

Written evidence from Low Incomes Tax Reform Group (LITRG) (DBB0004)

1 General comments

- 1.1 We welcome the fact that the government is proposing to extend eligibility for widowed parent's allowance (WPA) and bereavement support payment (BSP) to surviving cohabiting partners with dependent children. However, the remedial order only has retrospective effect to 30 August 2018. To address the legislative incompatibility with Article 14, WPA should be paid to all those who would have been eligible for payments since its introduction in 2001.
- 1.2 Our reading of the draft order is that the full amount of BSP (£9,800) could be paid out to those who would have been eligible for payments since its introduction in April 2017 (under Regulation 6 – as they would still be eligible for BSP as at 30 August 2018).¹ However, we see that there appears to be some confusion about this, with one person being told by DWP via an FOI request that the death of her partner in January 2018 would mean she would only be entitled to a pro-rated amount of BSP.² The draft legislation is not entirely clear on this point so confirmation and clarification is needed. For both practical and principled reasons, we think the approach taken in the order is the right one, and that pro-rating should not be used.
- 1.3 The draft legislation requires people to make a *claim* for payments. To properly achieve the objective here (and so as to address the incompatibility), those eligible must either be contacted proactively by the authorities about their entitlement or there must be a comprehensive communications plan to ensure that all those entitled to current or retrospective payments are made aware of this.
- 1.4 It is not clear what will happen under the remedial order if the formerly surviving partner has themselves died. Will the lump sum be paid to their estate? In a similar vein, we assume that people who have subsequently found a new partner can still claim backdated WPA for any periods from 30 August 2018 that they remained single? These things should be clarified as soon as possible in order that stakeholders can comment coherently on the adequacy of the remedial order.
- 1.5 Retrospective payments of BSP will be tax free and should be disregarded as income in the calculation of tax credits and universal credit. It is not entirely clear how any lump sum payments of BSP made under the remedial order would be treated from a capital perspective in universal credit (UC). Retrospective payments of WPA create huge complexities in terms of interactions with tax, tax credits and UC.

¹ See also explanatory information, para 7.13: <https://www.gov.uk/government/publications/bereavement-benefits-proposal-for-implementation-of-the-mclaughlin-2018-and-jackson-2020-judgments/draft-explanatory-memorandum-draft-bereavement-benefits-remedial-order-2021>

² https://www.whatdotheyknow.com/request/bereavement_support_payment#incoming-1836422

- 1.6 As things currently stand, there appears to be potential for unfairness between those who received the payments at the correct time versus those who receive the payments now depending on how the retrospective payments of WPA are taken into account for tax credits, UC and indeed other benefits (such as housing benefit and council tax support). Of course, on the other hand, those who missed out on the payments have not had the benefit of that support at a time they likely needed it and may have incurred costs or had other detrimental consequences as a result.
- 1.7 There are a number of options that could be pursued and some may need legislative changes. HMRC and DWP must be clear on the treatment of the backdated payments for tax, tax credits, UC and other benefits before this remedial order is finalised. It would be unacceptable for people to receive a large amount and then have it unexpectedly taxed, create tax credit and/or UC issues etc.
- 1.8 The remainder of this submission focuses on these interactions. We have produced a fuller briefing with more technical detail about the tax and benefit interactions which we can make available to the Committee if that is helpful.

2 Detailed technical comments on tax status and interaction with tax credits and universal credit

- 2.1 BSP (higher rate, where dependent children are involved) has a non-taxable capital payment (£3,500) and a non-taxable monthly allowance (£350) payable for up to 18 months. It is not counted as income for tax credits or UC. In certain circumstances¹, the first additional monthly payment (£3,500) is disregarded when calculating the person's capital for UC (for 12 months).
- 2.2 In line with this, any retrospective payments of BSP will be tax free and should be disregarded in the calculation of income for tax credits and UC.
- 2.3 It is not entirely clear how any lump sum payments of BSP made under the remedial order would be treated from a capital perspective for UC. Given that this money was not available at the relevant time and so could not be spent in each assessment period, it would seem fair to introduce a capital disregard for any lump sum payments as a result of the remedial order (whether for a 12 month period or longer) if one doesn't already exist². If this doesn't happen, any of the lump sum payment not spent after 12 months, could mean either the total capital attracts a tariff income or it could affect their entitlement to claim altogether.

¹ Where a claim for BSP is made 12 months or less after the date of death – see https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/932331/admh2.pdf.

² It is not clear whether any lump sum monthly payments count as payment of arrears of a 'social security benefit' for the purposes of the UC regulations and capital disregards – if so, they would also attract a capital disregard for 12 months. <https://www.legislation.gov.uk/ukxi/2013/376/schedule/10#commentary-key-8e6db1061d715949ab1a0322f17e5780>

2.4 The WPA position is more complex as it is taxable and does interact with other benefits.

2.5 ***Current tax/benefits treatment of WPA***

2.5.1 WPA is taxable as social security pension income¹. It is not subject to National Insurance contributions.

2.5.2 On its own, WPA is below the threshold for paying tax (currently £12,570). However, where other sources of taxable income (such as from work) plus the WPA mean that the threshold is breached, then the person will have to pay tax (with any such tax probably coded out against employment income).

2.5.3 For tax credits, WPA is counted as pension income². For Working Tax Credit purposes, there is a 41% withdrawal rate on gross income over £6,525 (2021/22 threshold).

2.5.4 Because of the tax and tax credit treatment of WPA, for someone receiving the amount of £122.55 in 2021/22, who earns around £15,000 a year, WPA is worth around £47.79 a week. This is after allowing for a 20% tax deduction and where the whole of the WPA (before tax) is covered by the tax credit taper of 41% (i.e. they have other income equal to the relevant tax credit income threshold).

2.5.5 For the purposes of UC, the gross amount of WPA will be treated as unearned income and it is subject to a 100% taper.³

2.5.6 As WPA is deducted pound-for-pound from the claimant's UC entitlement, the actual value of WPA for them can be greatly reduced (and can be nil or a negative amount⁴).

2.6 ***Some comments on the tax/benefits treatment of a WPA lump sum***

2.6.1 **Tax**

2.6.2 WPA payments are taxable by law based on the year in which the person was entitled to receive them (referred to as the amount 'accruing' in the year) and not when they are actually paid.

¹ Under sections 577 to 579 ITEPA 2003: <https://www.legislation.gov.uk/ukpga/2003/1/part/9/chapter/5>

² Under Reg 5 Tax Credits (Definition and Calculation of Income) Regs 2006/2002: https://revenuebenefits.org.uk/pdf/2002_2006_original.pdf

³ <https://www.legislation.gov.uk/uksi/2013/376/regulation/66>

⁴ Some working people will not only have had their WPA deducted in full from their UC entitlement, but will also have had to pay tax on it in addition (although those who pay tax on it via a larger deduction on their employment income may have the tax partially restored as UC is based on net employment income). The outcome of this is that some working widowed parents in receipt of both UC and WPA may have ended up *out of pocket* on account of their receipt of WPA.

- 2.6.3 If the normal accrual rules in s 578 ITEPA 2003 apply¹, people in receipt of backdated WPA may have underpayments of tax for the 2018/19, 2019/20, 2020/21 and 2021/22 tax years in respect of the amount due for those years. This assumes that the lump sum payment will be made gross by DWP – that is, without any tax taken off it (as currently happens).
- 2.6.4 HMRC are allowed to assess income tax for the current year and four years in arrears, so HMRC would still be within time to assess payments from 2018/19. In line with HMRC’s guidance², we assume that HMRC will have to manually recalculate the liability for those not in the Self Assessment (SA) system and for those in SA, make discovery assessments for any years that are out of time for amendment.
- 2.6.5 If the rules are changed (or it is decided that entitlement to the payment only occurs from the date of the remedial order), so that the payment is taxed in the year of claim or receipt, this would potentially create a large tax liability for that tax year and may mean the individual pays more tax than they would have done if they had received it at the correct time.
- 2.6.6 We assume that DWP will notify HMRC of payments made, but this needs confirming. Moreover, DWP communications will need to be very clear that the recipient will need to contact HMRC, as receipt of an untaxed lump sum could trigger a statutory obligation to notify HMRC of a tax liability and to give adequate warning that tax may be due to the lump sum received.³

2.7 Tax credits

- 2.7.1 Our understanding is that under the current rules, payments of WPA follow the tax treatment and will be income in the year they relate to⁴. The disregard system provides some cushioning for tax credits purposes, meaning that someone’s income can rise or fall by £2,500 before their tax credits change.
- 2.7.2 To the extent that there is a change to the tax credits award, 2018/19 and 2019/20 are likely to be finalised years⁵. HMRC have powers (for example, HMRC’s discovery powers are set out

¹ There is a potential argument that anyone getting a lump sum payment under the remedial order is only entitled to it from the date the remedial order has effect and that although the payment covers an earlier period, entitlement to it is not actually retrospective. If that is the case, then it might be argued that the payment should be taxed in the year it is claimed or received, irrespective of it having been notionally calculated by reference to an earlier period of time – i.e. it could be argued that the benefit did not actually ‘accrue’ in that earlier period. This issue needs to be given some thought and determined so that the tax position is fully understood.

² <https://www.gov.uk/hmrc-internal-manuals/self-assessment-manual/sam121161>

³ S7 TMA 1970: <https://www.legislation.gov.uk/ukpga/1970/9/section/7>

⁴ See above para 2.6.3 (footnote) for a possible argument that the tax treatment may look at the year of receipt of the payment. If that was the case, the tax credit position would likely follow the tax position creating a larger overpayment in the year of receipt and avoiding the issues set out in paragraphs 2.7.2 and 2.7.3.

in section 20 Tax Credits Act 2002¹) to re-open them but there is nothing forcing them to do so – it isn't automatic.

2.7.3 If HMRC did re-open tax credits awards to reflect the revised tax assessments, it would likely create overpayments for those years. If HMRC decide not to re-open finalised awards or are unable to do so, it will mean that overall those receiving backdated payments may be financially better off than those who received WPA at the correct time.

2.8 Universal credit

2.8.1 Usually, payments of WPA are treated as unearned income for UC, however the position for lump sums of WPA is not completely clear from the UC Regulations.

2.8.2 Although there are several possibilities, if the retrospective payment is treated as income only in the assessment period in which it is received (as normal WPA payments are treated), the claimant's income will probably be more than their maximum UC in that assessment period and so it would just reduce the UC payment in that one month. In theory, this means they could be better off financially from a UC perspective than if they had received the WPA payments at the correct time.

2.8.3 There is also the issue that unearned income is supposed to be reckoned gross for UC. Therefore if tax is collected on the WPA lump sum by HMRC, that tax will not be taken into account for UC. However, if the claimant had received WPA at the appropriate time, any tax may have been coded out against their employment income. The practical effect of that would be they might have had less net earnings taken into account for UC as a result.

2.8.4 There are also likely to be some very tricky issues given that some people will not have been on UC through the whole backdating period.

3 About us

3.1 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. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people, and carers.

3.2 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.

⁵ <https://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/the-yearly-cycle/claims-finishing/>

¹ <https://www.legislation.gov.uk/ukpga/2002/21/contents>

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