59 per cent was even lower than the acknowledged unsatisfactory take-up of WFTC. But WTC attained 82 per cent by expenditure - more or less comparable to WFTC levels.

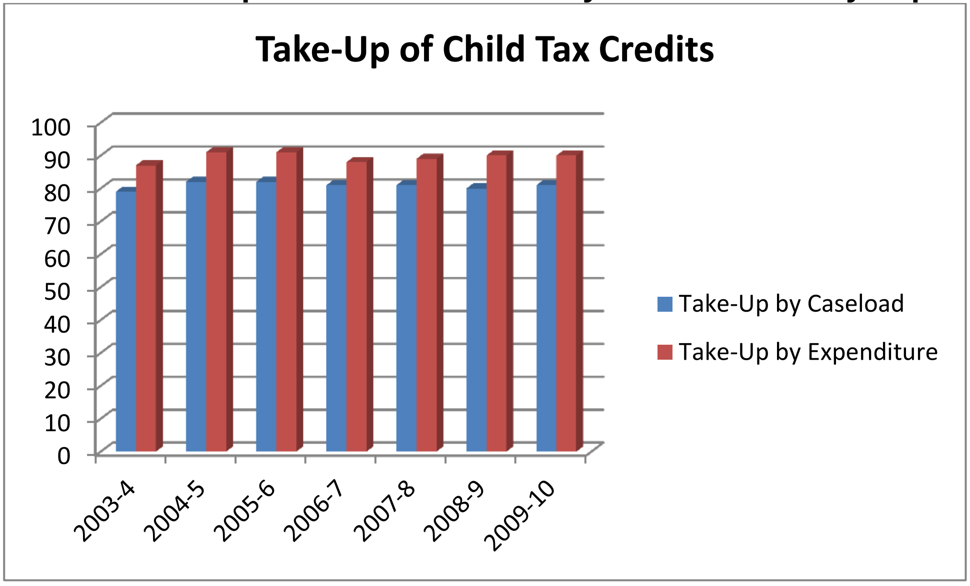
Chart 7: Take-Up of Working Tax Credit by Caseload and by Expenditure



Source: Personal Tax Credits and Child Benefit: finalised award statistics - take-up rates, www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-take-up.htm (accessed 21/8/2012).

In contrast, take-up of Child Tax Credit has been high throughout, averaging 81 per cent by caseload and 89 per cent by expenditure. This is interesting because CTC has always been paid directly from DWP to the claimant, unlike WTC.

Chart 8: Take-Up of Child Tax Credit by Caseload and by Expenditure



Source: Personal Tax Credits and Child Benefit: finalised award statistics - take-up rates, www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-take-up.htm (accessed 21/8/2012).

There have been estimates of WTC`s take-up shortcomings by household group and ethnic group. Single people without children form the largest non-claimant household group (HMRC, 2007a:12). Chinese and Indian households' take-up, by expenditure, has been estimated at, respectively, 23 per cent and 19 per cent less than that of White households. But take-up for Pakistani and Black households is only 5 per cent less than that of White households (HMRC, 2007b:9).

Take-up for lone parents, at 80 per cent, is vastly greater than the 55 per cent for couples (McKay, 2003:3,54). Field and Cackett (2007:25) explain this discrepancy by noting that a couple`s joint income is used to assess their WTC entitlement. In addition, because WTC is paid at a higher rate than was WFTC, this improved the work incentives facing single parents or the first earner in a couple, while lowering that for the second.

Reputational Damage to HM Revenue and Customs

The National Audit Office (NAO) and many other bodies have repeatedly criticised HMRC's administration of tax credits. As early as their 2005-6 report they commented on the fact that organised fraudsters were targeting TCs. "The Department … needs to improve its collection rate for tax credits debt, which is substantially lower than that for tax debts" stated the head the NAO in 2010. Continuing failure to eliminate administrative error in the operation of the Tax Credit system has resulted in HMRC having their accounts qualified by the Comptroller and Auditor General in every year since their introduction. In a summary of work on HMRC, the NAO reported that: "since the introduction of working tax credits and child tax credits in 2003 we have qualified our opinion on the regularity of this expenditure because of the estimated levels of error and fraud" (National Audit Office, 2011a:12). Accordingly, the reputation of HMRC for administrative competence has fallen, and it has come as little surprise that the body chosen to administer Universal Credit will be the DWP, not HMRC.

Comparison with Universal Credit

In 2010, the new Coalition administration announced its intention of introducing a new Universal Credit (UC) to be administered by the Department for Work and Pensions (DWP) to take effect from autumn 2013. This would co-ordinate the administration of CTC and WTC, Housing Benefit, income-related Job Seekers Allowance, Employment and Support Allowance, and Income Support.

It is claimed that take-up rates will be improved "By creating a single, integrated benefit, households who claim Universal Credit will now automatically receive everything they are entitled to …The new system ensures that someone either claims everything (because they are eligible) or nothing (because they are ineligible)… with this much simpler system, households will be more likely to claim their full entitlement… By virtue of the changes to entitlement and improved take up, Universal Credit will have a substantial positive impact on poverty, for both children and adults: Universal Credit could lift as many as 350,000 children and 500,000 working-age adults out of poverty" (DWP 2010b: 52).

The Universal Credit should end the complex system of annual reconciliations, by obtaining data direct from the new PAYE computer rather than relying on respondents' reports of their incomes. This will eliminate the issues of overpayment and underpayment which dogged TCs. "Overpayments and subsequent repayments can create serious cash-flow problems, making it even more difficult for [people] to manage their finances. A simpler and fairer system could…reduce the scope for error and fraud" (DWP, 2010a:6). It will reduce fraud and error because it will be easier to understand and will not rely on claimants' self-reported earnings.

A single organisation will deliver Universal Credit, enabling this waste and inefficiency to be eliminated (although Council Tax Benefit and its successor benefits will be excluded). It was no surprise when the new administration decided that the Universal Credit would be better handled by the DWP which already administers the main out of work benefits and operates employment and labour market services, than by HMRC.

The transition from Tax Credits to Universal Credit will be gradual: The new HMRC real-time earnings system will be piloted from April 2012, with the aim of going live by April 2013. There will be a direct link with HMRC's new real-time PAYE system, a link which was not made under Tax Credits. The first Universal Credit cases will be taken on in October 2013 and the last Tax Credit cases will be accepted in April 2014. Final transfer of existing TC cases to Universal Credit is targeted for October 2017.

Conclusions and Recommendations

After a catastrophic start, the Tax Credits programme never really solved the endemic problems associated with its error-proneness and scope for fraud, which has worsened rather than improved over its life. Fraud increased dramatically from £40 million in 2006-7 to £460 million in 2008-9. The most recent estimate, for 2010-11, is a new high of £670 million. The latter is the mid-point of a confidence interval for final expenditure of between £540m and £800m, based on a random sample of

4000 claimants. Since the 2006 reforms the cumulative amount of misappropriated revenue is roughly £1.25billion.

The term ‘Credits’ has been retained from Taylor’s original recommendations, but much else has gone by the board. He argued that calling the payment a tax credit would reduce stigma and so raise its take-up rate. HM Treasury (1998) accepted this hypothesis. He also suggested that delivering the credit through the employer would ‘reinforce the distinction between the rewards of work and remaining on welfare’ (Taylor, 1998:22). He speculated that ‘A tax credit will associate the payment in the recipient’s mind with the fact of working, a potentially valuable psychological change’ (Taylor, 1998:8). It is worth noting that when the WFTC was introduced, no evidence was presented on this ‘potentially valuable psychological change’. It is hard to see quite how the psychological change would have been necessarily associated with PVE.

It would appear that Taylor did not appreciate that while it is normal for US and Australian taxpayers to file an annual return and receive a repayment of overpaid tax (Hodgson and Boden, 2008:40), in the UK most employed workers are taxed under cumulative PAYE, which is designed to calculate total tax correctly, so they have no need to claim a rebate at the year end. Thus only a minority of UK taxpayers file annual tax returns. Indeed about a third of UK adults are below the income tax threshold, so have no other contact with the Revenue apart from their Tax Credit claim (Browne, 2012). In an interview several years after the introduction of TCs, Taylor conceded that "If I had my time over again, I'd shout louder about the dangers involved, and warn them against overloading the tax system” (Davis, 2007:58). It is perhaps both interesting and curious that a government advisor has recently suggested that overpayment and subsequent rebates of income tax should be instituted in the UK (McSmith, 2012). Experience with Tax Credits suggests that this plan would be fraught with risk.

Even so, Tax Credits delivered unprecedented financial support to working families during the past decade - “the largest reduction [of child poverty] … since 1961” (Cribb *et al*, 2012:5).

By 2011, 6.4 million families, containing 10.3 million children, were receiving tax credits or equivalent child support through benefits. Two million of the families were receiving both CTC and WTC, while 0.6 million were receiving only WTC (HMRC, 2011b).

It is anticipated that some CTC and WTC cases will continue alongside the new Universal Credit system until 2017. It is to be hoped that Universal Credit will overcome many of the disadvantages that were encountered with Tax Credits. The exclusion of Council Tax Benefit from the new system has also been criticised (Adam and Browne, 2012). The current administration appears to be divided between ‘centralisers’, who favour country-wide structures, and ‘decentralisers’, who argue for local variations in policies. The proposed restructuring of Council Tax Benefit, to allow local authorities some choice in its local application, appears to be a victory for decentralisers - won at the cost of excluding these payments from the Universal Credit system, so weakening the case for that system.

It is a commonplace in compliance cost literature that no matter how unwieldy a system, the costs of change to another system are always likely to be large. The experience with TCs suggests several improvements are needed. The Tax Credit Transformation Programme tackled some of the unsatisfactory features of TCs, but there have since been worrying signs that problems such as organised fraud remain unsolved. The parallel operation of TCs and UC between 2013 and 2017 may offer more opportunities to fraudsters.

Recommendation 1 An explosion of fraud and error, like that from 2007-8 to 2009-10, requires an explosion of anti-fraud and anti-error measures.

The overall level of TC error and fraud, at 8.1 per cent, is more than three times the current average of 2.1 per cent for DWP-administered benefits. The switching of administration of Universal Credit to DWP is a clear admission that HMRC was unsuited to the task of benefit administration.

Recommendation 2 Pay benefits through a specialist benefit agency, not through tax raising agencies.

Recommendation 3 Do not pay benefits through the employer – WTC`s low take-up may in part have been a result of PVE.

Recommendation 4 Avoid radical new delivery software. The link to HMRC`s new ‘Agile’ computer system, currently under testing, is a key feature of the Universal Credits programme, and there are already doubts about it (Seddon and Thornton, 2011). It is also unclear how the ‘real-time’ system will cope with the self-employed and their expenses.

Recommendation 5 Minimise overpayments, because they are difficult to recover.

Recommendation 6 Avoid payment systems that involve complex cumulative annual entitlement calculations.

Whiteford *et al.* (2003) state that the Canadian system worked well because it was designed to be less responsive to small changes in income, but the UK system, following Australia, aimed to be very responsive. It is clear that WTC and CTC erred too far in the direction of complexity in pursuit of the laudable aim of responsiveness to changes. It is preferable to pay fixed awards, if only because disregards can be expensive. Factors that create administrative error should be targeted: it is to be hoped that this will be done under Universal Credit.

References

Adam S and Browne J, (2012) Reforming Council Tax Benefit, Commentary no. 123, London: Institute for Fiscal Studies, May, 8-9, www.ifs.org.uk/comms/comm123.pdf (accessed 16.7.2012).

Adjudicator’s Reports 2003 - 2011. http://www.adjudicatorsoffice.gov.uk/publications.htm ,(accessed 27.3.2012).

Brewer M (2006a) answers to Q180, 181 and 195, Treasury Committee,18 January. pp Ev30 – Ev33, http://www.publications.parliament.uk/pa/cm200506/cmselect/cmtreasy/uc811-ii/uc81102.htm , (accessed 27.3.2012).

Brewer, M. (2006b) 'Tax credits: fixed or beyond repair?' IFS Green Budget, Institute for Fiscal Studies, pp. 133-148. http://www.ifs.org.uk/budgets/gb2006/06chap7.pdf (accessed 27.3.2012).

Brewer, M. and Shaw, J. (2006) How many lone parents are receiving tax credits? IFS Briefing Note 70, London: Institute for Fiscal Studies. www.ifs.org.uk/bns/bn70.pdf (accessed 21/8/2012).

Brown, J (2012) `A £10,000 personal allowance: who would benefit, and would it boost the economy?` Institute for Fiscal Studies, March, www.ifs.org.uk/publications/6045 (accessed 16.7.2012).

Cribb J, Joyce R and Phillips D (2012) in *Living Standards, Poverty and Inequality in the UK: 2012*, London, Institute for Fiscal Studies, www.ifs.org/comm124.pdf (accessed 16.7.2012).

Davies, W, (2007) `Tax Credits: The Success and Failure`, *Prospect Magazine*, 30, June, 57-62. www.prospectmagazine.co.uk/magazine/taxcreditsthesucessandfailure (accessed 16.3.2012).

Department for Work and Pensions (2010a) *21st Century Welfare*, July, Cm 7913, www.dwp.gov.uk/docs/21st-century-welfare.pdf (accessed 16.7.2012).

Department for Work and Pensions (2010b) *Universal Credit: Welfare That Works*, November, Cm7957, Ch7, www.dwp.gov.uk/docs/universal-credit-full-document.pdf (accessed 21/8/2012).

Field, F. and Cackett, B. (2007) *Welfare isn't working: Child poverty*, London: Reform.

Godwin, M. and Lawson, C. (2009a) `The Working Tax Credit and Child Tax Credit 2003-08: a critical analysis` *Benefits*, 17, (1), 3-14.

Godwin, M and Lawson, C (2009b) `Hidden Costs of the Welfare State: Employers' Compliance Costs and the Working Tax Credit`, *Social Policy and Society* 8, (2), 185-195.

Goode, J., Lister, R. and Callendar, C. (1998), *Purse or wallet? Gender inequalities and income distribution within families on benefit*, London: Policy Studies Institute.

Griggs J, McAllister M, Walker R (2005), *The New Tax Credits System: Knowledge and Awareness Among Recipients.* London: National Council for One Parent Families.

HMRC Tax Credit Statistics and Estimates, 2004-5 to 2010-11, e.g.
HMRC (2011) Child and Working Tax Credits Statistics, Finalised awards 2007-8: Supplement on payments in 2007-8, http://www.hmrc.gov.uk/stats/personal-tax-credits/ctcw-tax-credit-final-may09-sup.pdf (accessed 21/8/2012).

HMRC (2007a) Child Tax Credit and Working Tax Credit: Take-up rates 2004-05. www.hmrc.gov.uk/stats/personal-tax-credits/takeup-rates2004-05.pdf (accessed 21/8/2012).

HMRC (2007b) Child Tax Credit and Working Tax Credit: Take-up by ethnic group 2004-05 www.hmrc.gov.uk/stats/personal-tax-credits/takeup-ethnicgroup0405.pdf (accessed 22/8/2012).

HMRC (2011a) Child Benefit, Child Tax Credit and Working Tax Credit Take-up Rates 2009-10. www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-take-09-10.pdf (accessed 31.7.2012).

HMRC (2011b) Child and Working Tax Credit Statistics, Finalised annual awards 2009-10: Supplement on payments in 2009-10, London: HMSO. www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-final-awards-supp-may11.pdf (assessed 21/8/12).

HMRC (2012) Child and Working Tax Credits Error and Fraud Statistics 2003-4 to 2010-11. www.hmrc.gov.uk/stats/personal-tax-credits/cwtcredits-error1011.pdf (accessed 20.7.2012).

Hodgson H and Boden R (2008) `Not-so-distant cousins: Family benefits in the United Kingdom and Australia`, *International Social Security Review*, 61, 3, 29-46.

House of Commons Committee of Public Accounts (2006) *Inland Revenue: Tax Credits and Deleted Tax Cases, Fifth Report of Session 2005–06*, HC 412 (incorporating HC 269-i, Session 2004–05), House of Commons.

House of Commons Committee of Public Accounts (2007), *Tax Credits, Twenty-second Report of Session 2006–07, House of Commons.* (www.publications.parliament.uk/pa/cm200607/cmselect/cmpubacc/487/487.pdf (accessed 20.7.2012).

House of Commons Committee of Public Accounts (2007) Minutes of evidence: Oral evidence taken before the Committee of Public Accounts on Monday 23 October 2006, Q46-Q54. www.publications.parliament.uk/pa/cm200607/cmselect/cmpubacc/487/6102301.htm (accessed 22/8/2012).

HM Government (2011) *Tackling Fraud and Error in Government: A Report of the Fraud, Error and Debt Taskforce*, London: Cabinet Office.

HM Treasury (1998), The Working Families Tax Credit and Work Incentives: The Modernisation of Britain’s Tax and Benefit System, No. 3, London: HM Treasury.

Inland Revenue (2005) Working Families' Tax Credit: Estimates of Take-up rates in 2002-03. London: Inland Revenue Analysis and Research ?LAST PART OF REF OK? No sign of any HMSO involvement.

Howard, M (2004) *Tax Credits – One Year On*, London: Child Poverty Action Group.

Inland Revenue Tax Credit statistics and estimates, 2003/4. London: Inland Revenue, HMSO.

Kennedy J (2008) Hansard HC Deb, 4 March 2008, c2328W
http://www.theyworkforyou.com/wrans/?id=2008-03-04d.190338.h
(accessed 22/8/2012).

Lane K and Wheatley J assisted by Bremner A, (2005), `Money with Your Name on It: CAB clients' experience of tax credits` London, Citizens Advice Bureau and Citizens Advice Scotland.

McKay, S. (2003) Working Families' Tax Credit in 2001, DWP Research Report no 181, Leeds: Corporate Document Services
www.dwp.gov.uk/asd/asd5/rrep181.pdf , archived at
http://webarchive.nationalarchives.gov.uk/+/http://www.dwp.gov.uk/asd/asd5/rrep181.pdf/ (accessed 21/8/2012).

McSmith A (2012) `Government adviser urges the taxmen to overcharge us` *Independent*, 14 July. http://www.independent.co.uk/news/people/diary/diary-government-adviser-urges-the-taxmen-to-overcharge-us-7942387.html
(accessed 22/8/2012).

National Audit Office (2009) *Report By The Comptroller And Auditor General On HM Revenue & Customs 2008-09 Accounts.* London: NAO.

National Audit Office (2010) *Press Release - HM Revenue and Customs 2009-10 Accounts* London: NAO.
http://www.nao.org.uk/publications/press_notice_home/1011/hmrc_2009-10.aspx
accessed 22/8/2012.

National Audit Office (2011a) *A summary of the NAO's work on HM Revenue & Customs 2010-11*, London: NAO.
http://www.nao.org.uk/publications/1012/reducing_costs_in_hmrc.aspx , accessed 21/8/2012.

National Audit Office (2011b) *HM Customs and Excise Accounts 2010-2011: Comptroller and Auditor General's Report*, para 4.5, pR44. London: NAO.

Parliamentary Ombudsman (2005), `Tax Credits – Putting Things Right`, HC124, London: HMSO, www.ombudsman.org.uk/improving-public-service/reports-and-consultations/reports/parliamentary/tax-credits-putting-things-right
Or http://www.ombudsman.org.uk/__data/assets/pdf_file/0008/1115/Tax-Credits-Putting-Things-Right.pdf (accessed 21/8/2012).

Seddon J and Thornton D (2011) `Universal Credit: a brilliant idea guaranteed to fail` http://www.universalcredit.co.uk/universal-credit-a-brilliant-idea-guaranteed-to-fail/ , (accessed 27.3.2012).

Shaw J, Slemrod J and Whiting J (2010), `Administration and Compliance`, in J. Mirrlees, S. Adam, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles and J. Poterba (eds), *Dimensions of Tax Design: the Mirrlees Review Vol 2,* Oxford: Oxford University Press for the Institute for Fiscal Studies, 1100-1204.

Sunday Telegraph (2006) Interview with Sir John Bourne, 22 July.

Taylor, M. (1998), *Work Incentives: The Modernisation of Britain`s Tax and Benefit System, No. 2*, London: HM Treasury, www.hm-treasury.gov.uk/d/120.pdf (accessed 22/8/2012).

Whiteford, P., Mendelson, M. and Millar, J. (2003), *Timing it Right? Responding to Income Changes: A Comparison of Australia, Canada and the UK*, York: York Publishing Services for the Joseph Rowntree Foundation.