Britain: Tax credit system plunges families into debt

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Prime Minister Gordon Brown's Working Families Tax Credits (WFTC) system, launched in 2003 and which was supposed to lift families with children out of poverty, has caused untold stress and financial hardship for millions of families.

Designed to replace an earlier system of tax credits introduced by Brown when he was chancellor in 1999, a family of four with an annual income of £15,400 a year (half the male average earnings), would get an additional £4,200 in 2006, still less than two-thirds average male earnings, under WFTC.

But the new IT system was overly complex, dealt with three times the number of households and was riddled with design and implementation problems. Brown rejected warnings that the system would not be able to cope and pushed on regardless.

The system was designed so that claimants would notify Her Majesty's Revenue and Customs (HMRC), which administers the system, of changes to family circumstances and income after the year end so that adjustments could be made the following year. But HMRC had underestimated the volatility in poor people's income and the work after the year end this would give rise to, particularly as there is little information publicly available to show entitlements or how the credits are calculated.

While HMRC had anticipated 300,000-400,000 overpayments in the first year as the tax credit payment system bedded down, the volume was five times that number. It "overpaid" £2.3 billion to 1.9 million families in 2003-2004, £2 billion to 2 million families in 2004-2005, and £1.7 billion to 1.9 million families in 2005-2006. One third of payments to more than 6 million households were wrong. This is equivalent to an average overpayment of £1,000 a year or £20 a week, a large sum for a low-income family for whom this could represent more than 10 percent of their income.

HMRC then sought to claw back the overpayment automatically. Families were brusquely informed that deductions would be made in their tax credits for the subsequent year or recouped via increased taxes, arguing that families could "reasonably" have expected that their changed circumstances would result in HMRC seeking to recover the overpayment. Unless challenged, HMRC immediately begins recovery.

HMRC had made no provision to examine each family's situation on a case-by-case basis before automatic recovery of overpayments. The transfer to HMRC, which had been used to dealing with taxes, usually where people are more prosperous, meant that it would be totally unused and unsuited to dealing with highly vulnerable people for whom £10 a week matters.

Claimants were faced with bills to repay £5,000, a massive sum for families earning an average wage, let alone the more vulnerable families on low and fluctuating incomes, and were plunged into debt. Unable to pay, many found themselves facing court orders for the repayment of thousands of pounds of tax credits.

Having commissioned a fully automated system, HMRC had few staff to handle the volume of complaints that poured in. In 2006-2007, 371,282 families disputed the recovery of overpayments. When challenged, HMRC has taken months to reply and provides no explanation of the so-called overpayment. So error-prone and arbitrary is the system that some families have had their "overpayments" reduced and a few have had them written off, but many families found they were increased, again with no explanation.

There is scarcely a family in the country that does not have a horror story to tell about their experiences with WFTC: from the extreme complexity of forms that have been known to defeat qualified accountants to the nightmare of challenging the alleged overpayments and attempts to claw them back, and coping with reduced income the following year.

Nearly 55,000 people filed an official complaint expressing their dissatisfaction with HMRC, mostly relating to the handling of disputed overpayments. The parliamentary ombudsman has stated that more than a quarter of the cases she handles relate to the WFTC system, higher than any other department. In 2006-2007, she received 393 complaints about tax credits, of which 74 percent were fully or partially upheld, higher than in any other department.

The ombudsman's 2007 report, *Tax credits: getting it wrong?,* noted that a group of some of the poorest people in the country had said that this had led to them getting into debt where they had previously not been in debt—causing distress, anxiety and even family break-up.

Many families have refused to have anything to do with WFTC for fear of being caught up in the system's maladministration. As a result, hundreds of thousands of families do not claim the money to which they are entitled.

While families can appeal to an independent tribunal about the *amount* of tax credits to which they are entitled, they do not have a similar right in relation to a decision by HMRC to recover an overpayment once the claimant has disputed it. They cannot appeal the way the HMRC has reached its decision or applied the "reasonableness" test, unlike the comparable right of appeal in the benefit regime.

The state of play with WFTCs is not simply the result of bureaucratic error. WFTCs were part of the Tony Blair government's broader agenda of getting families off welfare and into work by "making work pay." When Blair took office as prime minister in 1997, he categorically rejected redistributive taxes and universal cash benefits to reduce the ever-growing social inequality that is the hallmark of Britain today.

Instead, he called in an array of big businessmen to review welfare and social policy issues and suggest how it should be reformed. Martin Taylor, then chief executive of Barclays Bank, was asked to set up a task force "to advise on the reform of the tax and benefits system."

His task force concentrated on work incentives and converting the existing system of family credits to a tax-based system. It was a crucial step in the direction of a unified benefit system more directly linked to the tax system and workplace, and a tax-based credit system that would force people off benefits and into low-paid work.

As a unified benefits system, WFTC would—it was claimed—reduce fraud and "offer joined up government," with a "more efficient service to customers." But a unified benefits system would have to bring together the assessment of eligibility for benefits *and* their payment. It therefore depended upon highly integrated IT systems linking the various agencies and the transfer of responsibility from the then-Department of Social Security to the Inland Revenue, which has subsequently merged with the Customs and Excise Agency, under the direct control of the Treasury.

This resulted in yet another lucrative IT contract for EDS, but a financial disaster for claimants. While most of the responsibility for the faulty IT system and the £7 billion worth of wrong payments has been laid at EDS's door, the contractor has been subject to a trifling £75 million penalty, and £25 million of this would only be payable if it won further government contracts. To date, less than £55 million has been repaid.

WFTC aligns benefits away from payments paid as a matter of right based on rules of eligibility to a means-tested tax credits system. In effect, it is determined by employers. Under the Labour government, welfare henceforth was to be linked to the responsibility to work. In the future, anyone refusing a job, however lowly paid, will have his or her benefits stopped. This is now being extended with attempts to force those with disabilities, long-term sick and health problems into work.

The "social safety net" of collective social insurance is being replaced by discretionary payments by the state. They can be withdrawn or changed as the state sees fit and are subject to tax regulations rather than those of the benefits system. Part at least of the benefits system has been brought under the direct control of the Treasury.

In this context, a little-reported measure in the Finance Bill going before parliament is significant. It will extend the right of Customs and Excise officials to turn up unannounced on taxpayers' doorsteps, demanding to go through records, to tax inspectors, as part of the ongoing merger of Revenue and Customs. The proposals will specify and standardise the records taxpayers must keep, although it is as yet unclear what these requirements will be.

While Customs officials have long had strong search rights, tax inspectors require official warrants to make surprise visits. Now, HMRC is seeking to extend these rights across the two merged agencies. While these new powers are ostensibly aimed at corporations and businesses, they will be used against working people under the guise of combating fraud.

A recent report published by the Economic and Social Research Council, *Tracking income: how working families' incomes vary through the year*, sheds light on the implications of the move to a tax credit system. It found that low-income households had much greater income volatility than had been expected. For example:

*Only 7 of the 93 families it tracked had incomes within 10 percent of the annual average.

* A quarter of the families had at least four periods with incomes outside the range of 85 to 115 percent of their annual average.

* The families with the highest volatility were generally those with the lowest incomes, and a higher proportion of lone parents and tenants had more variable income.

WFTC was aimed at creating a new pool of cheap labour by forcing people off benefits. That in turn would serve to drive down wages. By providing inducements to work in the form of tax credits, it was a barely disguised subvention to big business, enabling employers to pay poverty-level wages. The government admitted as much when it said that making savings was not the primary purpose of the scheme. Indeed, it would cost more, not less, as the evidence has confirmed.

WFTC is a £20-billion-a-year subsidy to the employers and has become key to making Britain a low-paid service centre, while the service companies are the Stock Market's darlings. It is an essential mechanism for corporate welfare—for redistributing wealth from the mass of the population to the financial elite.

The latest official figures show that unclaimed means-tested benefits—pension credits, housing benefit, council tax benefit, jobseekers' allowance and income support— amounted to about £9.37 billion in 2005-2006, the most recent year for which data is available. This is an increase of £1 billion on the previous year. It contrasts with the paltry £750 million for 2008-2009 and £950 million earmarked for tackling child poverty in the budget, which Save the Children believes means that the government will miss its own target for relieving child poverty by 450,000.

It is now deliberate government policy to increase the level of unclaimed benefits. According to official papers from the Department for Work and Pensions (DWP), ministers have decided not to try to meet the benefit take-up targets on the grounds that it would not represent "value for money to repeatedly press unwilling people to take up their entitlement."

In the case of pensions, the government has introduced legislation making it compulsory for workers to pay into a second-tier personal and portable insurance for pensions, whose funds are to be invested on the Stock Market.

The new welfare system radically alters the relationship between the government and its citizens: the individual's responsibility is to work, be independent, support family members, not just children, and save for retirement. The state's role is to ensure that people *do* work and thus become "economically independent" so that the state supports only those unable to work, and then only on the most stringent conditions with meagre entitlement. Thus, the Labour government has gone a long way towards dismantling the system of state social insurance, introduced by the post-war Labour government exactly 60 years ago as a mechanism for eradicating poverty.