HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

The Rt Hon Stephen Timms MP
Chair, Work and Pensions Committee
House of Commons
London
SW1A 0AA

2 September 2020

Dear Stephen,

## Tax credits debt repayments

Thank you for your letter of 27 July about the impact of tax credits debt repayments on Universal Credit claimants.

I have answered the questions below in the order you have asked them.

### 1. It's been estimated that there is around £6bn of outstanding tax credits debt. On average, how old is this debt?

There is £4.8bn of outstanding tax credits debt in HMRC up to and including the 2019-20 tax credits award year. On average, that debt is 6 years old. The average age of debt was derived using the April 2020 version of tax credits automated report generated by HMRC internal IT system, which provides the end-of-year update on tax credits debt for 2019-20.
Source: HMRC's internal IT tax credits report 2019-20

### 1a. The FCA has said that claims for debts must be made within a prescribed period (usually six years), otherwise it is statute barred. While we appreciate that tax credits debt is not regulated by the FCA, is there a case for the Government to adopt a similar approach?

For non-compliance debt cases where HMRC decides to take enforcement proceedings, the Limitation Action Act 1980 puts a six year time limit in which HMRC can take court proceedings or any enforcement action to recover a tax credits debt. For other cases where litigation is not entered, HMRC can ask a customer to repay a tax credits overpayment irrespective of how old the debt is.

HMRC has a duty to try to recover customers' overpayments, even if these debts relate to overpayments made some time ago. Putting a six year limit on the collection of tax credits debt could set a precedent to the effect that paying tax was optional and so result in a significant loss to HMT. While some tax credits debts are overpayments from tax credits awards that were paid a number of years ago, they remain collectable and HMRC's recovery figures bear this out. Many tax credits are collected over a number of years in the form of repayment plans. The length of these plans is determined by how much the customer can pay on a monthly basis. It is common for these plans to span a number of years, which for HMRC appears to be an 'ageing' tax credits debt balance, but much is in fact in repayment plans. This means that although the debt is being repaid on a monthly basis, as the repayment plan covers a number of years, the outstanding balance will continue to age until the debt is paid in full.

Taxpayers who leave tax credits receive a 'Notice to Pay' informing them of the debt position – the overpayments that remain outstanding from their tax credits award - prompting them to contact HMRC to arrange repayment. If the taxpayer does not contact HMRC on receipt of this notice, they receive regular correspondence reminding them of the need to pay.

In this correspondence to the taxpayer about their debt they will have also been given the opportunity to discuss a repayment plan with HMRC or a debt collection agency acting on HMRC's behalf if they were experiencing problems paying or wanted to discuss how the overpayment had occurred.

**1b. What assessment have you made of the costs and benefits of writing off all, or part of, outstanding tax credits debt? Is it possible that writing off all or some of the debt could result in savings elsewhere?**

HMRC's recoverability estimate of its £4.8bn outstanding debt stock will be published in the HMRC Accounts in October 2020. The figure published by HMRC last year estimated that £3.2bn would be recovered out of the £6.2bn of outstanding tax credits debt in HMRC relating to tax credits award years up to and including 2018-19. Writing-off the entire outstanding tax credits debt stock would have cost British taxpayer an extra £3.2bn

HMRC does remit some tax credits debt and has done so recently. This is only done where the debt is not viable to pursue. As mentioned in a response to an earlier question, much of the older tax credits debt is highly collectable and the customer has an ability and willingness to pay. In 2018-19, HMRC remitted debts for about 125,000 customers at a value of £152m.

**1c. How much tax credits debt has been accrued since 2010? What proportion of the total outstanding debt does that represent?**

£16.2bn of tax credits overpayments were finalised (not all of it became debt) since 2010, out of which:

- £8.8bn has been recovered;
- £3.2bn has either been transferred to DWP or remitted;
- £4.3bn is still outstanding on the tax credits system, which represents 89% of the total debt stock. The 11% remainder, £0.5bn (£4.8bn -

£4.3bn), relates to outstanding tax credits debt that was created before the 2010-11 tax credits award year.

*Source: 2019-20*

**2. Sir Ian Duncan Smith has recommended that, instead of it being clawed back through Universal Credit, HMRC should retain responsibility for tax credits debt. How feasible would it be for HMRC to take ownership and responsibility for reclaiming this debt?**

A government decision was made by the previous Exchequer Secretary to the Treasury and the Secretary of State for Work and Pensions in 2012 that DWP will collect all tax credits debts from Universal Credit claimants. It was later agreed in 2014 that DWP take on accountability for any tax credits overpayments they collect from Universal Credit. The IT infrastructure was built based on the agreement made at that time and therefore there is currently no IT function in place to return any debt to HMRC. To change that would be at significant cost.

The most efficient way to collect overpayments, and the least intrusive for customers, is to recover it from their ongoing awards. This is the default for recovery of any welfare debt across government. As tax credits awards end, the ability to collect through ongoing award for HMRC ends. If tax credits debt remained within HMRC, they will be left with the less efficient and more costly methods of direct recovery. More importantly, it would be a worse experience for the customer, contrary to the ethos of Universal Credit to have welfare payments managed in one place.

**2a. What is the rationale for reclaiming these debts through Universal Credit rather than HMRC, as the Department responsible for tax credits?**

Universal Credit was designed to replace tax credits and a number of other benefits. Universal Credit provides a single system of means-tested support for working-age people who are in or out of work and is designed to avoid some of the design features that can give rise to tax credits overpayments.

DWP collecting tax credits debt through Universal Credit provides for both a simpler customer journey and much simplified IT solutions for both DWP and HMRC, with all tax credits debt pertinent to one customer to stay with one department. It also provides some alignment with the recovery of tax credits debt under welfare reform and ensures equity in treatment of debtors.

DWP collecting tax credits debt ensures that a customer only has to engage with one department and there is no risk of dual recovery from Universal Credit and from direct action from HMRC which could inadvertently cause undue hardship for the customer.

Once Universal Credit migration is complete, the option for HMRC to collect from award will stop and they will be left with the less efficient and more costly direct recovery methods (such as letters, calls, etc) to collect any remaining tax credits debt.

Finally, as the decommissioning of the IT system housing tax credits debt was part of the Universal Credit business case, an alternative IT function would need to be used to house the remaining tax credits debt at a cost.

### 3. Please could you explain to us why people are not routinely informed about these debts before moving to Universal Credit?

It is not accurate to state that tax credits customers are not routinely informed of their debt position before moving them to Universal Credit. Once a tax credits recipient has an overpayment there are several occasions where they are notified about their situation and the action being taken to resolve the issue. This can be through the award notice they receive after notifying HMRC of a change of circumstances on their finalised award notice once the previous year's information has been confirmed during the renewals process and, if there is ongoing tax credits entitlement, a current year award notice will confirm the overpayment and that cross-year recovery will take place. This cycle happens year after year of an award and means that recipients can (and often do) receive multiple notifications of an overpayment (debt) which each set out the opportunity to challenge.

When someone claims Universal Credit, this will trigger HMRC receiving a Stop Notice and subsequently, the tax credits recipient will be sent a notice telling them about the crystallised debt before it is transferred to DWP (Universal Credit team). This notice essentially confirms the debt amount, and the fact that HMRC will send it to the Universal Credit team for collection. If a taxpayer comes out of tax credits before claiming Universal Credit, they will receive a further notification which confirms the debt amount and the means of recovery.

Those who have had a break between claiming tax credits and Universal Credit will have also received a 'Notice to Pay' informing them of the debt position and the need to contact HMRC to arrange repayment. If they do not contact HMRC on receipt of this notice, they will receive regular correspondence reminding them of the need to pay.

### 3a. How feasible would it be for HMRC to identify people with outstanding tax credits debts and inform them in advance of them moving onto Universal Credit? This is particularly pressing given that a large number of people on legacy benefits are due to move to Universal Credit before 2024.

It is not possible to identify tax credits recipients who are likely to have a change of circumstances in the future that would lead them make a claim to Universal Credit, and predict what the debt would look like at the precise point they made the Universal Credit claim. It is only at the point that the claim to Universal Credit is made that the tax credits debt would be crystallised (should there be one) and transferred to DWP. Under the current proposed process for 'Move to Universal Credit' (rather than natural migration) it is also unlikely that HMRC could do anything to identify the potential debt in advance. As the individual is given a three month window in which to make the Universal Credit claim, the exact date when they do make the claim will have a bearing on the circumstances and income that is used to finalise the tax credits claim and so crystallise the debt. There is an opportunity to educate the recipient about debt in the preparation phase of the 'Move to Universal Credit' process, so that they are ready to make the claim with all the facts presented to them; however, any debt calculation would be an estimate until the Universal Credit claim is made.

However, as referred to in the answer to question 3, all tax credits recipients are notified of their debt at regular intervals and ahead of their migration.

### 4. The Government's Breathing Space scheme for people with problem debt will be rolled out in 2021. Will the scheme cover debts within the benefits system, particularly the tax credit debt and repayments of Universal Credit Advances? What discussion have you had with DWP about this?

As set out in the Treasury's Breathing Space Scheme: response to a policy proposal in June 2019, the protections of the breathing space scheme will cover almost all benefit system debts, including tax credits debt, legacy benefits and Universal Credit. However, Universal Credit advances and third-party deductions will be included in the protections on a phased basis as early as possible following the start of the scheme in May 2021. This is important in order to ensure that IT changes required align with other requirements of the wider Universal Credit programme. This approach was collectively agreed in the usual way.

### 5. Can you tell us what is the maximum number of Faster Payments the banks can process for DWP and for the Government as a whole?

NatWest, the supplier bank for DWP, is currently able to submit Faster Payments into the central payments infrastructure at a rate of around 40,000 per hour. This is shared across their entire customer base i.e. their personal, corporate and Government customers although in this final category it is only DWP that submits in high volumes. At present DWP can only process a maximum of 360,000 faster payments per day. This limitation arises because NatWest statement reports cannot exceed 360,000 lines of data and DWP require each transaction to be shown separately.

### 5a. Can you tell us why banks are unable to process more Faster Payments?

The rate of transmission into the Faster Payments infrastructure is dependent on the technical capabilities of individual banks and the speed at which the central payments infrastructure can receive and respond to the payment messages and will therefore vary between banks. Future upgrades to supplier banks architecture and changes to the central payments infrastructure by Pay.UK will take account of the expected increase in the use of faster payments based on changes in consumer behaviour and emerging technologies e.g. open banking.

**5b. Neil Couling told us that Faster Payments come at a higher price than BACS payments. Can you tell us why they cost more, and break down how much extra it costs to pay a benefit claim via Faster Payments as opposed to BACS?**

Faster Payments are more expensive for Government customers than Bacs payments. This is because all banks have to hold additional funds at the Bank of England as collateral to ensure they can settle for all faster payments their customers have issued. This results in additional costs for the supplier bank which they pass on to customers. There is no equivalent requirement for this process for Government Bacs payments as there are alternative settlement arrangements in place for these payments that do not involve the supplier banks. In terms of transaction costs, currently a faster payment is around 10 times more expensive than a Bacs payment.

**5c. How does the Government prioritise which Departments can use Faster Payments?**

Government policy currently does not prioritise access to Faster Payment services between departments or policy areas, but Managing Public Money guidance does dictate the priority of transaction type by which departments should seek to make payments.

Annex 5.6* (see footnote) states regarding Money Transmission that public sector organisations should generally use the cheapest, safest and most certain means of moving public funds, depending on the context. For payments to counterparties outside the Exchequer, it is good practice for public sector organisations to use BACS Grade 3 (Government Grade) due to its considerable benefits over other payment types, such as transaction cost, cashflow certainty, and reliability as a method of payment.

*https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/835558/Managing_Public_Money
MPM__with_annexes_2019.pdf

**5d. Has the Government considered alternatives to Fast Payments that are faster than BACS payments?**

The only other payment method available is CHAPS but this would not be suitable as it is designed for low volumes of high value payments and could not manage the high number of payments undertaken by Faster Payments or Bacs. Transaction costs for CHAPS are the highest of all payment methods.

Thank you again for raising the issue of tax credits debt repayments. I hope that my response set out above has addressed your questions.

Yours ever,

Jesse

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From the Chair

Rt Hon Jesse Norman MP
Financial Secretary to the Treasury

27 July 2020

Dear Jesse,

The Work and Pensions Committee is undertaking an inquiry into the wait for a first payment in Universal Credit.

During our inquiry, we have heard evidence about the impact of repayments of tax credit debt on Universal Credit claimants. Many people moving from legacy benefits are only told that they have outstanding tax credit debts when they make a claim for Universal Credit. Finding out that they must repay these additional, older debts can compound hardship for people who are already struggling and may be facing other deductions from their payment (for example, repayments of Universal Credit Advances).

The Committee is considering possible recommendations on how the Government should approach tax credit debt. To that end, it would be helpful to have answers to the following questions:

1. **It's been estimated that there is around £6bn of outstanding tax credit debt. On average, how old is this debt?**
    a. **The FCA has said that claims for debts must be made within a prescribed period (usually six years), otherwise it is statute barred. While we appreciate that tax credit debt is not regulated by the FCA, is there a case for the Government to adopt a similar approach?**
    b. **What assessment have you made of the costs and benefits of writing off all, or part of, outstanding tax credit debt? Is it possible that writing off all or some of the debt could result in savings elsewhere?**
    c. **How much tax credit debt has been accrued since 2010? What proportion of the total outstanding debt does that represent?**

2. **Sir Iain Duncan Smith has recommended that, instead it of being clawed back through Universal Credit, HMRC should retain responsibility for tax credit debt. How feasible would it be for HMRC to take ownership and responsibility for reclaiming this debt?**

    a. **What is the rationale for reclaiming these debts through Universal Credit rather than HMRC, as the Department responsible for tax credits?**

Both the Trussell Trust and Nicholas Timmins of the Institute for Government have told us that many claimants are not informed of these outstanding debts until they make a claim for Universal Credit, leaving them with potentially large amounts of debt of which they were not aware.

3. **Please could you explain to us why people are not routinely informed about these debts before moving to Universal Credit?**
    a. **How feasible would it be for HMRC to identify people with outstanding tax credit debts and inform them in advance of them moving onto Universal Credit? This is particularly pressing given that a large number of people on legacy benefits are due to move to Universal Credit before 2024.**

4. **The Government's Breathing Space scheme for people with problem debt will be rolled out in 2021. Will the scheme cover debts within the benefits system, particularly tax credit debt and repayments of Universal Credit Advances? What discussions have you had with DWP about this?**

As part of our inquiry, we are interested in how DWP can speed up its payments to reduce the fifth week of the wait. We were told by Tom Loosemore, the founder of the Government Digital Service, that DWP's use of BACS payments adds up to four days to a claim. At our session on 15 July, Neil Couling, the Senior Responsible Owner for Universal Credit told us that the banks are limited in the number of Faster Payments they can process. It would be helpful to have more information about what limits DWP from using Faster Payments more.

5. **Can you tell us what is the maximum number of Faster Payments the banks can process for DWP and for the Government as a whole?**
    a. **Can you tell us why banks are unable to process more Faster Payments?**
    b. **Neil Couling told us that Faster Payments come at a higher price than BACS payments. Can you tell us why they cost more, and break down how much extra it costs to pay a benefit claim via Faster Payments as opposed to BACS?**
    c. **How does the Government prioritise which Departments can use Faster Payments?**
    d. **Has the Government considered alternatives to Faster Payments that are faster than BACS payments?**

It would be helpful to have a response by **Monday 24 August**.

Yours sincerely,

Stephen Timms

**Rt Hon Stephen Timms MP**
Chair, Work and Pensions Committee